



# THE REVIEW OF INTERNATIONAL AFFAIRS

BELGRADE, VOL. LXVII, No. 1161, JANUARY–MARCH 2016

## *Thematic Issue:*

### **CHINESE SILK ROAD AND CONTEMPORARY RELATIONS OF CHINA AND CENTRAL AND EASTERN EUROPEAN COUNTRIES (CEEC)**

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# INTERNATIONAL RELATIONS

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Original Scientific Paper

## NEW SILK ROAD – NEW GROWTH ENGINE

Aleksandar JANKOVIĆ<sup>1</sup>

*Abstract:* New Silk Road is the strategic initiative that encompasses the construction of the Silk Road Economic Belt and the 21st Century Maritime Silk Road. It is commonly abbreviated as the Belt and Road. The main objective of the Belt and Road Initiative is to ensure stable and more balanced economic growth in China, as well as strengthening economic and transport connections with neighbours in Central Asia, with Europe, South Asia, Southeast Asia, and Africa. China is the initiator and leader of connection and cooperation within the Belt and Road. However, the initiative represents a development opportunity not just for China, but also for over 60 countries that are lined along the new Silk Road. One of these countries is Serbia, whose position on the New Silk Road is determined by many factors.

*Key words:* New Silk Road, Belt and Road Initiative, China, Serbia, economic growth.

## NEW SILK ROAD – NEW GROWTH ENGINE

New Silk Road encompasses two strategic initiatives from November 2013 aimed at ensuring stable and more balanced economic growth in China, as well as strengthening China's economic and transport connections with its neighbours in Central Asia, as well as with Europe, South Asia, Southeast Asia, and Africa. One part of this concept, commonly referred to in Chinese as *Yi Dai Yi Lu* ("Belt and Road"), envisages the construction of the Silk Road Economic Belt, and the other -

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<sup>1</sup> Aleksandar Janković, Head of Asia, Australia, and Pacific Department at the Ministry of Foreign Affairs of the Republic of Serbia. This research paper reflects exclusively personal views and opinions of the author.

the establishment of the 21st Century Maritime Silk Road. Although it is referred to as the Belt and Road, the concept does not envisage the construction of one specific road or belt. Instead, it actually involves the construction of the entire network of transport and energy links in the vast area connecting the Far East and Europe.

The concept's precursor is the ancient Silk Road – a set of trade routes which, at the time, linked across the Central Asia two leading civilizations and economies in the world - China and Europe. The corridor was symbolically named the Silk Road. Today, the main idea is to connect highly developed European countries with the emerging economies of China and other Asian countries.

On its economic part, the Belt and Road initiative aims at the development and the liberalization of the movement of goods and capital, better allocation of resources, and deepening market integration, as well as transport links between Asia, Africa and Europe. The initiative is open to all countries and international and regional organizations, while adhering to the principles of mutual respect, broad consultations, joint contribution, market orientation and comprehensive prosperity, i.e. common interests.

In total, the Belt and Road initiative tends to cover the vast area with more than 4,4 billion people and total economic output of USD 21 trillion (almost one third of the world's GDP). The network of infrastructure projects might create the world's largest economic corridor, encompassing more than 60 countries from different.

## **PRINCIPLES AND FRAMEWORK OF COOPERATION**

Cooperation in the framework of the Belt and Road is based on the provisions of the UN Charter as well as on the five principles of peaceful coexistence (“Vision and Actions”). The initiative is characterized by its openness, meaning that countries that are not part of the area of the historic Silk Road could participate too. The initiative also strives towards harmony and bridging differences between civilizations. Clearly, market orientation, i.e. respect for market rules and relevant international standards are at the core of this initiative so that benefits for all stakeholders could be achieved. The essence of the New Silk Road is reflected in the linking. This linking is multidimensional - it includes various components.

General geographical scope of cooperation includes linking three continents - Asia, Europe and Africa. Hence, the Silk Road Economic Belt has several directions. On the one side, it aims to promote better connections between China, Central Asia, Russia and the northern part of Europe. It also strives to connect China through Central Asia with the Persian Gulf, West Asia, the Mediterranean and Central and Eastern Europe. Thirdly, it aims at improving links between China and South East Asia, South Asia and the Indian Ocean. 21st century Maritime Silk Road tends to bring together (eastern) coast of China and Europe via the South China

Sea and the Indian Ocean, as well as the (southern) China's coast with the Pacific across the South China Sea.

At the sectoral scope, the Belt and Road features “five links” – policy, road, trade, currency, and people. The aim is to integrate and create synergies from political principles, economy, transportation, commerce, finance, culture, education, etc., in order to provide conditions and encouragement for the overall economic development. Cooperation along the New Silk Road will move from individual projects, scattered throughout the region, to the more integrated system of projects spread through the entire region. The Belt and Road should also develop existing markets and provide new markets for Chinese products, and also bring new market opportunities for other participating countries.

On the partnership plan, the Belt and Road is a sort of joint venture of several countries, not just China. Although China is the initiator and leading force behind the Belt and Road, all the other countries are equal partners. As Chinese Foreign Minister Wang Yi said the Belt and Road “is not a single move of China, but a symphony performed by all the relevant countries.”

At the institutional level, the concept involves engaging a number of national, regional and international institutions and organizations. It also envisages the establishment of specialized institutions such as the Silk Road Fund. Their main task is to provide financial support for specific projects within the initiative.

The Belt and Road initiative is not to be seen as a competitive force to existing initiatives in the region. On the contrary, this initiative seeks to connect and build on existing bilateral and multilateral mechanisms and initiatives for regional cooperation, such as the Shanghai Cooperation Organization (SCO), ASEAN + 1 (ASEAN + China), APEC (Asia-Pacific Economic Cooperation), ASEM (Asia-Europe Meeting), etc. This also applies to many other regional gatherings such as conferences, forums, exhibitions etc. organized by the Belt and Road participating countries.

## **DEVELOPMENT OF THE INITIATIVE**

The Belt and Road initiative was first presented in September 2013. During his visit to Kazakhstan, Chinese President Xi Jinping proposed that China and Central Asian countries work together on building the Silk Road Economic Belt. In October the same year, during a visit to Indonesia, President Xi called for China and ASEAN countries to work together in building a Maritime Silk Road of the 21st century. He then proposed the establishment of a separate regional bank (AIIB) to finance the construction and development of connectivity and economic integration of the region.

President Xi's initiative received full support both domestically and internationally. In China, Belt and Road initiative received full backing of the



country's leadership and the ruling party - at the third plenum of the Central Committee of the CCP in November 2013 and at the annual sessions of China's parliament in 2014 and 2015.<sup>2</sup>

From abroad, the first positive responses to the initiative came from China's immediate neighbourhood - from Russia, Kazakhstan, Pakistan, and Myanmar. In February 2014, presidents Putin and Xi reached an agreement on connecting the Belt and Road initiative with the Russian Eurasian railway. The concept was also supported by Kazakhstan (construction of terminals, rail and road corridors from China, via Kazakhstan to Russia). Other countries in the region followed the suit. The initiative is also closely related to the Bangladesh-China-India-Myanmar Economic Corridor, China-Mongolia-Russia Economic Corridor (CMREC), etc.

In February 2015, China came out with a list of priorities within the initiative. These priorities include building transporting infrastructure, facilitating the flow of investment and trade (simplification of customs procedures, the construction of logistics centers), financial cooperation, with the expansion of cooperation between nations, through intensifying exchanges in culture, education, science, the media and other fields. In March 2015, the "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road" (Vision and Actions) was revealed. This landmark document was jointly prepared by the National Development and Reform Commission (NDRC), Ministry of Foreign Affairs and Ministry of Commerce with the authorization of the State Council of the People's Republic of China. It outlines the framework and principles, as well as the priorities and mechanisms of cooperation within the Initiative. In October 2015, NDRC issued the "Action Plan for Harmonization of Standards Along the Belt and Road (2015-2017)" highlighting how the goals set out in the "Vision and Actions" are to be achieved.

At the end of September 2015, EU agreed to the Chinese participation in the European Investment Plan. China hence became the first non-European country to be included in this EU plan. Along with that, China and the EU have signed Memorandum of Understanding on the EU-China Connectivity Platform. This platform aims at increasing the synergies between the Chinese Belt and Road initiative and EU transportation initiatives, such as the Trans-European Transport Network (TEN-T). Just before that, in June 2015, China and Hungary (EU member state) signed the Memorandum of Understanding on joint promotion of the Belt and Road. In November 2015 in Suzhou, China signed similar documents with five other countries in the region - Poland, Serbia, the Czech Republic, Bulgaria and Slovakia. The main purpose of these agreements is to link the Belt and Road initiative with the national development strategies of countries in the region.

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<sup>2</sup> During the annual sessions of China's parliament (NPC and CNPCC) in March 2015, leading Chinese economists and experts emphasized that the Belt and Road represents a new engine of the economic development of China.

## UNDERSTANDING THE BELT AND ROAD

For a better understanding of the Belt and Road initiative, it is necessary to take into account the broader context of China's policy of reforms and opening up and its constituent segments, including the concept symbolically called the "Chinese Dream". Also, it is necessary to analyze the Belt and Road initiative in the context of being China's Marshall Plan.

In terms of scope and set goals, China's Belt and Road initiative might prove to be one of the most ambitious projects in the modern history of mankind. Many analysts say that it is actually a kind of Chinese Marshall Plan, seeing in it not only the economic development but rather geopolitical and strategic overtures. The New Silk Road and the Marshall Plan, however, differ in scope and scale, and also by the historical context and modalities of implementation. In this regard, China stresses that Belt and Road leads to an inclusive partnership, and is not a geopolitical tool nor should it be viewed from the aspect of outdated Cold War mentality. China regularly stresses the need to overcome the Cold War rhetoric and mentality. Unlike the Marshall Plan, the Belt and Road concept is not limited in time and its content is more broadly conceived. Also, it is geographically much more ambitious and more inclusive, because in addition to China and the Far East, it includes the rest of Asia, Europe and Eurasia, the Middle East and a significant part of the African continent.

The concept of the Belt and Road should be viewed within the broader concept of Chinese economic and social reforms. From 1978 to 2012, average annual GDP growth rate in China was almost 10%. However, due to the rising global economic imbalances and uncertainties, especially after the break out of the financial crisis in 2008, the annual GDP growth rates declined to around 7%. A new normal for the China's rapid economic development today means the growth rates between 6% and 8%. Also, the Chinese economy is rapidly changing and restructuring, due to changes in the global market triggered by the global financial crisis. Focus has been shifted from export driven economy towards the strengthening of domestic demand and consumption. Therefore, the Belt and Road will represent a new growth engine of the Chinese economy.

The Belt and Road might also be closely linked to the concept of the Chinese Dream. In November 2012 the then vice-president of China and the new leader of the CCP, Xi Jinping came out with the vision of the future of the Chinese nation, symbolically named - Chinese Dream. Achieving the Chinese dream means achieving the national unity, sustainable economic growth, a greater degree of equality and better balancing the cultural values with the materialistic elements of the concept. After having been elected to the position of the president of the PR of China, in March 2013, Xi Jinping defined that Chinese Dream envisages the great rejuvenation of the Chinese nation and it embodies achieving prosperity for the country and happiness for the citizens. The concept of the Chinese Dream integrates five levels

of components: national, personal, historical, global and antithetical. Domestically, the Chinese Dream key elements include demands for free education, greater coverage and availability of health services and social security, better air quality and a cleaner environment, and sufficient availability and quality of food and energy, as well as improving housing conditions. Externally, the Chinese Dream aims to improve the China's reputation in the world. Hence the commitment to shape the perception of China as a fast-growing economy, which seeks to improve the standard of living of its population and also to attain the leading place in the international community. This provision refers also to the upgrading the perception of China and collective quality and general reputation of Chinese products and services in the world. On the broader level, Chinese Dream advocates peace, development, cooperation and mutual benefit.

It should also be noted that, according to many parameters, China is still a developing country, just like most of the countries that are in the primary area of the Belt and Road. In these countries, the processes of industrialization and urbanization are still taking place. These countries are almost as per rule rich in natural resources, and on the other hand, they lack capital and modern technology. By investing in developing the new Silk Road, China will strengthen its influence in the world, promote its culture and technologies, and increase exports and overall economic growth.

### **SILK ROAD ECONOMIC BELT**

During the period of reform and opening up (from 1978 onwards) the eastern part of China developed at a much greater pace compared to the central and western parts of the country. Apart from regional differences, particular sensitivity to this issue gives the fact that the central and western parts comprise nearly two-thirds of the country. Also, a significant part of the population in western China is made by minorities, such as the Uyghurs, Tibetans, Hui people and others. Noticeable activities of terrorist and extremist groups in neighbouring countries like Afghanistan and Pakistan require, too, special care and attention of the Chinese authorities to the economic development of the western parts of China. China's western regions are also geographically aligning to the Central Asia. Today, the region of Central Asia is gaining in importance due to its unique geographical location, and because of the rich natural resources, especially oil and gas. Therefore, in addition to the cooperation with Central Asian countries and Russia through the Shanghai Cooperation Organization (since 2001) in combating the 'three evils' (separatism, terrorism, and extremism), China is also increasingly trying to open its western regions for cooperation with the outside world. In this sense, the construction of adequate rail, road and energy networks represents a kind of precondition.

Chinese central authorities have launched a new, large wave of investments in infrastructure and energy in the western areas of the country, worth over 60 billion USD. Thousands of kilometers of modern highways and high-speed railways have been built. Electricity transmission networks have been put in place, as well as gas and oil pipelines, and telecommunication lines. The construction of high-speed railway that would pass along the areas where ancient Silk Road stood is well underway (high-speed rail between Xi'an and Urumqi in Xinjiang Region and further towards Kashgar and the border with Kazakhstan). This Pan-Asian railway artery will be linking China's central and eastern parts with the western parts of the country, and through the Kazakhstan's major cities of Almaty and Astana, further to the Caspian Sea all the way to Russia as well as to Turkmenistan, Iran and Turkey to Europe. In January 2016, the longest rail link between China and Europe opened for services. The train carried 40 containers and travelled 13,000 kilometers from the coastal city of Yiwu (Zhejiang) to reach, within three weeks, Madrid in Spain, half the time needed to transport the goods by ship. Similar lines are already in place between China and Germany, Poland and France.

It is expected that Chinese companies will build sections of express rail links in Kazakhstan, while in Turkey the works on the section of high-speed railway between Ankara and Istanbul have almost been fully completed. Serbia and Hungary, with the support of their Chinese partners should soon begin the construction of high-speed railway between Belgrade and Budapest with possible extensions to the south (linking with Greece and its ports of Piraeus and Thessaloniki - connection with the Maritime Silk Road), north to central Europe (through Vienna to Central and Western Europe), and possibly to Bulgaria and Turkey (the Silk Road Economic Belt) and other countries in the region.

## **21ST CENTURY MARITIME SILK ROAD**

The Maritime Silk Road connects China and the West by sea and on a wider scale will represent a transport corridor linking the Pacific to the Indian Ocean and the Mediterranean. As it is the case with the Silk Road Economic Belt, the Maritime Silk Road has as its goal the strengthening of cooperation between China and other countries. It starts from the southern Chinese ports and across the South China Sea and the Malacca Strait heads towards the Indian Ocean. From there it branches out in several directions: toward the Persian Gulf (Middle East), toward the Red Sea and Suez (Europe) and towards the Gulf of Aden (Africa). It passes through more than 20 countries and regions which account for almost 18% of Chinese foreign trade. On a broader scale, in addition to transportation and trade, the Maritime Silk Road also promotes a number of large joint infrastructure projects, such as renovation and construction of large ports and terminals for container traffic (e.g. Gwadar port in Pakistan, the port in Sri Lanka, etc.). It also

envisages bettering the cooperation in the field of security (the fight against piracy at sea), tourism, culture, and so on. It could also be a useful tool for relaxing tensions over territorial disputes in the region, especially in the South China Sea (an area rich in oil and gas reserves and important navigation corridor). Furthermore, it might also lead to the reduction of marine navigational constraints that China faced in the recent past.

### **NEW SILK ROAD AND NEW BANKING AND FINANCIAL ARCHITECTURE**

Both sets of routes—the Silk Road Economic Belt and the Maritime Silk Road, presume heavy investments. Total value of investments could reach hundreds of billions USD, while some estimates put the total economic implications of the new Silk Road to more than USD 20 trillion. In March 2015, Premier Li Keqiang said that China will invest more than USD 130 billion in the construction of 8,000 kilometers of railway tracks and another USD 130 billion in 84 water conservation projects that year alone.

As part of its active engagement in the international arena, especially in finance and banking, China in 2013 initiated the establishment of special banks for investment in infrastructure in Asia. China argued that the existing international financial institutions such as the WB, the IMF and the Asian Development Bank (ADB) do not have enough capacities to meet increasing needs for investment in the Asian region. According to ADB, between 2010 and 2020, Asia needs to invest approximately USD 8 trillion in overall national infrastructure (Infrastructure for a Seamless Asia, p. 4). The formation of AIIB could also be seen as a reflection of dissatisfaction of China and other leading developing countries with the functioning of the Bretton Woods institutions - the inadequate representation of developing countries at the WB and IMF as well as the slow reform of the quota system and voting rights.

### **ASIAN INFRASTRUCTURE INVESTMENT BANK (AIIB)**

In late October 2014, twenty countries have signed with the Chinese Ministry of Finance the Memorandum of Understanding on the establishment of AIIB. By 31 March 2015, the deadline the number of prospective founding members grew to 57.<sup>3</sup> China and the representatives of 49 countries signed on 21 June 2015 in

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<sup>3</sup> In 24 October 2014 the following countries have signed the MoU: Bangladesh, Brunei, Vietnam, India, Kazakhstan, Cambodia, Qatar, Kuwait, Laos, Malaysia, Myanmar, Mongolia, Nepal, Oman, Pakistan, Singapore, Thailand, Uzbekistan, the Philippines and Sri Lanka. In November and December 2014, Indonesia and Maldives acceded to the Bank, and in 2015 Azerbaijan, Australia,

Beijing the founding document on the establishment of AIIB. The remaining seven countries were to sign the document by the end of December 2015 in order to be recognized as founding members. The AIIB formally commenced its work on 16 January 2016. The headquarters of the bank is in Beijing and will have regional offices in other countries. The initial capital of the bank amounts to 100 billion USD.

The main governing bodies of the Bank are the Board of Governors, Board of Directors and the Secretariat. The first president of AIIB is Chinese Jin Liqun. Each member country of the Bank shall have the right to vote, which will be proportionate to its role. No country will have the right of veto. Based on the provisions of the founding act and pledged funds, the largest share of the voting rights in AIIB has China (30.34% of the shares and 26.06% of votes), followed by India (8.52% of shares, 7.51% of votes), Russia (6.6% and 5.93%), and Germany (4.57% and 4.15%).

AIIB is, in principle, open for membership to all member countries of the International Bank for Reconstruction and Development (World Bank) and/or the Asian Development Bank. A decision on each country's application for membership is made by the AIIB Board of Governors. Among the world's leading economies only the US, Japan and Canada so far remain out of AIIB.

AIIB is a multilateral development bank whose work will focus on developing infrastructure and other productive sectors in Asia, including energy, transportation, telecommunications, rural infrastructure, agricultural development, water supply, environmental protection, urban development and others. This implies the promotion and encouragement of investments made by both, public and private entities in development projects in Asia, primarily in infrastructure. AIIB will act as a supplement in the case when private capital is not available on reasonable terms. The main objective of AIIB is to provide funds and expertise in the field of infrastructure investment in Asia. The resources of the Bank are available to all Member States - their companies and other legal entities, as well as to international and regional agencies engaged in development projects in Asia. There is also a possibility of granting funds to institutions located outside the region in case it could contribute to the economic development of Asia. The economic viability of the project will be one of the main guiding principle in deciding on the allocation of funds. Many countries that have already supported the Belt and Road initiative are also members of AIIB. Hence, some analysts reckon that AIIB could also serve as another financing arm for the projects along the new Silk Road.

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Austria, Brazil, Great Britain, Georgia, Denmark, Egypt, Israel, Iran, Iceland, Italy, Jordan, South Africa, Kyrgyzstan, Republic of Korea, Luxembourg, Malta, Germany, New Zealand, Norway, Poland, Portugal, Russia, Saudi Arabia, Tajikistan, Turkey, UAE, Finland, France, Netherlands, Switzerland, Sweden and Spain.

## SILK ROAD FUND

Following the introduction of the Belt and Road initiative, a separate mechanism has been set up in the form of a development fund whose main task is financing projects in the framework of the new Silk Road. In November 2014, Chinese President Xi Jinping announced the creation of a special development fund with initial capital of USD 40 billion. In December 2014 the Silk Road Fund Co. Ltd. (SRF) was officially established, with an initial capital of 40 billion USD. This state investment fund has been formed by four Chinese institutions: the State Administration for Foreign Exchange, China Investment Corporation, Export-Import Bank and China Development Bank.<sup>4</sup> Unlike other financial institutions, i.e. banks which lend money, the Fund is tasked for resourcing and funding the specific projects in the framework of the Belt and Road.

Soon after the announcement of establishing of the SRF, the Pakistan's government has applied for funding for the construction of the Karot hydropower plant on the river Jhelum near Islamabad. Total cost of the construction of 720 MW power plant is 1.65 billion dollars. The project was initiated in April 2015 with the goal to be completed by the end of 2020. In September 2015, SRF bought a 9.9% stake in the Yamal LNG project (developing the gas fields and building the processing units) located in Russia's eastern Siberia. The agreement was concluded with the Russian gas giant Novatek (note: apart from Novatek and the SRF, investors in the project are also French and Chinese energy giants Total and CNPC with each having 20% stake in the project).

## BRICS AND SCO BANKING MECHANISMS

SRF's engagement in financing the projects along the Belt and Road is also complementary to the existing financing mechanisms in the region. A special sort of synergy is therefore expected to be achieved with AIIB, banking architectures of BRICS and SCO, and other international financial institutions.

New Development Bank (original title BRICS Development Bank) was established by Brazil, Russia, India, China and South Africa. During the fourth BRICS summit in New Delhi in 2012, India proposed the establishment of such a bank. At the next BRICS Summit in Durban in March 2013, leaders of five countries agreed on the establishment of the bank. In July 2014 in Fortaleza (Brazil), during the Sixth BRICS summit, five countries signed the founding act of the Bank, which entered into force in July 2015. The president of the Bank is K.V. Kamath from India. Other Bank management includes the vice-presidents as well as the

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<sup>4</sup> State Administration for Foreign Exchange (65% of shares), China Investment Corporation (15%), Export-Import Bank of China (15%), and China Development Bank (5%).

Board of Directors (the first chairman is from Brazil) and the Board of Governors (the first chairman is from Russia). Bank's headquarters is in Shanghai, while regional office for Africa will be located in Johannesburg.

Five BRICS countries cover more than a quarter of the world's landmass with a total population of more than 3 billion (41% of the world population), accounting for more than a quarter of the world's GDP. The initial capital of the bank amounted to USD 50 bn (ten billion dollars contributed by each of five countries), with the goal to reach USD 100bn. Each of the five founding members has an equal share and voting rights (20%). The Bank is open for other countries who are interested to become shareholders.

By establishing this bank, BRICS countries are trying to strengthen their influence in the global banking and financial sphere. The Bank thus represents a kind of alternative to the existing international financial institutions (WB, IMF) dominated by US and EU. The main objectives of the Bank are linked to the mobilization of resources for projects in infrastructure and sustainable development of five founding countries, but also in other developing countries.

In October 2005, six member states of the Shanghai Cooperation Organization (SCO) - China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan and Uzbekistan signed an agreement establishing the SCO Interbank Consortium. The agreement was signed by the state development banks of six countries, with the main objective of forming a mechanism of funding and banking services for large investment projects supported by governments of SCO member states. Coordinating work of the Consortium is performed by the Council made up of representatives of the six development banks. The position of the Chair of the Council rotates annually. In late 2013, China proposed the establishment of the SCO Development Bank in order to bring to a higher level the cooperation among the members of this organization in the field of finance and banking. For this purpose China also offered to invest a significant amount to the Bank as initial capital. The Bank would offer financing the large infrastructure projects and foreign trade operations among current six SCO members, as well as with future members (India and Pakistan) and observers (Afghanistan, Mongolia, Iran, Belarus).

## **SERBIA ON THE NEW SILK ROAD**

As a European country, an EU member-candidate and active participant into the China-CEEC cooperation, Serbia is a logical partner on the New Silk Road. Serbia's position and future role in the Belt and Road initiative is determined by many factors.

Serbia and China maintain very close relations, which are characterized by traditional friendship and strategic partnership and a high level of mutual trust and



understanding. Two countries support each other in the most important issues of national interest. China is the most important economic partner of Serbia in Asia and one of the major pillars of Serbia's foreign policy. Chinese officials frequently point out to Serbia as China's key partner and the best friend in the region. Relations and cooperation between two countries are now at the highest level since the establishment of diplomatic relations in 1955, and every day they are broadening with new contents.

Serbia's place along the New Silk Road is also determined by joint documents signed with China. During Serbian Prime Minister Vučić's recent visit to China, in November 2015, Serbia and China signed the Memorandum of Understanding on Joint Promotion of the Belt and Road initiative. Prime Minister Vučić said on this occasion that Serbia wants to become one of the key trade hubs in this part of Europe being part of the Belt and Road Initiative. He also noted that this is a development chance for Serbia. Back in August 2009, Serbia and China established strategic partnership (joint statement of the then presidents Boris Tadić and Hu Jintao), which is then deepened in August 2013 with the Joint Statement signed by the presidents Tomislav Nikolić and Xi Jinping. Since then, a series of framework agreements on economic cooperation have been concluded. The Agreement on Economic and Technical Cooperation in the field of infrastructure signed in August 2009, paved the way for many joint projects in the field of infrastructure (Danube bridge in Belgrade, sections on highway E-763 - Corridor 11) and energy (Kostolac-B Power Plant Project). On a broader scale, there are numerous meetings held and joint documents adopted in the framework of the mechanism of cooperation between China and 16 countries of Central and Eastern Europe (China-CEEC). The Suzhou Guidelines adopted during the meeting of the heads of government of China and CEEC (China-CEEC Summit), held in November 2015 further affirmed the importance of cooperation within the Belt and Road Initiative.

China-CEEC mechanism, where Serbia is an active participant, becomes an important and cooperation mechanism along the new Silk Road. Serbia became a leader among CEECs in implementing joint infrastructure and energy projects with China. Therefore, it is of no surprise that China and CEECs supported Serbia's efforts to establish a China-CEEC association on transport and infrastructure cooperation in Belgrade.

Bearing also in mind its geographical location, traffic and energy connections with the region and beyond, Serbia could be an important link along the new Silk Road. Serbia is one of the countries on the New Silk Road, which was first to initiate activities on transport and energy infrastructure projects with China - bridge over the Danube river in Belgrade, Kostolac-B Power Plant Project, sections on highway E-763 (Corridor 11 connecting Belgrade and South Adriatic Coast).

The Belgrade-Budapest railway project will be carried out jointly by Serbia, Hungary and China. The total length of the rail is 350km, providing the maximum speed of trains between 160 and 200km/h, which would reduce the travel time between two capitals to 2.5-3hrs. The estimated value of the entire project is around 2.5 bn euros. The railway project was first endorsed in November 2013 in Bucharest, following the meeting between Prime Ministers of Serbia, China and Hungary (Ivica Dačić, Li Keqiang, Viktor Orban), on the sidelines of the China-CEEC Summit. A year after, in December 2014, Memorandum of Understanding on cooperation in the project the Hungarian-Serbian railway between Serbia, Hungary and China was signed, on the sidelines of the China-CEEC Summit in Belgrade in the presence of Prime Ministers of Serbia - A. Vučić, China - Li Keqiang, Hungary - V. Orban and Macedonia - N. Gruevski. On this occasion, the Framework Agreement on Joint Cooperation in Facilitating the Customs Cooperation between Serbia, China, Hungary and Macedonia has also been signed, and four parties undertook to intensify customs cooperation, and to simplify customs procedures. Prime ministers of four countries unanimously agreed to jointly work on building Land-Sea Express Passage linking China and Europe. All this should lead to setting up a unified railway-transport and customs system that would connect the port of Piraeus, through Macedonia with Serbia and Hungary and the rest of Europe, transporting the goods from China to Central Europe and vice versa.<sup>5</sup> Premier Li Keqiang said at the time that railway project will contribute not only to developing and connecting countries in the region, but also to further strengthening cooperation between China and the EU.

At the Fourth China-CEEC summit in Suzhou, in November 2015, Serbian and Hungarian sides signed with Chinese partners, general agreements for modernization and construction of sections of Belgrade-Budapest railway in their respective territories. The launching ceremony of modernization and upgrading of Serbia-Hungary railway line in the territory of Serbia was held in Novi Sad, in late December 2015. First construction works are scheduled for 2016 with the expected completion by the end of 2018. The section through Serbia (Belgrade - Novi Sad-Subotica - border with Hungary) has a length of 188km.

Railway project will serve as an important impetus for economic development of Serbia, Hungary and other countries in the region. The importance of this project for Serbia is also echoed by Prime Minister Vučić's remarks that the Belgrade-

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<sup>5</sup> Chinese state-owned company Cosco Group in 2008 took a long-term lease (35 years) for two tiers of Piraeus port cargo terminal, paying for it 490 million euros. The Chinese company has meanwhile leased and expanded terminal and in 2013 began construction of a new, third pier investing 230 million euros. After a few years of management, volume of transport in the port exceeded 3 million containers per year. COSCO thus created rail cargo link between the port of Piraeus and Central Europe. Leading Chinese telecommunications companies Huawei and ZTE, as well as American Hewlett Packard and Sony of Japan started using terminals as logistics centers. In January 2016, Cosco was also the sole bidder for a 67% stake in the port owned by the Greek Government.

Budapest railway would contribute to the realization of the transport networks, as well as to the movement of people and goods, which would hitherto encourage the creation of logistics routes and distribution centers, and long-term access to new markets.

### CONCLUSION

Overall, the Belt and Road initiative could serve as another important bridge linking Asia, Europe and Africa. By developing the new Silk Road, China could strengthen its influence in the world, enhance cooperation and mutual trust with its neighbours, promote its culture and technologies, and increase overall economic growth. China needs to work hard and carefully to gain the trust and support of other countries so that its Belt and Road initiative gain the widespread acceptance. The improvement of transportation and energy infrastructure is one of the key preconditions for further strong economic development of Asian countries. Hence, it is important that the new financial institutions, such as SRF, will focus on investments in transportation and energy infrastructure. The Belt and Road also gives strong encouragement for project cooperation between countries along the new Silk Road, and could be an important developing chance not just for China and Asia, but also for other partners including Serbia and the CEE countries. Given the fact of still lurking global economic downturns and volatilities of international markets, the Belt and Road initiative could also prove to be an important engine for ensuring the stable and sustainable economic growth.

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Aleksandar JANKOVIĆ

### **NOVI PUT SVILE - NOVI POKRETAČ RASTA**

*Apstrakt:* Novi Put svile je strateška inicijativa koja obuhvata izgradnju ekonomskog pojasa Puta svile i pomorskog Puta svile. Obično se skraćeno nazivaju Pojas i Put. Glavni cilj inicijativa Pojasa i Puta je obezbeđenje stabilanog i uravnoteženog ekonomskog rasta u Kini, kao i jačanje ekonomske i saobraćajne veze sa susedima u centralnoj Aziji, Evropi, južnoj Aziji, jugoistočnoj Aziji i Africi. Kina je inicijator i lider povezivanja i saradnje u okviru Pojasa i Puta. Međutim, inicijativa predstavlja razvojnu šansu ne samo za Kinu već i za više od 60 zemalja duž novog Puta svile. Jedna od tih zemalja je Srbija, čija je pozicija na novom Putu svile određena mnogim faktorima.

*Ključne reči:* novi Put svile, Pojas i Put inicijativa, Kina, Srbija, ekonomski rast.

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## CHINA'S "NEW SILK ROAD" DEVELOPMENT STRATEGY

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*Abstract:* China's tremendous economic development has made China an increasingly attractive economic partner in the first and second decade of the 21<sup>st</sup> century. During this period, the ancient Silk Road trade route became attractive once again; today, it is a symbol for trade and investment involving China, Central Asia, Europe, the Middle East and Africa. China's "New Silk Road" development strategy consist of two geopolitical initiatives – one of them is the "Silk Road Economic Belt", with stronger ties with Central Asia (and special focus on trade and transport) as a goal; the other is known as the "21<sup>st</sup> Century Maritime Silk Road", and it is an attempt to improve trade relations with South and Southeast Asia. The authors argue that Belt and Road Initiatives bear political and economic consequences. They could bring about better political understanding and economic benefits for all participants. However, both initiatives will have consequences on the US' dominance in international relations. While there are condemnations of the two initiatives, some parts of the EU (especially the Central and Eastern European countries) and ASEAN have high expectations from these initiatives. A successful fruit-bearing of these initiatives in the following ten years should thus ease the opponents' concerns. To use China's favourite foreign policy catchphrase, it is a "win-win" situation – China can achieve a softer image for itself while increasing its regional influence.

*Key words:* New Silk Road, Maritime Silk Road, Silk Road Economic Belt, China, EU, ASEAN.

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## INTRODUCTION

The China's "New Silk Road" development strategy is among the most important geopolitical and geo-economics initiative of the early 21<sup>st</sup> century. Its importance is huge due to the number of countries they could encompass, and the potential political, economic, security, cultural, scientific and energy benefits for all of them. Just like a number of other initiatives, China's the "New Silk Road" development strategy encountered some opposition and dissent, especially from major powers such as Russia and the USA which have their own geopolitical concepts of regional development or strategy of the "New Silk Road"; however, the "New Silk Road" strategy also encountered approval from the developing countries.

This paper will first give some introductory explanations regarding the concept of the "New Silk Road", its origins and importance to China's domestic development and cross-border cooperation. This part will also cover the possible (though still not strictly defined) routes of the "New Silk Road" initiatives. The next part will examine the possible economic benefits arising from the initiatives, and will be followed by an estimate of the two initiatives' political and security effects (with particular accent given to the US response, EU's internal debate, India's stance, CEEC-China "16+1" platform, the position of China's Xinjiang Province, Central Asian countries and the Russian reaction as well as the ASEAN countries). Finally, the paper will shed light on the two initiatives' relevance to China's energy security.

## THE STRATEGIC CONCEPT OF THE "NEW SILK ROAD"

The strategic concept of the "New Silk Road" is not a new one. This idea was seriously taken into consideration in the 1990s after the disintegration of the Soviet Union. At that time, Deng Xiaoping confirmed his vision of economic reforms based on China's coastal development (e.g. special economic zones in coastal provinces, open coastal cities, eastern comprehensive development zones).<sup>3</sup> In this idea, there was no provision for the development of the inland parts of China. Nowadays, the situation is different. China is facing economic threats. The global economic crisis and domestic social problems have outdated the current export and FDI driven economic model. Against this backdrop, China needs to find new export markets or

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<sup>3</sup> In 1978 when China began its economic structural reform, it also implemented a policy of gradual opening up. According to Deng Xiaoping proposal, in May 1984, the CPC Central Committee decided to designate 14 coastal port cities to open to foreign investment and trade – Tianjin, Shanghai, Dalian, Qinhuangdao, Yantai, Qingdao, Lianyungang, Nantong, Ningbo, Wenzhou, Fuzhou, Guangzhou, Zhanjiang and Beihai. In February 1985, the CPC Central Committee decided to open the Yangtze River Delta, the Pearl River Delta and the Triangle Area of Southern Fujian, Xiamen and Quanzhou to be coastal economic open areas. (Hongyuan, Yun, Qifa, 2012, p. 128; China, Foreign Languages Press Co, Beijing, 2013, p. 117).

preserve existing ones, as well as to narrow development gaps between the well-developed coastal areas and the less-developed inland parts of the country, and to preserve the stability inside China and in its neighbourhood. This is the main reason why the actual Chinese Government and Chinese leaders came up with the concept of “New Silk Road,” which is widely quoted by political experts and prominent world media. From the political model of “Chinese Dream”, often summarised as a rejuvenation of the Chinese nation, the concept of “the New Silk Road” (inspired by the ancient trade route) consists of two geopolitical initiatives. First one is the “Silk Road Economic Belt”, which indicates stronger trade and investment relations with Central Asia, while the second one is “Maritime Silk Road”, perceived as an attempt to improve trade relations with South and Southeast Asia on the basis of maritime security. Both initiatives were mentioned in a document exposed after the 3rd plenary session of the 18th Central Committee of the Chinese Communist Party held in mid-November 2013, in Beijing (Xinhua 2013a). With its “Peaceful Development Policy” and two “New Silk Road” initiatives, China could promote its own economic growth through trade routes that meet the Chinese demand for better regional cooperation, trade diversifications, investing in transportation, and in mining and energy sectors (Petrović Piroćanac, 2014, pp. 86-98).<sup>4</sup> With the implementation of the so-called “New Silk Road diplomacy”, China will preserve stability on its borders and in the western part of China. In addition, China will secure export markets and energy supplies, develop inland transport routes as an alternative to unreliable sea-lines, and narrow the development gap between the eastern and western parts of China (Tianquan, 2012, pp. 33-51) In February 2015, Chinese Vice-Premier Zhang Gaoli distinguished their common priorities as: transport infrastructure building; trade and investment facilitation; financial cooperation; cultural exchanges and environmental protection and social responsibility (Xinhua, 2015a). Hence, “the New Silk Road” initiatives indicate a positive climate for building a new international system that could bring prosperity much like the ancient Silk Road.

## INTRODUCTION TO CHINA'S DEVELOPMENT STRATEGY OF THE “NEW SILK ROAD“

The first initiative of the China's development strategy of the “Silk Road Economic Belt” was presented during President Xi Jinping official visit to four

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<sup>4</sup> The Chinese policy discourse often stresses the distinctiveness of China's approach as a responsible great power (*fu zeren de daguo*) that respects other countries' sovereignty, in contrast to what are perceived as Western powers' efforts to interfere in other countries' social systems, development paths, and internal and external policies. Professor Yu Hongjun comprises five essential elements of this New China foreign policy: 1. The path of the peaceful development; 2. Independent nature of the development; 3. Scientific nature of development; 4 Cooperative nature of development; 5. Mutual development (Hongjun, 2013, p. 9).



Central Asian states: Turkmenistan, Kazakhstan, Uzbekistan and Kyrgyzstan, in September 2013. The concept was announced in his speech in Astana and reiterated in his address at the 13th Shanghai Cooperation Organization (SCO) summit in Bishkek. On this occasion President Xi Jinping put forward major initiatives of “jointly building the Silk Road Economic Belt with innovative models of cooperation”, between China, Central Asia and Europe. They are as follows: 1. strengthen policy communication, which may help “switch on a green light” for joint economic cooperation; 2. strengthen road connections, with the idea to establish a great transport corridor from the Pacific to the Baltic Sea, and from Central Asia to the Indian Ocean, then gradually build a network of transport connections between eastern, western and southern Asia; 3. strengthen trade facilitation, with a focus on eliminating trade barriers and taking steps to reduce trade and investment expenses; 4. strengthen monetary cooperation, with special attention to currency settlements that could decrease transaction costs and lessen financial risk while increasing economic competitiveness; 5. strengthen people-to-people relation (Xinhua 2013b). According to the initiative, “the Silk Road Economic Belt” is expected to include countries located along the ancient Silk Road trade route (China, Central Asia, the Middle East and on to Europe). One of the potential routes of Silk Road Economic Belt begins in Xi’an, in central China, before reaching the border with Kazakhstan. The Silk Road then continues southwest to Iran before passing through Iraq, Syria and Turkey. The new Silk Road then crosses the Bosphorus and heads through Europe, traversing Bulgaria, Romania, the Czech Republic, Germany and Rotterdam in the Netherlands; there is a connection between Rotterdam and Venice, the terminal of the planned Maritime Silk Road.

On the other hand, the second initiative of the China’s development strategy of the “21st century Maritime Silk Road” was first suggested by the President Xi Jinping’s in his speech in the Indonesian parliament in early October 2013. The Initiative was made public during Li Keqiang’s attendance at the 16th ASEAN + China summit in Brunei. Two Chinese leaders used the 10th anniversary of the ASEAN-China strategic partnership to present this idea. The content of both speeches equals the viewpoints presented in Chinese President’s Astana address. The main emphasis was placed on stronger economic regional cooperation, which means the implementation of President Xi’s suggestion to establish the Asian Infrastructure Investment Bank (AIIB), with the purpose of financing infrastructure construction (e.g. building ports, roads and railways), and promoting regional interconnectivity and integration (Xinhua, 2015b). The result of this idea would be an improvement of maritime economy as well as environment protection, science, technology and security cooperation.

The difference between said two initiatives can be explained by technological differences that exist between maritime transport (which China greatly benefits) in relation to the railway transport (which China limited benefits), which opens the

possibility to transport both complement each other. Hence, it would be possible to draw the conclusion that China will retain the role of a main trading partner with the improved infrastructure for international trade; in addition, although the infrastructural investment increases Chinese strength in international affairs, it must be noted that for the time being, China is building commercial installations (and not the military installations, as usually suspected) – naval strength is a goal for Chinese navy, but only in the Western Pacific (Puten, Meijnders, 2015, p. 28, 33).<sup>5</sup>

Some authors believe that the initiatives coming because of China's dissatisfaction with financial order in the world, especially in terms of its efforts to reform the World Bank, the IMF and the Asian Development Bank. In that context, they believe that through the establishment of the Asian Infrastructure Investment Bank (AIIB), with the purpose of financing infrastructure construction (e.g., building roads and railways), and promoting regional interconnectivity and integration, China may find a higher degree of legitimacy in international relations and the acceptance of its proposals for infrastructure projects which enable multilateral and bilateral cooperation. Also, they suggest that for China, it is more prudent to redirect funds from its US dollar reserves towards infrastructure than to further acquire US treasury bonds; these infrastructure projects may also lead to greater use of renminbi as a means of payment (Hilpert, Wacker, 2015, p. 2, etc.).

According to the recent information, published by the Xinhua state agency, the Maritime Silk Road begins in Quanzhou (Fujian) and hits other southern Chinese ports (Fujian, Zhejiang and Guangdong) before heading to the Malacca Strait. From Kuala Lumpur, the Maritime Silk Road heads to Kolkata, crosses the rest of the Indian Ocean to Nairobi and then around the Horn of Africa into the Mediterranean – with final stops in Greece and Italy. The route will deliver Chinese goods and services to ASEAN countries, Sri Lanka, the Horn of Africa, the Middle East and the Mediterranean. Both of these initiatives are expected to become fully operative by 2025 (Escobar, 2015).

A particularly important aspect of the development of Silk Road Economic Belt is the construction of the railway network and rail corridors that need to connect China with other continents. Currently there are three railway freight corridors in China, connecting Asia and Europe, namely through the northern Eurasian corridor (via Trans-Siberian Railway), through the Central Eurasian railway corridor (part of the Second Eurasian Continental Bridge) and the future Southern Eurasian railway corridor. China has already opened eight international railway lines related to the Eurasian corridor and the Silk Road Economic Belt respectively, connecting national railways of four countries. Chinese Railways have three connection points with Russian Railways (Manchuria, Suifenhe and Hunchun) and one connection point to Mongolia

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<sup>5</sup> Such goals do not exist in the Indian Ocean or the Mediterranean.

Railways (Erenhot); these four cross-border railway lines are connected with the northern Eurasian railway corridor (Trans-Siberian railroad). There are two connection points with Kazakhstan railways (Alashankou, Horgos/Huoerguosi), which is part of the Central Eurasian railway corridor through China's Longhai railway line and Lanxin railway line. Finally, there are two connection points with Vietnam Railways (Pingxiang, Estuary), which belongs to the South Eurasian railway corridor, namely the Trans Asian Railway Passage. Through joint efforts of China, Mongolia, Russia, Kazakhstan, Germany and other countries, China's railway authorities have organized several direct container trains, traveling to European countries. Currently there is a number of Eurasian direct container trains: Hohhot-Frankfurt container train, "Foxconn" international intermodal train, Beijing-Hamburg container demonstration train, Urumqi-Hamburg container train, "Yu-Xin-Ou" container train (connecting the city of Chongqing with Duisburg, Germany, via Urumqi in Xinjiang Province), "Su-Man-Ou" container train (Suzhou (China) – Manzhouli (China) - Poland), "Han-Xin-Ou" railway international freight train (Wuhan (China) - Czech Republic), "Rong European fast iron" container train (Chengdu (China) - Poland), "Zheng-Xin-Ou" (Zhengzhou (China) – Xinjiang (China) – Hamburg (Germany)) international freight train as well as November 2014-launched train between Yiwu (an important wholesale centre for small consumer goods located in Zhejiang Province) and Madrid, capital of Spain (a distance of 13 thousand kilometres, covered in around three weeks). The countries along the way, in addition to China and Spain, include Kazakhstan, Russia, Belarus, Poland, Germany and France. (Xinhua 2014a). The railway transport enjoys certain advantages over the maritime option. These include a CO<sub>2</sub> emission which is 62 percent lower, but also the evasion of several naval choke points along the maritime way (the most notable being the Malacca Strait and the Gulf of Aden), and the potential terrorist attacks (Bürgen, 2015).

### **THE POSSIBLE ECONOMIC BENEFITS**

The Silk Road Economic Belt, the world's most potential of economic growth, covers parts of Central, South and West Asia and Europe, connecting two major economic circles, both Asia and Europe's together. The area consists of more than 50 countries, with a combined population of 3.6 billion, accounting for 51.4% of the total world population. As it was already mentioned, the "Belt and Road Initiatives" are expected to become fully operational by 2025. According to some estimates, their aggregate worth is expected to surpass 21 trillion US dollars, which could easily make it one of the landmark projects of the 21<sup>st</sup> century. These initiatives have been proposed with the purpose of benefiting both China and the countries along the land and maritime route. The most important economic benefits include 1) the improvement of trade and investment flows (facilitated through greater use of local currencies in cross-border exchange, and through currency swap

arrangements between the People's Bank of China and other central banks) and 2) the improvement and upgrade of transport infrastructure (the railway and highway network, and the deep water port facilities) and greater economic integration (greater access to Chinese market for all countries along the route, and vice versa). There is, in addition, an economic benefit that will affect the still-developing provinces in China's west. The infrastructure improvement, coupled with foreign trade and investment and cross-border exchange are expected to benefit regions (the today's provinces of Gansu, Qinghai, Xinjiang, etc.) which have remained far from the main economic activity during the 35 years of China's economic reforms.

The "Belt and Road Initiatives" are already being compared to the Marshall Plan, suggested and enacted by the US after the World War II. Some western political analysts see the deployment of economic strengths in order to achieve foreign policy goals (among which a particular place belongs to the sustaining of the domestic economy) as the common feature of both initiatives. Analysing the possible economic benefits of the initiatives, some authors concluded that the Chinese authorities hope to achieve it in the same extent as it was with the Marshall Plan after World War II. Through a strategy of "New Silk Road", China has hence can be treated as bona fide super power (Tiezzi, 2014). On the other hand, however, some authors believe that the common features between China's "One Belt, One Road" strategic initiatives and the U.S. Marshall plan, is included in the ambition of exporting countries to export the country's capital, commodities, technology and other capacity to the countries in need. In this regard, particularly emphasize three in many ways crucial differences, namely: motivation - where it is thought that China is not motivated to be a great power or a hegemonic actor in Asia and beyond. In fact, China is satisfied with achieving a "win-win" situation with other participants in the initiative. In doing so, China underlines the fact that the "Belt and Road" initiatives are open to all countries, despite the fact that some of the participants would be inclined to take a 'free ride' on the initiative. Another difference concerns the challenges ahead of China's "Belt and Road" initiatives, which are far more abundant than in the case of Marshall Plan. It is believed that in fact, in order to succeed, China's initiative has to overcome the differences in values and beliefs and the potential resistance and distrust from the countries involved (none of which existed to such an extent in the case of Marshall Plan). Third difference is the potential impact – there is clarifying potential ranges of the "Belt and Road" strategic initiatives as much broader than any of the results achieved by the Marshall Plan. Contrary to the Marshall Plan, the "Belt and Road" initiatives could include the whole world, i.e. any country willing to cooperate with China and to benefit from its economic growth. An economic development without hidden political requests is appealing to many developing countries and the "Belt and Road" initiatives seem to be better suited to such a purpose than the Marshall Plan is (Chan, 2014).

## THE POSSIBLE POLITICAL AND SECURITY EFFECTS

While it is certain that the Belt and Road Initiatives were launched with a purpose of achieving economic goals, at the time of their realisation they will imminently cause some political and security consequences. According to Asanga Abeyagoonasekera (executive director of the Lakshman Institute of International Relations and Strategic Studies, Sri Lanka), the most important political consequence, involving all participating countries, will amount to an increased political understanding and trust, but also to broader political channels of communication through which it will be possible to exchange political viewpoints and the values and norms in their basis (Xinhua, 2015c). In the end, the likelihood of achieving a common political position will be increased. It is also worth mentioning that mutually beneficial economic cooperation will also raise awareness of the security threats that could undermine the successful functioning of the trade routes. As a result, the countries concerned will dedicate more attention to combating terrorism threats, and to achieving greater stability along the trade routes.

## THE US RESPONSE

Flynt Leverett and some other political analysts have also analysed the political and strategic calculus behind the “Belt and Road” initiatives, as well as Chinese Government’s advocacy of greater influence of Asian countries in strictly Asian affairs. They have described the initiatives as China’s response to US “pivot to Asia”, a landmark policy during both Barack Obama presidencies – as they believe, Chinese political elites are aware of US’ ambition to contain China by using economic, political and military means (Leverett et al, 2015). They view the transformation of the contemporary international relations as the long-term goal of the Chinese leadership; the Chinese leadership strives for a truly multipolar international order and the ability to match the US dominance (Leverett et al, 2015). The “Belt and Road” initiatives could (after reaching the proclaimed goals) contribute to the decline of US supremacy, especially in the Middle East and other regions along the trade routes. The conclusion made by Leverett is that a successful implementation of the “Belt and Road” initiatives will almost inevitably lead Beijing to ignore US displeasure on multiple fronts in the near-to-medium future (with one of the examples being the Iran policy – Chinese Government will be in a position to choose between greater understanding for the US’ Iran policy and forthright deepening of Sino-Iranian relations).

Christina Lin, a former visiting fellow at the Washington Institute for Near East Policy, determined the China government call on the “New Silk Road” strategy desire to diversify and increase its energy supplies *via* natural gas and other options that has led it to greater engagement with countries rich in resources, in Central

Asia, the Caucasus, and the Middle East. She believes that inclusion of the foreign affairs, security, and military intelligence apparatus reflect the government's deep concerns about energy security. To address these concerns, Beijing has turned to the Shanghai Cooperation Organization (SCO). Established in 2001, the SCO consists of China, Russia, and the four Central Asian republics of Kazakhstan, Kyrgyzstan, Tajikistan, and Uzbekistan, along with four observer states (Iran, Pakistan, India, and Mongolia). China has used the organization to achieve gradual economic integration with the Central Asian/Caspian region and meet three main goals: (1) pacifying the restive Xinjiang province, home to significant Muslim-Uyghur separatist forces, (2) diversifying energy sources from the Persian Gulf and hedging against any maritime embargoes, and (3) projecting Chinese hegemony across Eurasia. This strategy has largely centred on using financial means to create dependency among regional governments, building on increased political, military, and hydrocarbon cooperation (Lin, 2011).

Other American experts for foreign affairs point out to the potential competitor status of the China-supported Asian Infrastructure Investment Bank against the World Bank and Asian Development Bank, both of which are institutions with crucial influence exerted by the US and its Asian allies (Daily Star, 2014). The Chinese Government has, however, praised the experience of the World Bank and Asian Development Bank as precious, pointing to the sufficient number of projects available for all lenders. Jeremy Page is one of the reputable political analysts who are noting the debate among Western and Asian governments regarding the Belt and Road Initiatives. In his study about this topic, he exposed the positive view and great expectations of China's ambitions, but also he highlighted the critical posture towards China's initiatives (with arguments focusing around the strategic dimension of the initiatives and the potential undermining of the governance standards at existing lending institutions, such as the World Bank or the Asian Development Bank) (Page, 2014).

## **THE EU'S INTERNAL DEBATE**

As regards the European Union's posture towards the "Belt and Road Initiatives", a number of analysts have highlighted the positive effects of these initiatives, expressing belief that they will reinforce China-EU ties. According to David Gosset of Shanghai's China Europe International Business School, the proposal made by Chinese President Xi should not be ignored, for successful realization of the initiatives would reshape Eurasia. Gosset foresaw the new levels of prosperity and cohesiveness for all Eurasian actors if the two initiatives are fully embraced. Bai Ming of Chinese Academy of International Trade and Economic Cooperation pointed to the contribution of two trade routes to greater China's openness to the West and the EU's openness to the East, describing it as a real "win-win" deal. Bai noticed the likelihood

of an increase in business opportunities in Asia available to the EU. Finally, Zhu Dan of European Union Chamber of Commerce in China highlighted the policy dividends of the “Belt and Road Initiatives”, and their attractiveness given the economic hardships the European economy is facing. She pointed to the complementary economic structure of China and Europe, describing it as a good starting point for bilateral trade and cooperation, and an increase in Chinese investments abroad (Xinhua, 2015d). On the other hand, Dragan Pavličević highlighted the ambiguous attitude of the EU toward China’s growing involvement in its backyard. He noted the intra-EU discussion regarding the nature of China-Central and Eastern Europe cooperation, and the existing concerns that it could be used to split the EU in a way that could benefit China. In December 2014, Chinese Premier Li Keqiang attempted to allay such concerns by reiterating China’s support to the European integration process and the European unification. According to Li, the EU would benefit from successful China’s cooperation with Central and Eastern Europe (an important part of the overall China-Europe cooperation) due to the narrowing of the development gap between different parts of the EU. In addition, Li announced the adherence to EU laws and standards in the conduction of China’s infrastructure projects in Europe. As a conclusion, Pavličević described the future China’s relations with Central and Eastern Europe as dependent on the overall EU posture towards China’s interests in the region. Due to the Brussels’ political leverage over the EU’s east, the China-CEE relations will deteriorate should the EU decide to treat China’s incursions as harmful (Pavličević, 2015). Bearing in mind the expressed opinions in order to give the final assessment of EU-China relationship, the following facts are notable. China has been always attaching great importance to good relations with the EU not only because the EU’s development represents an important trend of multi-polarization (which is in line with China’s view of the international order), but also because Europe is the largest trade partner to China. A prosperous Europe can provide overseas market, advanced technology and investment for China’s economy. Nowadays, Chinese leadership regards China-Europe relationship as the focal point and growth point. This positioning is proven by frequent diplomatic actions taken by the new Chinese leadership since 2013. The benefits of One Belt, One Road initiative to Europe had also been addressed by Wang Yiwei. Wang highlighted the easier EU participation in Asia-Pacific affairs and EU benefit from Asia-Pacific economic development, as well as greater EU influence worldwide (in the latter case, the countries of the One Belt, One Road will call for European experience and practice in global and local governance) (Yiwei 2015, p. 105). Finally, Wang mentioned an upgrade of China-EU comprehensive strategic partnership (a symbol of which is the negotiations for the Bilateral Investment Treaty (BIT) and the prospect of a China-EU free trade agreement) and a chance for European countries to balance the development of trans-Atlantic partnership (i.e. to improve the European standing position vis-à-vis the United States) (Yiwei 2015, p. 106).

## CEE-CHINA "16+1" PLATFORM

According to the Joint Statement made during the President Xi's trip to the EU headquarters, China and EU decided to develop synergies between China's "Silk Road Economic Belt" initiative and EU policies and jointly to explore common initiatives along these lines.<sup>6</sup> Due to the fact that Central and Eastern Europe (CEE) is an important part of Europe and is located at the gateway for China to Europe, China also calls on CEE countries to join "the New Silk Road" Initiative.<sup>7</sup> "The New Silk Road Economic Belt" initiative and the China-CEE cooperation, both in their objectives and pathways, are accommodating and complementary to each other. And the latter is expected to become a positive driving force in the development of this large strategic plan (Jing, 2015) (China Daily, 2014).

Relations between China and the CEE, have been increasingly attracting attention around Europe since the opening-up of the "16+1" platform. Chinese Premier Wen Jiabao took the first steps towards this platform in 2011 in Budapest, at the China-CEE Economic and Trade Forum, where he announced a "5-point proposal" to enhance bilateral cooperation. A year later, in Warsaw during the first summit of leaders of China and CEE, this became the "12-point initiative". This document is perceived as China's new engagement strategy in the region (Szcudlik-Tatar, 2013). The first point from the "12-points initiative" was the establishment of a Secretariat for Cooperation between China and the 16 CEE countries which was officially established in September 2012, in Beijing, in the presence of the National Coordinators of all 16 European countries, and China. The other 11 points included the establishment of a 10 billion US\$ special credit line for the CEE countries; setting up an investment cooperation fund between China and CEE countries with the goal of raising 500 million US\$ in the first stage; increase of the total trade volume between China and CEE to 100 billion US\$ by 2015; stimulation of Chinese enterprises to invest in special economic and technology zones in CEE; exploration of potential financial cooperation such as "currency swap, local currency settlement for cross-border trade, and establishment of bank branches in each other's countries"; establishment of an expert advisory committee on the construction of transportation network between China and CEE countries (e.g. regional highway or railway through joint venture, joint contracting and other means); expansion of cultural cooperation; provision of scholarships to the CESEE countries and support of the Confucius

<sup>6</sup> Joint Statement Deepening the China-EU Comprehensive Strategic Partnership for Mutual Benefit, available at [http://www.fmprc.gov.cn/mfa\\_eng/wjdt\\_665385/2649\\_665393/t1145387.shtml](http://www.fmprc.gov.cn/mfa_eng/wjdt_665385/2649_665393/t1145387.shtml), last accessed on 31 March 2014.

<sup>7</sup> The 16 CEE countries, which are involved in the Chinese initiative present heterogeneous group – there are 11 EU members (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and 5 countries with ambition to become EU members (Albania, Bosnia and Herzegovina, Macedonia, Montenegro, and Serbia).



Institutes and Confucius Classrooms programs, and invitation of Chinese language students to China; establishment of a tourism promotion alliance between China and CESEE countries, coordinated by the China Tourism Administration; establishment of a research fund on relations between China and CESEE; hosting of the first young political leaders forum of China and CESEE in 2013 (Vangeli, 2014).

On 26 November 2013, the Meeting of Heads of Government of China and Central and Eastern European Countries was held in Bucharest, Romania. To further improve China-CEEC cooperation, parties at the meeting jointly formulated and issued the “Bucharest Guidelines for Cooperation between China and CEE“. ”The Bucharest Guidelines” are focused on the theme of the ”win-win“ cooperation, which implies increased investment and trade volumes, as well as increased cooperation in the fields of science, technology, innovation, environmental protection and energy (especially in the matter of nuclear power, wind power, hydro power, solar power and other sources of clean power). The document promotes people to people exchanges and cultural exchanges and cooperation. Special emphasis is given to infrastructure development such as construction of roads, railways, ports and airports based on the principle of mutual benefit. The “Bucharest Guidelines” encourage China and CEE countries to build an international railway transportation corridor connecting China with CEE countries; along this railway corridor, distribution centres will be established in order to build a new logistics passage between China and Europe. The document particularly supports the establishment of cooperation in the area of free movement of capital and financial services in China and CEE countries financial institutions. It establishes the obligation of their financial institutions to engage in cooperation in flexible and diverse forms and bring into full play the role of the 10 billion US\$ special credit line in promoting China-CEE economic cooperation and trade. It welcomes the official launch of the China-CEE Investment Cooperation Fund, commends the efforts made by Chinese, Polish and Hungarian financial institutions, supports the relevant financial institutions in launching stage two of the fund at an appropriate time and encourages more financial institutions and businesses to contribute to the fund. “The Bucharest Guidelines” also support the People’s Bank of China and the central banks of CEE countries in signing agreements of currency swaps as they see necessary and promote local currency settlement as one of the means to promote trade and investment.<sup>8</sup>

On 16 December 2014 in Belgrade, at the third meeting between China and the CEE countries (held from 16-17 December), the parties announced the “Belgrade Guidelines for Cooperation“. According to “the Guidelines“, the parties will expand

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<sup>8</sup> The Bucharest Guidelines for Cooperation between China and Central and Eastern European Countries, Secretariat for Cooperation between China and Central and Eastern European Countries, 29 November 2013, available at <http://www.china-ceec.org/151/2014/01/02/41s1569.htm>, last accessed on 10 December 2014.

trade, investment, and economic cooperation (EurActiv, 2014). They will also support the establishment of the executive body of the China-CEE countries business council in Warsaw, Poland, and urge "relevant business organizations from both sides to cooperate on a voluntary basis". The "Belgrade Guidelines for Cooperation" welcome the founding of the secretariat of the contact mechanism for China-CEE investment promotion agencies in Beijing and Warsaw. *Inter alia*, the document supports the role of Bulgaria in leading joint efforts to set up a Chinese-CEE consortium in promoting agricultural cooperation in the first half of 2015, and calls on the parties to fully utilize 10 billion US\$ in special loans and other financing tools, provided by China, for the promotion of trade and economic cooperation. The document considers the signing of currency swap agreements between China and Hungary and Albania, with the use of RMB by business circles as the settlement currency in cross-border trade and investment, notes the parties' common will to boost cooperation in science, technology, innovation, environment protection and energy, among other fields, and pledges to deepen people-to-people exchanges and cooperation at various levels (Xinhua, 2014b).

At the third meeting in Belgrade under the platform "16+1", China announced the provision of new funds to pursue new ventures with the CEE countries, "stressing that the cooperation will be in line with European standards". The most discussed project at the summit was the modernization of the Belgrade-Budapest railroad, in connection with which China, Serbia, and Hungary signed agreements at the meeting. The project, which would cost between 1.5 and 2 billion € (about 1.8 -2 billion US\$) and shorten travel time from 8 to 2.4 hours, is scheduled for completion in two years, with a subsequent planned extension to Skopje and then Athens. China sees the railroad as an eventual "land and maritime express line" between China and Europe (Zeldin, 2015).

Professor Liu Zuokui is among the experts who have analysed the importance of cooperation with CEE countries to China's initiatives. He voiced his support in the early tackling of easy issues, followed by a gradual increase in complexity. In addition, the evasion of economic and political risks is his advice to the Chinese Government; the Chinese Government should, according to his assessment, fully respect the market laws, assign the leading role to the enterprises and let the key projects be the driving force (Zuokui, 2015, p.193). When analysing all effects of all of these summits between China and CEE countries, it can be concluded that the "16+1" platform may serve as a catalyst which would bring some new approaches to development and strategic partnership in various productive spheres. Even more, the cooperation between China and CEE countries is in line with China's objective of being a partner for growth with the EU. In other words, China regards the renewal of its relationship with CEE countries as a growth driver in the framework of China-EU relations, and believes that, by enhancing the overall

level of China's relations with CEE countries, she will be promoting a more stable and healthy China-Europe relationship as well.<sup>9</sup>

## **XINJIANG PROVINCE AND THE RUSSIAN REACTION**

In order to preserve its territorial integrity, the Chinese government has made combating what it calls the 'three evils' - religious extremism, separatism and terrorism. To achieve its aims and reduce local discontent, the Chinese government has replaced its policy of 'stability above all else' - with a strategy of regional economic development. Part of this strategy entails promoting the export of goods produced in Xinjiang to China's Central Asian neighbours - Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, and Uzbekistan. Considering that 78% of the province's exports already go to Central Asian states, the creation of a Silk Road Economic Belt would allow the consolidation of long-term export hubs in Central Asia for Xinjiang's goods, thereby guaranteeing further economic development in the region. In order to improve trade flows between Xinjiang and Central Asian countries, the Chinese government has already invested more than 91 billion US\$ in trade-related infrastructure in the Western province (including in roads, hydropower plants, and primary industry facilities). These investments in the infrastructure of Central Asian states, as well as the development of border cities, are designed to stabilise the wider region both economically and politically (Brugier, 2014). Hence, security and stability in Central Asia is not only a matter of protection of China investments, but also a matter of protection of possible spill over effects that insecurity and instability might have within China's northwestern region of Xinjiang. Furthermore, China has started to become a player, although until now only tentatively, in Central Asia's security landscape.

Australian analyst Colin Mackerras from the Griffith University has shed light on China's stance towards its Xinjiang province in the aftermath of the July 2009 terrorist attacks. He recognised the aim of China's domestic economic policies related to the Xinjiang province as an attempt to improve the economic

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<sup>9</sup> During the fourth meeting between China and the CEE countries, held in November 2015, at Suzhou, China, the participants state their readiness to formulate the Medium-Term Agenda for Cooperation between China and Central and Eastern European Countries which will aim to improve 16+1 cooperation and further unleash its potential by setting out directions and priorities for 16+1 cooperation from 2015 to 2020. The Agenda taking the China-EU 2020 Strategic Agenda for Cooperation as the guideline document for China-EU relations and in accordance with the Press Communiqué of the Meeting between the Prime Ministers of China and Central and Eastern European Countries, China's Twelve Measures for Promoting Friendly Cooperation with Central and Eastern European Countries, the Bucharest Guidelines for Cooperation between China and Central and Eastern European Countries and the Belgrade Guidelines for Cooperation between China and Central and Eastern European Countries.

performance of the province, as well as the living standard of its inhabitants (with the purpose of at least mitigating the ethnical tensions) (Mackerras, 2015). Such policies are matched with initiatives to improve the cross-border economic and cultural exchange with the neighbouring Central Asian countries (which, as such, originated long before the Belt and Road Initiatives were officially proclaimed). Mackerras pointed to the Central Asian countries' stance towards the Xinjiang ethnic tensions and July 2009 terrorist attacks, which caused China's concern; China's attempt to alleviate the economic causes of the tensions led China to forge strong economic ties with Central Asian countries. As a result, China's influence in the region increased substantially, coinciding with the decline of Russia's influence and the expected US withdrawal from Afghanistan (Mackerras, 2015). While Mackerras acknowledged the absence of China's plans for establishing hegemony among these countries, he described China's overwhelming influence in the region as the inadvertent consequence of China's economic policies aimed at Xinjiang and the bordering areas. Finally, Mackerras is among the analyst who noticed the unease on the Russian side regarding China's initiatives as well as the possibility of Sino-Russian competition for the dominant position in the region (which still lingers on despite examples of successful Sino-Russian cooperation).

Sino-Russian relations and Russia's perception of the "Belt and Road" initiatives has been particularly explained by experts such as Yu Bin of Wittenberg University. Yu stressed the coinciding of the Silk Road Economic Belt with Russia's attempts to gather the former Soviet republics under the auspices of the institutions such as the Commonwealth of Independent States (CIS), Collective Security Treaty Organisation (CSTO) and the Eurasian Economic Space, in which Russia will have the most say (Yu, 2014). Yu described Russia's approach towards the region as geopolitics-laden and facing competition from the West (accessing the region with a mixture of economic aid and political conditions to be fulfilled) and China (mostly restraining itself to achieving economic goals). Yu also noted the Russian unease related to the fact that China and Central Asian countries have become economically intertwined over the last 20 years, with an example in trade volume between China and the region (which rose from 460 million US\$ in the early 1990s to the 46 billion US\$ in 2012) as well as billions of US\$ in Chinese investment (Yu, 2014). As in other regions, an important share of Chinese investment is directed at the infrastructure; Yu had highlighted Russia's particular sensitivity to China's attempts at constructing a railway connection between China's Xinjiang province, Kyrgyzstan and Uzbekistan (due to Chinese attempts to replace the existing Russian track gauge of 1,520 mm with Chinese-standard 1,435 mm gauge). Finally, Yu explained the subsequent Kyrgyzstan withdrawal from the project as a consequence of strong Russian lobbying (Yu, 2014). From this analysis, we can make subsequent conclusions. Russia and China obviously have different strategies, different interests, and different priorities in Central Asia that at times appear irreconcilable

with China's emerging role. While cooperation between them in energy, investment, high technology, and military equipment has significantly increased over the past two decades, given Russia's strategic *rapprochement* to Central Asia it is too early to say whether the phenomenon of collaboration or competition between Russia and China will lead to reaching an agreement on jointly controlling the region, or whether the region will serve as a field of confrontation between them (Mariani, 2013). The new Silk Road and the rationale(s) behind it show the extent of the wariness that exists between Russia and China, but it would be wrong to assume that Beijing is pushing the project just to counter-balance or limit Russian influence in Central Asia. It is obvious that the new Silk Road allows China to bypass Russia economically, politically, and geographically. It also has domestic (development in Xinjiang), regional (cross-border trade and infrastructure) and global benefit potentials (creation of supply lines). By creating a faster inland route to the European continent, it puts China in direct contact with countries that have long been in Russia's alleged 'zone of influence'. This includes Europe itself, where China has already become much more active – as shown by the participation of Prime Minister Li Keqiang in the second and third China-CEE leaders' summits in Bucharest 2013 and in Belgrade 2014 under the platform of the 16+1, which has injected new impetus into mutually beneficial cooperation.

Zhang Hongzhou gives another assessment of the potential consequences of New Silk Road initiatives to Central Asian countries. In his opinion, leaders of Central Asian countries formally approve the initiatives while actually being at unease about closer ties with China and the negative consequences they might bring (for example, the decrease in domestic productivity due to inexpensive Chinese imports such as textiles or light industrial products). Further on, the leaders of Central Asian countries are not totally calmed down by Chinese leaders' promised non-interference in internal affairs – an eventual Chinese intervention, with the purpose of protecting the then-substantive Chinese investment, is not excluded in the future. The realization of Silk Road Economic Belt is also made difficult by occasional outbursts of anti-Chinese sentiments, by the perceived low quality of Chinese products, by Chinese businesses' scarce knowledge of local cultural and religious traditions, by the widespread condemning of China's handling of the Xinjiang issue, and by Chinese Government's preferred dealing with ruling political elites (which causes heavy criticism by the opposition in each of these countries). Zhang's advice to Chinese side is to go one step at a time and to seek success in smaller scale projects before switching to larger ones; China should also include into cooperation fields other than energy, fields (such as agriculture or technology) that benefit the broader population of each of these states. Finally, Zhang recommended a greater emphasis on Silk Road Fund than on the Asian Infrastructure Investment Bank – with the participation of European countries, South Korea and Australia, the AIIB loan-issuing criteria might include human

rights, which would lead the current Central Asian administrations away from seeking financial support from this institution ((Hongzhou, 2015, p. 10-15).

## **INDIA'S APPROACH**

India met the New Silk Road with mixed feelings. On the one hand, Indian businesses and military circles have shown support of the initiatives. On the other hand, India has been much more supportive of the Bangladesh-China-India-Myanmar Economic Corridor (due to the importance of a link between Kolkata and southern China). Hence the relationship is more ambivalent, especially because Indian policy-makers prefer projects they have designed and do not show enthusiasm to merely execute pre-formulated projects (Price, 2015).<sup>10</sup>

## **THE ASEAN COUNTRIES – BETWEEN APPROVAL AND WARINESS**

ASEAN countries are the most interested in the success of China's initiatives. On the other hand, China is interested to enhance the idea which has been promoted as the "2+7" cooperation framework (suggestion drawn by Li Keqiang during his presence at the 16th ASEAN + China summit in Brunei). The idea "2+7" means consensus on two issues - strategic trust as part of the good neighbour principle and economic cooperation based on mutual benefits. It also means seven plans: 1) Signing the China–ASEAN good neighbour treaty; 2) More effective use of the China–ASEAN Free Trade Agreements (FTA) and intensive Regional Comprehensive Economic Partnership negotiations (the FTA between ASEAN and China, Japan, South Korea, India, Australia and New Zealand); 3) Acceleration of joint infrastructure projects; 4) Stronger regional financial and risk-prevention cooperation; 5) Closer maritime cooperation; 6) Enhanced cooperation on security; 7) More intensive people-to-people contacts along with increased cultural, scientific and environmental protection cooperation (Parameswaran, 2013, p. 10).

A number of analysts from ASEAN countries expect the sooner establishing of Asia-Pacific economic community and growth of the emerging markets as a consequence of the initiatives. Political analyst Zhao Hong from the Singapore Institute of Southeast Asian Studies described the transportation infrastructure and connectivity in the region as hungry for improvements and large-scale investments. To support this argument, Zhao quoted an estimate by Asian Development Bank,

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<sup>10</sup> The TAPI (Turkmenistan-Afghanistan–Pakistan–India) pipeline is one of the important geostrategic factors of the "New Silk Road" strategy proclaimed by the US Government in 2011. Funded by the Asian Development Bank, the 1078-mile pipeline is expected to transport Caspian gas from Turkmenistan through Afghanistan and Pakistan into India (Fedorenko, 2013, pp. 4, 6).

according to which as much as 730 billion US dollars will need to be invested in infrastructure throughout Asia by 2020, which would, in his opinion, leave sufficient room for all lending institutions interested (Association of International Accountants, 2015). Another analyst in support of China's initiatives is Zheng Yongnian from the Singapore East Asian Institute. He argued that China preferred "win-win" cooperation with countries in Asia, Africa and Latin America to hegemony, adding that the Maritime Silk Road could be used as a vehicle to transfer capital and technology to developing countries, but also as a mean to reduce trade friction between China and the developed countries (through redirecting Chinese investments away from the developed countries and to the developing countries) (Association of International Accountants, 2015). Some experts, however, point out to the ongoing maritime dispute in South China Sea as a possible hindrance to "the Maritime Silk Road" initiative. After noting that the South China Sea is an important corridor for the initiative, Chen Dingding pointed out to the Southeast Asian countries' concerns that in return for economic benefits from the initiative, they will be compelled to give in to China's interpretations and viewpoints of the South China Sea dispute (that is to say, if China remained stiff in its policy towards the dispute, "the Maritime Silk Road" initiative would cause more concessions of these countries to the US with the purpose of protecting them from China) (Chen, 2014). Taking into account the maritime disputes in the South China Sea that have been aggravated since 2011, the China's leaders' skilfully used "New Silk Road" strategy for defusing tensions. Although its elements are not entirely new in China's policy, the fact is that this approach is based on a lucrative economic offer, which includes security guarantees to the ASEAN states. Despite this foreign policy *raison d'être*, this allows the Chinese stronger presence in the region as a response to the U.S. pivot to Asia-Pacific (Szcudlik-Tatar, 2012, p. 6).

### **RELEVANCE TO THE CHINA'S ENERGY SECURITY**

Between 1989 and 2011, China enjoyed an average economic growth rate of 10%, and its energy needs have grown accordingly. The country has gone from self-sufficiency in the 1980s to dependence on external sources for approximately half of its domestic consumption today. Political analyst Camille Brugier's assessment of the two initiatives' energy aspects is constrained to the assessment of Sino-Russian energy relations since the early 2000s (Brugier, 2014). Brugier described the increase of Chinese energy imports from Russia in early 2000s as an attempt to limit China's energy dependency on the Middle East and sub-Saharan Africa (due to the lack of political stability in the two regions and the possibility of terrorist attacks during the sea-based transportation of energy resources to China). Further on, Brugier describes the recent China's stance towards Russia as more cautious, resulting in greater importance given to the Central Asian states (most

notably, Kazakhstan and Turkmenistan). By her words, China has taken the same cautious approach towards Russia that it had earlier towards Middle East and Africa; she expects the New Silk Road to result in greater energy imports to China originating in Central Asian states (Brugier, 2014). Nadège Rolland of the National Bureau of Asian Research also acknowledged China's ambition to redirect transportation corridors for its energy away from the Malacca Strait, attributing it however to China's fear of US naval blockade, which would be likely to happen in case of a conflict between East Asian nations (Rolland, 2015). When we know that almost 85% of imports to China are transported along this route, including 80% of its energy imports, then the Malacca Strait is in fact one of the busiest littoral sea lanes to Malaysia, Indonesia and Singapore. Hence, China not only strives to secure those sea-lanes, but also to boost inland transport or find the means to gain access to the Bengal Bay and Indian Ocean and bypass Malacca. This is the reason for China's great engagement in Myanmar, which is seen as a gate to Bengal Bay and the Indian Ocean. It is also worth mentioning China's relations with Pakistan. Close cooperation with Islamabad on such infrastructure projects such as roads, railways and pipelines, and the recent decision by Pakistan to give operational control and management of the Gwadar port on the Arabian Sea to a Chinese company, offer China access to the Persian Gulf and the whole Middle East. The additional attention to an inland transport network is meant to shorten transport times and make trade less dependent on those unstable littoral sea lanes. Through enhancing relations mainly with Central Asia, China not only tries to circumvent Malacca and decrease dependence on sea transport, but also to establish an inland transport network (construction of roads, railways, pipelines) to ensure a stable supply of energy and raw materials from Central Asia and the Middle East. The additional attention to an inland transport network is meant to shorten transport times and make trade less dependent on those unstable littoral sea lanes. Through enhancing relations mainly with Central Asia, China not only tries to circumvent Malacca and decrease dependence on sea transport, but also to establish an inland transport network (construction of roads, railways, pipelines) to ensure a stable supply of energy and raw materials from Central Asia and the Middle East.

## SUMMARY

After entering into the new century, with the rise of the comprehensive national strength, China has become more widely and deeply involved in the international affairs. While sticking firmly to its position as a developing country, China gradually began to accept the tasks ahead of a great power and to act as a major responsible country, especially since President Xi Jinping's promotion of the concept of "major-country diplomacy with Chinese characteristics". China's diplomacy in the new era is taking a more global perspective with a more enterprising and innovative spirit.



This strategy contains many new concepts and new thoughts, including the concept of “a new model of major-country relationship”, which refers to China-Russia relationship and China-US relationship, the principles of “amity, sincerity, mutual benefit and inclusiveness” regarding China’s periphery policy, and also the new concept of “morality and interest” when China promotes the relations with other developing countries. The proclaimed economic, political and social goals of the New Silk Road Strategy and its “Belt and Road” initiatives are very ambitious, with the potential of being among the most important phenomena of the 21<sup>st</sup> century. If conducted properly, the initiatives would amount to a good choice (in a political, economic, cultural and any other sense) to all participant countries. Although the initiatives are open to all the countries along the old Silk Road trade route and have the potential of reaching out to all the countries in the world, they have also stirred some concern among the developed countries, especially when it comes to China’s real motives. The achieved success of the “Belt and Road” initiatives” (measured through an improvement of infrastructure and living standard, greater cross-border exchange and greater observing of the environmental protection standards) will make it easier for the Chinese Government to convince the countries concerned into their non-aggressive nature. These conclusions are particularly important for cooperation between China and the countries of Central and Eastern Europe (CEE) in the framework of political platform “16+1”. This platform has injected new impetus into bilateral ties and cooperation that benefits all sides. Through this mechanism, the comprehensive strategic partnership China and CEEC will be achieved and consolidated.

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### **RAZVOJNA STRATEGIJA KINESKOG NOVOG PUTA SVILE**

*Apstrakt:* Izuzetan ekonomski napredak, učinio je Kinu privlačnim ekonomskim partnerom u prvoj i drugoj deceniji 21. veka. Tokom ovog perioda, drevni trgovački Put svile postao je ponovo atraktivan i danas predstavlja simbol trgovine i investicija koji pored Kine, obuhvata još i Centralnu Aziju, Evropu, Bliski Istok i Afriku. Kineska razvojna strategija Novog puta svile, sačinjena je od dve geopolitičke inicijative - jedna je, Ekonomski pojas puta svile povezana čvršćim vezama u centralnoj Aziji (a s posebnim fokusom na trgovinu i transport), i druga je, Pomorski put svile za 21. vek, osmišljena da poboljša trgovinske odnose južne i jugoistočne Azije. Studija pokazuje da pomenute inicijative povlače i određene političke i ekonomske posledice. Inicijative mogu da dovedu do boljeg razumevanja političke situacije i veće ekonomske koristi za sve učesnike. Međutim, obe inicijative mogu imati i određene posledice s obzirom na američku dominaciju u međunarodnim odnosima. Stoga, i pored kritika koje su upućene na njihov račun, neki delovi EU (posebno zemlje centralne i istočne Evrope), ali i članice ASEAN-a, imaju velika očekivanja povodom iznetih inicijativa. Uspeh inicijativa u narednoj deceniji treba da ublaži zabrinutost njihovih oponenta. Koristeći omiljenu spoljnopolitičku frazu o pobedi (*win-win situation*), Kina putem njih želi da ostvari bolju sliku o sebi, a time i da poveća svoj regionalni uticaj.

*Gljučne reči:* novi Put svile, pomorski Put svile, ekonomski Put svile, Kina, EU, ASEAN.

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## **CENTRAL-EASTERN EUROPEAN COUNTRIES' (CEEC) AND SERBIA'S PERSPECTIVE AND POSITION TOWARDS CHINESE "ONE BELT, ONE ROAD" INITIATIVE—A GEO-POLITICAL OVERVIEW<sup>1</sup>**

Marko NIKOLIĆ<sup>2</sup>

*Abstract:* The paper presents an attempt related to Chinese “One Belt, One Road” initiative (2013) assessment from a geo-political perspective, focusing on the position and role of Serbia. In the context of deep World economic crisis and, at least, skeptical (if not opposite) influence and interests of Trans-Atlantic partners (USA and EU), China has constructively been aspiring to establish and maintain three continents’ network of intensive economic cooperation, trying to contribute to its own and mutual peaceful development. China-Central and Eastern European Countries (CEEC) cooperation is “regional” and linking aspect of emerging Strategic China-EU cooperation. In that geo-political context, starting from its Identity and Foreign policy priorities, Serbia has been showing the will and readiness to become an active Chinese partner and South-East European leader in “One Road, One Belt” initiative’s implementation.

*Key words:* Silk Road, China-EU relations, China-CEEC Cooperation, “One Belt, One Road” initiative, Serbia’s Will and “Regionally-Integrative” role.

### **INTRODUCTION**

The economic progress of China made its strategic approach and foreign policy changed, especially at the beginning of the 21<sup>st</sup> Century. Its priorities became mainly directed to preserve and create a peaceful external environment for strengthening internal development. Perceiving itself a “Third world” country, China’s logical partners have been developing countries with similar economic, energy, political and

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security interests. The “Silk Road” was synonym for various Eurasian trade and cultural communication routes that had been existing for more than 2.000 years, possessing strategic and even universal significance (Lewis 2009, pp. 15-23).<sup>3</sup> Routes’ geo-strategic, geo-political and geo-economic potentials were “frozen” during the Cold War’s “Balance of Fear”, helped by several decades of technological progress that had caused “overcoming” of geo-political way of thinking. The international Silk Road’s focus was revived by several Governments’ initiatives and smaller projects at the end of the 20<sup>th</sup> Century, and majority of them remained partly implemented until now. China also launched its Silk Road initiative in 2013. It was generally considered “China’s threat” (“Sleeping Asian Tiger”) in the West (USA, EU and Japan) starting from several indicators and facts: China is first economic and second world trade power, its reserves exchange with USA represents the largest and most important universal link, and China’s military budget is annually increasing from 10-15 percent during the past several years. On the other hand, Chinese leadership has been pointing out that Chinese Silk Road approach was primarily economic aiming to achieve benefits for all participating countries. In the light of these obviously opposite positions, it is of crucial importance to emphasize well-known Chinese civilization starting point related to non-violence, being based on philosophical and religious values and principles of Taoism, Confucianism and Zen-Buddhism. That is why its strategic approach and foreign policy proclaimed and achieved to “incorporate” five key principles into the International Security System in 1970 (Jurišić, K., No. 3/1999, p. 37-39).<sup>4</sup> Thanks to that fact, today’s World Order has been maintained and still was based on decisions of International institutions and organizations. On the other hand, in an economic sense, Chinese “strategic weapon” in present International Affairs has no doubt been the competitiveness. Finally, if “Chinese threat” really exists in practice today, it is a question towards whom or to what it has been directed? Logically, towards the ones who have been expressing some violent and military expansion tendencies... It is not questionable that China, as at least “regional power” with “universal prerogatives”, has been pretending to be and stay present and active in whole Euro-Asian area, trying to achieve economic, geo-political and “preventive-security” (defensive) interests, through its “win-win” Foreign Policy based on Peace as a goal and Development precondition. That approach within this stage of the International Community’s existence (Deep Identity and Economic Crisis) is no doubt beneficial not only for China and its partners but also for whole International Community. The essence of newest Chinese Silk Road Strategy has generally been related to the demands and

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<sup>3</sup> Author pointed out that widespread network of silk roads, both on land and sea, had been existed for many centuries, linking Europe and Asia, China, Byzantium and Rome.

<sup>4</sup> That time UN General Assembly Declaration has been mentioning peaceful coexistence, respect for sovereignty and territorial integrity, non-aggression, non-interference in internal affairs and equality and mutual benefits.

needs of its own and the International Community development, through positioning this Country, “from shadow”, to the one of the most influential particularly in Euro-Asian “heartland”, but also in the Middle East and Africa.

## **CONTEMPORARY SILK ROAD'S UNIVERSALISM AND INITIATIVES' NETWORK**

The Silk Road had primarily been geo-economical route that linked different civilizations, continents, empires and countries. Therefore, its potentials were always closely linked with world power's interests. Contemporary Silk Road's “universalism” re-gained importance after the end of the Cold War and multi-polarism revival in International relations at the beginning of the 21<sup>st</sup> Century (increased progress of China, Russia, BRICS Countries, Turkey, etc.). Silk Road initiatives were launched by the United Nations (UN), European Union (EU), Turkey, United States (US) with India's “back-up”, Russia, and at last by China. Starting from its strategic policy principles (“patience”), China obviously wanted to see what other partners could “offer”, later on making the “synthesis” formed by own objectives and goals.

The European Union (EU) launched “first newest” Silk Road initiative (TRACECA) in Brussels in 1993 including participation of the EU and 14 Member States of Eastern Europe, Caucasus and Central Asia. The major objective was related to forming International Transport Corridor from Europe, crossing the Black Sea, the Caucasus, the Caspian Sea and reaching the Central Asian countries.<sup>5</sup> Within TRACECA International Conference, the “TRACECA—Restoration of the Historic Silk Route” was held in Baku (Azerbaijan) on 8 September 1998, resulting with signed “Basic Multilateral Agreement on International Transport for Development of the Transport Corridor Europe-Caucasus-Asia” (MLA) and Technical Annexes on international railway transport, commercial maritime navigation, road transport, customs and documentation procedures. Despite financial support for initiative's implementation was maintained by the European Bank for Reconstruction and Development, the World Bank, Asian Development Bank and Islamic Development Bank, the opposition of the USA and Russia (with Iran) led to its “freezing”. Only railway China-Kyrgyzstan was constructed in 1999 (Zhiping, 2014). Later on, both Americans (during the Second India-US Strategic Dialogue in 2011) and Russians (starting from a context of Agreement between Russia, Belarus and Kazakhstan that led to creation of Eurasian Economic Union in 2015) introduced their “New Silk Road” initiatives. After withdrawal of the US

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<sup>5</sup> TRACECA members are Armenia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Turkmenistan, Uzbekistan, Ukraine, Mongolia, Moldova, Bulgaria, Romania, Turkey, Iran, and Observer Lithuania. More details can be found on <http://www.traceca-org.org/en/traceca/history-of-traceca/>. Accessed June 20, 2015.



Army from Afghanistan in 2014, the USA intended to link South, Central and Western Asia with Europe through strategic trade and energy corridor, bypassing Iran. For that purpose, the US Government initiated about 40 infrastructural projects (Shaofeng, 2010, p. 7). Objective of US “Silk Road vision” obviously considered “containment” and reducing Russian and Chinese influence in Euro-Asian sphere, isolating also both countries’ important partner in Oil trade—Iran. That strategic deficit made “brighter” implementation perspective for “Silk Wind” project initiated within the framework of TRACECA in Izmir (Turkey) in 2012. In that context, Americans supported construction of Baku-Tbilisi-Kars railway until the end of 2015 (Fedorenko, V. 2013, pp. 17–19.). Mentioned facts lead to conclusion that US-Russian “Leadership in Partnership” has been considering both existence of common and opposed strategic interests, kind of “US influence Primacy”, and respecting some Russian “passive” and “regional” economic and security priorities. The United Nations Educational, Scientific and Cultural Organization (UNESCO), United Nation Economic and Social Commission for Asia and the Pacific (UNESCAP) and International Road Transport Union also offered their Silk Road “plans” in 2000, 2005 and 1998 (Zuokui, 2014).

Turkey also initiated its “own” ambitious Silk Road plan that pretended to link ancient large “Euro-Asian” market through new transport simplification measures, customs facilities and later enhanced security cooperation. Its initiative was launched at the International Forum on the Role of Customs Administrations on facilitating and Promoting Trade among the Silk Road Countries in Antalya (Turkey) in 2008. The proposal included participation of Russia, Azerbaijan, Georgia, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Syria, Iraq, Iran, Mongolia, Afghanistan, South Korea, India, Pakistan and China. It is noticeable that almost all countries, even “rivalry” ones with the US “exception”, were gathered around this strategic and comprehensive initiative. One should conclude that it was not supported by the USA, or the USA supported it “through” Turkey. A second hypothesis seems logical since “strategic” co-operation of Turkish and TRACECA project (EU and US dominated) was agreed and realized at the Forum in Batumi (Georgia) by signing the Memorandum of Understanding (Bozkurt, 2015). Turkish initiative obviously represented a “sum” of Silk Road network initiatives, supposed to be supported (and controlled) by the US and the EU. In that context, Turkish interests probably have considered its new proclaimed “Rising Regional Power” role, with “given” increased influence (economic and security) in Euro-Asian sphere, as compensation for EU non-entering during several decades.

### **CHINESE “ONE BELT, ONE ROAD” INITIATIVE**

Internal market reform and liberalization in China during 1970’s had enabled inflow of foreign capital and development of its industry and production.

Predominantly export-oriented “new” economy was moved in “coastal economic free zone” cities in the eastern part of China. Due to growing production country became an oil importer in 1993 and the world’s largest one in September 2013. Since oil supplying from Russia, Iran, Saudi Arabia and Angola has scrolled off through route “Malacca Strait” (dominated by the USA), China faced the need for alternative routes. Skovorodino–Daqing, Pakistan–China, Kazakhstan–China oil pipelines, and Central Asia–China, Myanmar–China, Altai and Power of Siberia gas pipelines were then promoted (Storey, I. 2015).<sup>6</sup> Strategic and sustainable energy supplying in the 21<sup>st</sup> Century’s complex geo-political context has been a crucial precondition for further Chinese development.

The “One Belt, One Road” (2013) initiative has obviously been important aspect and part of “Chinese Dream” Vision.<sup>7</sup> It was predicted to consist of parallel “Silk Road Economic Belt” and “One way to the 21<sup>st</sup> century Maritime Silk Road”, linking Eastern and Central China, Middle Asia, Africa and Europe, through land and sea routes.<sup>8</sup> New founded Asian Infrastructure Investment Bank (50 billion dollars), Silk Road Fund (40 billion dollars, Chinese State’s Council 65% and National Development Fund’s 15% contribution through Exim and China Development bank) and private lenders (50 billion dollars) have been supposed to finance whole project, under supervision of the Shanghai Cooperation Organization (China File 2014). From geo-strategic point of view, the initiative is much more land oriented trying to reduce dependence on maritime routes, avoid “devastating restrictions” for development and support “enhanced cooperation” of all participating countries (Shi Ze 2014). From the internal one it “will compel China to introduce structural reforms in order to adapt the system to the needs of development”, through “new system and model of innovation”. Theoretically and methodologically, pillars of the Strategy have been “market potential and geographic advantages”, increased “bilateral cooperation” through “corridor construction”, “diversified cooperative mechanisms” and models of “Equal Development of East

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<sup>6</sup> Author stated out that “whoever controls the Strait of Malacca, effectively grips China’s strategic energy passage, and can threaten China’s energy security at any time”.

<sup>7</sup> Chinese President Mr. Xi Jinping launched it at the Third plenary session of the 18th Chinese Communist Party (CPC) Congress in November 2012, based on four key pillars: *cooperation, development, peace* and “*win-win*” results.

<sup>8</sup> “Silk Road Economic Belt” should be passing through Xi’an (Central China), Lanzhou (Gansu province), Urumqi (Xinjiang), Khorgas (Xinjiang), northern Iran, Iraq, Syria and Turkey (Bosporus Strait), through Europe in Bulgaria, Romania, Czech Republic, Germany, Netherlands (Rotterdam) and ending in Italy (Venice). “21<sup>st</sup> century Maritime Silk Road” has been supposed to start in Quanzhou (Fujian province), passing through Guangzhou (Guangdong province), Beihai (Guangxi) and Haikou (Hainan), joining Malacca Strait—Kuala Lumpur, India (Kolkata and Indian Ocean), Africa (Kenya, Nairobi), turning to Red Sea, entering the Mediterranean and Greece (Athens), and finally joining “Silk Road” in Italy (Venice).

and West, in stages” (Zuokui, 2014). Construction of planned railway should enable faster and cheaper transportation of goods and products than ones by sea and air. The initiative represents comprehensive “Chinese preventive response” on the USA strategic efforts to “contain”, control and “isolate” this country’s “independence”, primarily in the energy sphere.

The implementation of such complex strategy will no doubt be “universal”, geo-political and geo-economic challenge for China and all involving countries, being depended of their national interests, will, capacities, consistence and mutual cooperation. This country insists that every single and/or common activity should be based on no interference in internal affairs, no creation of spheres of influence and no striving for hegemony principles (Shi Ze, 2014). Mentioned intentions have to be marked as an important contribution to international peace and development, established on economic cooperation of sovereign countries with particular identities, dignities and interests. Five crucial preconditions are necessary to be accomplished for the Strategy implementation — improved political cooperation and transport infrastructure, the existence of free trade and convertible local currencies, and increased cultural integration (H.E. Mr. Li Keqiang, 2014). This comprehensive, constructive and integrative approach has been offering serious potentials for project’s realization. It is supposed to be implemented and finalized in the next 10 to 15 years (Zhiping, 2014). Important support China got from Russia in the framework of two countries’ strategic cooperation that enabled China privileged access to Russia’s natural resources. Two Presidents, Mr. Vladimir Putin and Mr. Xi Jinping, agreed cooperation aiming to connect transport infrastructure with Russia-Eurasian Railway.<sup>9</sup> It also considered Russia’s support for China’s economic investments in Former Soviet Republics in Central Asia (Xinhuanet, 2015). Russian-Chinese strategic cooperation, from geo-political point of view defensive one, is a logical consequence of Trans-Atlantic “offensive activities” on all “Heartland” (Euro-Asian) borders, as well as many common neighboring economic, political and security interests.

General “security threat” for “One Belt, One Road” initiative should no doubt be in many terms the USA’s opposite geo-strategic and geo-political interests (as well as EU ones), otherwise this country is a first trade partner of China.<sup>10</sup> In that context worldwide and “regional” terrorist “capacities and potentials” of the Islamic State of Iraq and Levant’s (ISIL) should also be seriously prevented, particularly bearing in mind its obvious link with Uyghur’s extremists from China. These facts somehow lead to the hypothesis that possible terrorist attacks in any Silk Road

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<sup>9</sup> Xinhuanet, “Chronology of China’s ‘Belt and Road’ initiatives”, 2015, Internet: [http://news.xinhuanet.com/english/china/2015-02/05/c\\_133972101.htm](http://news.xinhuanet.com/english/china/2015-02/05/c_133972101.htm), Accessed 03 June 2015.

<sup>10</sup> Majority of economic analysis showed that for many years USA were the largest importer of Chinese products in the world, and the largest goods export from China was going to the USA.

country should be “useful” for the USA’s geo-political interests in the sense of “slowing down” implementation of Chinese Strategy.<sup>11</sup> The example of “Silk Road” initiatives showed that very high level of economic interdependence and cooperation in contemporary American-Chinese relations, in one moment and phase, could be threatened by different geo-political interests. In that context important “regional pillar” for Chinese strategy implementation is supposed to be India, strategic USA’s partner, in many terms skeptical position (like, for example, the EU one). Finally, the concrete economic challenge for Chinese Silk Road initiative implementation will be different level of participating countries’ economic and infrastructure development. In long-term perspective, in “rivalry game” for universal “Silk Road Crown”, Chinese “economic constructivism” has obvious “strategic advantage” in comparison with USA’s “revisionism”.

From Chinese perspective main “One Belt, One Road” initiative’s objectives have obviously been to secure China’s alternative options for safe energy supplying, its production export and agricultural import (food for 1,3 billion people population) as preconditions for further economic development. That is why Chinese interests consider the existence of “safe surroundings” for numerous Silk Road routes passing through three Continents and many countries. All that countries are logically supposed to be stable, offer concrete “regional” and “local” contribution, and later on enjoy many benefits. Chinese economic and infrastructure investments in them are obvious contribution to their stability, development and security, particularly ones in Central Asia and Europe that still have not become members of North Atlantic Treaty Organization (NATO) and/or European Union (EU)—Former Soviet Union Republics and Southeastern European Countries. All of them have economic and geo-strategic perspective and interest to become active “One Belt, One Road” initiative contributors, but their actions will remain limited in by American influence in Central Asia, Middle East and Western Europe. Since the EU membership accession process for every country considers approximately a decade, main Chinese “Silk Road partners” in Southeastern Europe mostly remain Serbia and Macedonia despite security challenges related to the Status of Serbian Kosovo and Metohija (KiM) Province and internal (also external) Macedonian divisions.

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<sup>11</sup> During the Round Table entitled “USA Foreign Policy Priorities”, held in IIPE on 15 May 2015, Introduction speech was given by Mr. Branislav Anocić, Former Director of Serbian Military-Intelligence Agency (VOA) and Military Attaché in Washington. One of his considerations and hypothesis was that in General USA’s interest, both on universal, regional and local level, was to *maintain status quo*, “leaving things to happen but allowing nothing to achieve”. The author of this article is free to conclude that USA should generally like to preserve its “World Primacy” by “containing” not only Russia but also China by implementing “negative-balancing approach” (kind of *universal obstruction*). This concretely implies that USA’s interest regarding “One Belt, One Road” Strategy considers its “control” for promoting and further developing of American Silk Road initiative.

## **EUROPEAN UNION (EU) AND CENTRAL-EASTERN EUROPEAN (CEEC) COUNTRIES' POSITION AND ROLE**

Trans-Atlantic USA-NATO-EU geo-strategic, military and economic link has probably been representing a key universal player in International Affairs at least in the second part of the 20<sup>th</sup> Century. At the beginning of the 21<sup>st</sup> Century, in the context of China's and Russia's "rising", Trans-Atlantic geo-political interest regarding logically and generally considered the need for prevention and reducing their higher influence in Europe (especially EU). That is the main reason why both the USA and EU generally assess "One Road, One Belt" Initiative with skepticism. On "subsidiary" level, USA Foreign Policy has been far-seeing planned, "universally" oriented and consistent. On the other partner's side, otherwise the EU has officially been expressing tendency to act as "independent political player" in International relations, its Common Foreign and Security Policy (CFSP) was still not coherent and united, expressing often unclear and double barreled position towards many international issues. "Undefined space" and NATO "umbrella" has been proving USA's key influence in European foreign affairs in the second part of the 20<sup>th</sup> Century. However, mentioned "undefined space" also became strategic "potential" and chance for Russian and Chinese influence in Europe in the 21<sup>st</sup> Century.

"Old" EU members (who founded the European Economic Community (EEC) at the end of 1950's) have already established political and economic cooperation with China for several decades, "setting aside" China—Central and Eastern Countries cooperation (CEEC). One could imagine that from European perspective, cooperation with "Asian Tiger" is somewhat most influential EU countries' (Germany, France, Netherlands, Britain, etc.) "privilege", supposed to direct and control it. It is even logical since the contemporary EU has been facing serious internal and border challenges (Britain's EU position, deep economic crisis in Greece, Croatia and Portugal; civil war in Ukraine; illegal migration flows; uncertain political and security situation in Macedonia, Serbia (Kosovo and Metohija) and Bosnia and Herzegovina). Otherwise, many of mentioned countries out of the EU showed a clear tendency to become EU members, their perspectives for sure were uncertain for described reasons. New geo-political pre-composition and picture which are in creating at the European continent has obviously been considering formation of "multi-dimensional concentric circle" zones, existence of separated spheres of big countries' influence and many "buffer-link" countries possessing "mixed DNA presence". Comprehensive Chinese understanding of responsibility and cooperation does not have "elitist political character" but primary mutual economic benefit.

Most indicative and important example of current EU's position (through member Greece) towards "One Belt, One Road" initiative has been related to the

privatization of Greek Piraeus port.<sup>12</sup> It started with support of Former Greek Prime Minister Antonis Samaras, Syriza and new Prime Minister Alexis Tsipras prevented further privatization with European Central Bank (ECB) and International Monetary Fund (IMF) support, while Deputy Prime Minister Yannis Dragasakis recently announced that the privatization would continue after a short delay in the context of New Government's full support to "One Belt, One Road" initiative (China Daily, 2015). At this moment, Chinese company owns 33% of the Port, while 67% are supposed to be sold (Zuokui, 2014). Mentioned position is primary to be understood as Greek (rather than EU) one within its efforts to "balance" pressures ("blackmails") from EU (particularly Germany) and the IMF. Greece obviously tried to gain more comfortable "short-term" perspective and position. Since its Government recently accomplished to agree with the IMF and EU new credit conditions, Greek further actions towards "One Belt, One Road" initiative (and port privatization) would obviously stay mostly influenced by mentioned supra-national institutions, rather than national interests. That fact would additionally "limit" Chinese economic dynamism in Europe and Greece. Despite that, China has been considering the EU the "major role player" in global political and economic architecture, its crucial partner to build World based on "civilization, peace, reform and growth", with "no conflict of fundamental interests" (H.E. Li Keqiang, 2014). China has generally supported "multi-polar world moving toward globalization", as well as "European integration process, stable Europe and strong euro". Also, in this case the essential difference between the EU's and Chinese strategic approach could be described by the lack and the existence of Constructivism. China obviously remains widely open for comprehensive and sophisticated cooperation and trade, while the EU "crucifies" and agonizes itself with unclear position and goals, influenced by the USA.

Central and Eastern European countries' (CEEC) geographic position and market capacities represented important "regional potential" for "One Belt, One Road" initiative's implementation. These countries already enjoy good political relations with China, accompanied by mutual trust and deepened practical cooperation. Mechanism for China—CEEC cooperation (China+16) was established in Warsaw (Poland) in 2012 as a framework supposed to facilitate growing cooperation in the areas of energy infrastructure, agriculture, science,

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<sup>12</sup> Analyzing current crisis in Greece several researchers from German Schiller Institute are even of opinion that this is another country (beside Ukraine, Middle East and Central Asia ones) where USA's, Russia's and Chinese interests met in conflict. As its worst outcome they even predict Greek withdrawal from the EU (as consequence of EU "blackmail") and Russia's increased involvement in Greece "backed-up" by Chinese "sensitive" contribution. Starting from its geo-political priorities USA (with Britain's support) would then be "forced" even to start the war in this area. Of course position like this, at least in case of China, do not bear in mind proclaimed and mentioned Chinese principle of *non creation of spheres of influence...*

education, culture and tourism, as well as faster construction of “Silk Road Economic Belt”. For mentioned purposes, that time Chinese Prime Minister, Mr. Wen Jiabao, approved 10 billion dollars for whole Region’s development. Trying to establish more coherent and intensive cooperation, he proposed institutional and annual meetings of Prime Ministers. During the Second one in Bucharest (Romania) in November 2013 new Chinese Prime Minister, Mr. Li Keqiang, approved the proposal and established Development Fund in which every country would individually participate. Since CEEC have been passing through economic transition during deep international and European crisis, for all of them investments from China were mostly welcomed. On the other side CEEC were supposed to “help” China to access EU market more easily and get modern technologies (Zuokui, 2014). Poland and Hungary showed special will and interest for cooperation with China. Even Czech Republic overcomes some historical disputes. High-ranking exchanges followed. Polish Government launched the two-way project “Go China” and “Go Poland” in 2012, aspiring to create free action space for Polish enterprises in China and Chinese ones in Poland. It was focusing on trade, reciprocal investments and railways’ construction (“Chongqing-Xinjiang-Europe” and “Chengdu-Lodz”). Hungarian officials also expressed high-level interest for joining “Silk Road Economic Belt” initiative. Many CEEC, especially Hungary, obviously recognized concrete bilateral economic and national interest for cooperation with China. In that context the EU’s “One Belt, One Road consideration” was related to “mediation” through Asia-Europe Meeting (ASEM) and new launched initiative for Bilateral investment treaty (BIT) during 2014. Its approach continued to be undefined and “parallel” (supra-national and bilateral), seeking implementation through Mechanisms of EU-China and China-EU members’ bilateral cooperation (European Commission 2014). EU strategic approach towards Chinese initiative obviously added up to some of its border countries’ bilateral relations, to be controlled and directed from “supra-national” Brussels. It allows the EU to have “more flexible” position in sense of undertaking responsibility for results of strategic cooperation.

Central-Eastern European countries (CEEC) are key players and partners in the implementation process of Chinese land Silk Road Strategy. The majority of them have concrete *economic interest* to improve cooperation with China. Bearing in mind previously described EU skepticism towards “One Belt, One Road” initiative (“slow down” and control intention) and the fact that mostly CEEC are EU members, it is logical to conclude that their bilateral cooperation with China do not have high-level and international perspective. It will remain “subsidiary intensive” because exactly that is both in short and middle term interest of China, and acceptable to the EU. Whatever happens in further strategic USA-EU-Russia-China relations, CEEC (especially Poland being positioned between EU and Russia) will remain “Eurasian Continental Bridge” interested constantly to improve bilateral

(mostly economic, infrastructure and transportation) relations with China. Intensity and level of China-CEEC cooperation in many terms will be conditioned by the achieved level of “strategic” China-EU cooperation, as well as Chinese “local” dynamism and intensity of activities in CEEC.

## SERBIA’S “REGIONALLY INTEGRATIVE” PERSPECTIVE AND POSITION

Identity of the modern Serbian state had been founded on universal *Orthodox principles* incorporated in term of *Svetosavlje*.<sup>13</sup> Svetosavlje, finally formed by Saint Nikolaj (Velimirović) as a *living philosophy* of Serbian people in the first half of the 20<sup>th</sup> Century, had been consisting of spiritual values necessarily linked and implemented in social and political life. The very essence of this philosophy is related to the Source of God’s Love given to people for *universal, collective and individual benefit*, and *Final Salvation* (Popović, 2012, pp. 240-241). “Horizontal aspect” and social implementation of Svetosavlje, like *Taoism* and *Confucianism*, is crucially *non-violent* and *widespread responsible* (care for “everyone’s benefit and interest” in context of *Symphony* and *Salvation*). In geo-political sense, according to Saint Sava, “Serbs had been determined by destiny to be the East on the West and the West on the East, recognizing on Earth no one but Heavenly Jerusalem!” (Serbian Academy of Sciences and Arts, 1979, p. 138). Mentioned principle is often causing large scale of misunderstandings and misinterpretations like those accusing it for “unclearness” and “non-pragmatism”. In fact it is closely linked with freedom and dignity values, meaning in practice that every cooperation and collaboration, with everyone, are mostly welcomed and supported only if are in common (collective) benefit of participators, despite their particular interests. In that context, the essential criteria to evaluate each position and activity, collective and/or individual, have been the action’s results despite any declarative intentions (Pavle, Patriarch, 1991, pp. 1-2). Saint Sava had been a real peacemaker who achieved to create well-being relations between all people in that time Southeastern Europe, taking also particular care to preserve and protect political independence of Serbian State, positioned on the “cross-roads of civilizations”. It is clear and obvious that contemporary Serbia has been trying to achieve the same in completely new international circumstances linked with high level of universal interdependence.

Bearing in mind mentioned value and identity pre-conditions and heritage, Serbia’s Foreign Policy has been based on (conditioned on) four (4) pillars — the

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<sup>13</sup> The “Spirit of Ecumenical Christianity”, promoted through “national experience and expression of Orthodoxy”, had been introduced to Serbian People by *Saint Sava (Nemanjić)* in the 12<sup>th</sup> Century. This man was founder both of Serbian Church and State, positioning these two “existential entities” into relation of *Symphony*.



European Union (EU) whose member would like to become; Russia as a rising power, important energy subject and traditional historical friend; the USA as the dominant power in International relations; and, China as a rising world economic power (Petrović & Đukanović, 2012, p. 9). Otherwise, Serbia is a small Southeastern European country in sense of territory and limited economic capacities, its identity, culture and historical heritage influenced and made her international approach “universal”, “strategic” and responsible in the 21<sup>st</sup> Century. Despite the lack of economic potentials in predominantly economic era and bearing in mind current geo-political situation, Serbia’s and China’s peaceful openness, some identity “commonalities”, excellent historical relations and both sides’ clear political will made Serbia to be probably most reliable partner of China in this part of the World.<sup>14</sup> That is why Strategic Chinese-Serbian Cooperation (Agreement) was officially established in 2009, consisting of economic, political and security cooperation.<sup>15</sup> It brought two countries’ relations to high level and opened up new horizons and perspectives. Especially important for Serbia was economic cooperation, bearing in mind wider crisis context, universal, European and internal. Mentioned strategic cooperation framework already enabled Serbia to deliver 56 projects to the Secretariat of CEEC Mechanism.

Most important impetus for two countries’ cooperation was given during The Third Meeting of Heads of Government of China and CEEC, held in Belgrade (Serbia) in December 2014. Implementation progress of 2013 Bucharest Guidelines opened “new driving force” for multilateral and bilateral cooperation within the EU-China 2020 Strategic Agenda for Cooperation. Prime Ministers (PM) wanted to give further contribution to “peace, growth and reform” through “civilization based principles of equality, respect and trust” (The Belgrade Guidelines for Cooperation between China and Central and Eastern European Countries 2014). Basic instruments for accomplishing these objectives and goals have been “win-win cooperation” based on respect of participating countries’ legislation and regulations. A formulation of the Medium-term agenda for China-CEEC cooperation was agreed for the next PM meeting in China in 2015, while Serbia was individually encouraged to lead the

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<sup>14</sup> Namely, Serbia has been pretending to become EU member for economic reasons and further development, is officially *neutral* country (despite some very extensive foreign and internal political elites want to make it NATO member) that has still been facing open threats and pressures related to territorial integrity (Kosovo and Metohija Province) by major Transatlantic partners. On the other side China has also been crucially interested to improve strategic cooperation with EU for economic reasons and peaceful strategic development, stayed *military neutral* and *defensive oriented*, and faced some threats related to “surroundings” strategic stability supposed to enable country’s development.

<sup>15</sup> During several receptions Former Chinese Ambassador in Serbia, Mr. *Zhang Wanxue*, explained the author that similar historical experiences, geographic position of Serbia, common views on many international issues, non-interference principle in relation with other countries and economic and trade cooperation potentials brought China to establish Strategic Partnership with Serbia.

establishment of China-CEEC Association on transport and infrastructure cooperation.<sup>16</sup> Also, enhanced economic cooperation, trade and investments were promoted in Belgrade (The Belgrade Guidelines for Cooperation between China and Central and Eastern European Countries, 2014, pp. 1-3).<sup>17</sup> Regarding financial cooperation, Prime Ministers invited all their financial institutions to improve financing conditions for business (10 billion dollar credit was offered for these purposes), expand business in participating countries and support Central Banks to sign currency swap agreements (The Belgrade Guidelines for Cooperation between China and Central and Eastern European Countries, 2014, pp. 4-5). Finally, they stimulated cooperation in science, technology, innovation, environmental protection and energy,<sup>18</sup> as well as people-to-people and cultural exchanges at sub-national level.<sup>19</sup> China-CEEC Cooperation Framework contours' were obviously strengthened, "strategically" positioned and "centralized" at Belgrade Meeting, but *as regional aspect* of wider Strategic China-EU Cooperation. A mix of Chinese constructivism, EU's skepticism and CEEC's individual optimism could somehow "strategically isolate" the EU in the future, or come it to "Old and Core Europe". For sure, that kind of scenario would primarily be a logical consequence of EU's internal tightness that knocks off the general law of market—competitiveness. Of course, "Trans-Atlantic protectionism" is supposed to "fulfill" that kind of "emptiness". For Serbia at this moment remain crucial to maintain economic instruments and political support for further reforms, stability and development, and exactly that this country "subsidiary" gets from China due to its interests in this part of the World. On the other side current "calm but intensive" NATO's influence and tendencies within some parts of the Serbian political elite, related to possible Serbia's membership, doubtless "slow down" development of Serbian-Chinese Strategic Cooperation.

During Belgrade Meeting, Premier of the State Council of the People's Republic of China, Mr. Li Keqiang, starting from "win-win strategy of opening-up",

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<sup>16</sup> Within enhanced transportation infrastructure were mentioned building of China-Europe International and Belgrade-Budapest railways; roads, ports and airports infrastructure development; customs clearance facilitation, etc.

<sup>17</sup> Financial cooperation considered fight against protectionism, forming China-CEEC Business Council in Warsaw and New Secretariat of Investment Promotion Agencies, Bulgaria's leadership in Association for agricultural trade, Ministerial Meetings every two years and cooperation of Small and Medium Enterprises.

<sup>18</sup> Communication technologies and research projects, protecting wildlife and forests, green economy and eco-culture, responsible use of nuclear energy, sustainable use of natural resources, op. cit., pp. 5-6.

<sup>19</sup> Cultural and Art organizations, training and creative work, platform building, Expert Forum for cultural heritage, High-level and regular Think Thanks and Educational Symposiums, journalists and Young Political Leaders visits, Promotion of Tourism, Film Festivals, Health ministers exchange, op. cit., pp. 6-7.

repeated that Top China's Priority remains linked to World's peaceful development, regional stability and security. In that context, he emphasized geo-strategic importance of China-CEEC "growing mutual trust", marking as the core of cooperation Chinese huge market and sufficient capital, and CEEC's "solid economic foundation", natural resources and high-level of scientific and educational development (H.E. Mr. Li Keqiang, 2014). He supported "industrial integration" based on Chinese investments, industrial and financial cooperation, and cultural exchange (H.E. Mr. Li Keqiang, 2014). Prime Minister of the Republic of Serbia, Mr. Aleksandar Vučić, as source and key point of Chinese-Serbian cooperation perspective marked his country's political courage and will to overcome the negative heritage from the past of the Western Balkans, focusing mainly on economic development through the European integration process (H.E. Mr. Aleksandar Vučić, 2014). To accomplish this goal, Serbia needs investments, infrastructure, economic growth and competitive market, offering in turn talented young people and suitable conditions for the China-CEEC projects' implementation (H.E. Mr. Aleksandar Vučić, 2014). Regarding concrete steps within Serbian-Chinese strategic cooperation he marked visa liberalization and Serbia's full support to all innovative models, agreements of currency swap, new forms of inter-banking cooperation and "diversification of Project systems financing" through "concessions or private-public partnership" (H.E. Mr. Aleksandar Vučić, 2014). It is obvious that Serbian PM generally evaluates China-CEEC cooperation within the EU's "umbrella". Serbian-Chinese cooperation is seen as an aspect and an instrument, which will support and speed up Serbia's reforms and EU Integration process and later Membership. Regarding the forms of various projects' implementation Serbian support to all types of concessions can be expected in the future, especially ones related to transportation infrastructure (Cleaning the riverbed of the Danube, highways and railways, etc.). According to PM Vučić, implementation of China-Serbia- -Hungary Railway Agreement remains Serbia's top priority due to its wider potential to connect in perspective also Greece and Macedonia with CEEC (H.E. Mr. Aleksandar Vučić, 2014). Since Serbia has been privileged to lead the Infrastructure Coordination Council within China-CEEC cooperation he concluded that it would continue to promote "long-term strategies" and "political visions" for "future of stability, cooperation and prosperity" of all participating countries (H.E. Mr. Aleksandar Vučić, 2014). PM Vučić obviously emphasized that Serbia remained Chinese "Strategic pillar partner" and leader of China-CEEC cooperation in South-eastern Europe. Belgrade Speeches of two Prime Ministers shown that China's approach was comprehensively planned, "reality-based and optimistic", "ratio-patient" and "step by step" oriented, representing China's universal and constructive strategic responsibility and leadership. On the other side, being "crucified" between past and current economic situation, and "East" and "West" orientation and future, Serbia showed the clear political will and readiness to support actively China-CEEC

and all aspects of bilateral cooperation. Previously described Serbia's identity, current geo-political and its economic position could lead to a hypothesis and prediction that in Serbia's midterm interest, before the potential EU membership, could be quick implementation of some "shared" and concession projects, particularly ones that link China, this country and the EU. Beside railway Budapest-Belgrade, in the light of recent initiatives related to "revival" of Corridor 10 even in some EU countries (during several conferences in Vienna, Austria, in June 2015 the Danube river also possesses important "potentials" for "uniting" strategic interests of China, EU and Serbia's. For example, investments in this river would for sure facilitate transportation and trade in the area from the Black Sea, through several EU countries and Serbia, to Germany.

Starting from the Agreement between the Chinese Government and European Community on Cooperation and Mutual Administrative Assistance in Custom Matters (December 2004) and Strategic Framework for Customs Cooperation between China and the EU 2014-2017, during Belgrade Meeting Chinese, Hungarian, Serbian and Macedonian Customs have signed the Framework Agreement on Cooperation in Facilitating Customs Clearance. The Document consisted of envisaged cooperation in customs control, mutual administrative assistance and exchange of information (Framework Agreement on Cooperation in Facilitating Customs Clearance among the Chinese, Hungarian, Serbian and Macedonian Customs, 2014, p. 2). The parties agreed to make scope of cooperation through publicly available customs procedures supposed to establish and maintain liaison channels for information exchange and share best practices; make lower inspection rate respecting each party's jurisdiction; commonly prevent, investigate and punish violations of customs laws; exchange and train experts and officers within information technologies shared experience; and cooperate with private sector (Framework Agreement on Cooperation in Facilitating Customs Clearance among the Chinese, Hungarian, Serbian and Macedonian Customs, 2014, p. 3). Customs working group was established to evaluate and coordinate implementation on the regular meetings basis (Framework Agreement on Cooperation in Facilitating Customs Clearance among the Chinese, Hungarian, Serbian and Macedonian Customs, 2014, p. 3). Regarding Legal status, the Document was not an international convention with possible amendments or appendixes to be adopted through consensus (Framework Agreement on Cooperation in Facilitating Customs Clearance among the Chinese, Hungarian, Serbian and Macedonian Customs 2014, p. 4). Framework Agreement on Cooperation in Facilitating Customs Clearance between four (4) partner countries represented another important framework and instrument supposed to facilitate and increase trade cooperation on a regional level within the strategic context. It is noticeable that in the territorial sense, as partly Belgrade-Budapest railway, this Agreement has also been linking countries of Corridor 10 and ones through which further "Turkish Stream" (Gas pipeline

supposed to start in Russia and link Turkey, Western Balkans and Europe) should pass. That fact makes it geo-politically and energy important.

Finally, Memorandum of Understanding related to cooperation on Project Hungarian-Serbian Railways was signed by the Chinese National Commission for Development and Reforms, Hungarian Ministry of Foreign Affairs and Trade and Serbian Ministry of Construction, Transport and Infrastructure in Belgrade in December 2014. It was based on three countries' "clear intention to promote the economic benefits through infrastructure project's cooperation" (Memorandum of Understanding related to cooperation on Project Hungarian-Serbian Railways between the National Commission for Development and Reforms of People's Republic of China, Ministry of Foreign Affairs and Trade of Hungary and Ministry of Construction, Transport and Infrastructure of the Republic of Serbia, No. 1/2015). Envisaged railway should link two capitals, Budapest and Belgrade, in the length of 350km. Modernized double-path and electricity lines would be used for transport of passengers and goods, according to Hungary's and Serbia's national regulations.<sup>20</sup> Chinese role in the Project should be kind of "supervisory" one, imaged on participation of its railway technologies and equipment (Memorandum of Understanding related to cooperation on Project Hungarian-Serbian Railways between the National Commission for Development and Reforms of People's Republic of China, Ministry of Foreign Affairs and Trade of Hungary and Ministry of Construction, Transport and Infrastructure of the Republic of Serbia, No. 1/2015). This "trilateral" cooperation would be based on the Project's Feasibility Study led by China, and implemented through INI (engineering, tender and construction) with financing, Public-Private Partnership (JPP) and/or concession (construct and manage). The final form is to be defined after Feasibility Study, and could consider a mix of all mentioned ones depending on Hungary's and Serbia's capacities. China is also allowed to propose authorized Chinese company to lead construction and offer financing loans till the 85% amount of the Project value (Memorandum of Understanding related to cooperation on Project Hungarian-Serbian Railways between the National Commission for Development and Reforms of People's Republic of China, Ministry of Foreign Affairs and Trade of Hungary and Ministry of Construction, Transport and Infrastructure of the Republic of Serbia, No. 1/2015). Representative organizations appointed by the three parties (Chinese Railway Corporation, Hungarian State Railways Co. and Railways of Serbia) would do the Feasibility Study, create a Working Plan until 30 June 2015, and meet on a regularly basis and send the evaluation reports. The Memorandum will stay in force until the Project's realization, with the exception of one side written intention to leave it (Memorandum of Understanding related to cooperation on Project Hungarian-Serbian Railways between the National Commission for

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<sup>20</sup> *Ibidem*, Articles 2 and 3.

Development and Reforms of People's Republic of China, Ministry of Foreign Affairs and Trade of Hungary and Ministry of Construction, Transport and Infrastructure of the Republic of Serbia, No. 1/2015). Full implementation of China-Hungary-Serbia Railway Project is without doubt of crucial importance for Serbian national interests. This railway should link part of South-eastern Europe transport and trade spine with one EU capital, making pre-condition and first step for line extension to Thessaloniki in Greece (EU seaport). In case the railway is to be completely built in the future, Serbia would become a core centre and Southern "bridge" within China-EU (and CEEC) strategic cooperation and trade.

## CONCLUSION

Through centuries, there had been many Silk Road initiatives and routes depending on present power states' influence. Contemporary ones also represent a mix of their geo-political and economic interests, pretending to create a trade link, but also "buffer corridor" between three Continents—Asia, Africa and Europe. In the high-level interdependent World, most competitive Silk Road "rivals and partners" today are the United States (USA), China, the European Union (EU) and Russia, supporting numerous "regional players".

From Chinese perspective "One Belt, One Road" initiative's objective has primarily been related to the demands of this country's further economic development (safe energy supplying, support to product export and agricultural import) but also International Community one through promoting universal, peaceful and comprehensive values and cooperation. Starting from their "universally-particular" geo-political interests and China's accelerated development, Trans-Atlantic partners (USA-EU) generally consider this initiative with skepticism trying to "slow down" its wider implementation. In the context of deep economic crisis Central and Eastern European Countries (CEEC), as "Eurasian Continental Bridge", have a concrete bilateral interest (economic, infrastructure and transportation one) to improve and increase cooperation with China, expressing clear willingness to participate actively in "One Belt, One Road" initiative. Despite that intensity and level of China-CEEC cooperation in many terms will be conditioned by the results of strategic China-EU cooperation, USA's influence in Europe and Chinese "subsidiary" and "local" dynamism and activities. The outcome will be a consequence of mixed Chinese constructivism, EU's skepticism and CEEC's individual optimism.

Serbia's EU membership is not certain for at least 7-8 years due to length of accession process and challenges both the EU and Serbia (Kosovo issue) have been facing with. That is why this country has an obvious national interest to preserve and increase strategic partnership with China and implement all "One Belt, One Road" projects in its territory as soon as possible. In short and midterm such

outcome would “balance” all “strategic pressures” towards Serbia by “Western partners” (USA and EU), allowing it to act more “politically independent” in International Affairs. Concretely, Chinese investments and common projects realization would support Serbia’s economic growth, especially its infrastructure and trade potentials. The country would doubtless then be more “suitable and stable” candidate for the EU membership, which is country’s first “regional” priority. Once built Budapest-Belgrade Railway and implemented the Agreement on Cooperation in Facilitating Customs Clearance would make Serbia transport and trade spine of South-eastern Europe that links even three continents through “One Belt, One Road” initiative. On the other side China would have a reliable partner in South-eastern Europe, important stronghold and “short-term” EU candidate who offers link and “balance contribution” within China-EU (and CEEC) strategic relations. If Serbia becomes EU member one day, China will already have achieved a high level of cooperation with another EU country. If Serbia remains an EU candidate or non-EU country for a long time, China will even have “more space” for economic cooperation with this country. It is obvious that in every case Serbia remains an “unavoidable” partner of China in this part of the World.

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Marko NIKOLIĆ

**PERSPEKTIVA I POZICIJA CENTRALNIH I  
ISTOČNOEVROPSKIH ZEMALJA I SRBIJE U ODNOSU  
NA KINESKU INICIJATIVU “ONE BELT, ONE ROAD”  
—GEOPOLITIČKI PREGLED**

*Apstrakt:* U radu je načinjen pokušaj sagledavanja i ocene Kineske inicijative “One Belt, One Road” (2013) iz geopolitičke perspektive, polazeći od pozicije i uloge Srbije. U kontekstu duboke svetske ekonomske krize i barem skeptičnog (ako ne suprotstavljenog) uticaja i interesa Trans-Atlantskih partnera (SAD i EU), Kina konstruktivno teži uspostavljanju i obezbeđivanju mreže intenzivne ekonomske saradnje između tri kontinenta, pokušavajući da da sopstveni doprinos miru i zajedničkom razvoju. Saradnja Kine i Centralnih i istočnoevropskih zemalja ima „regionalni” karakter, i predstavlja aspect njene strateške saradnje sa EU. U pomenutom geopolitičkom kontekstu, polazeći od svog identiteta I spoljnopolitičkih prioriteta, Srbija iskazuje volju i spremnost da postane aktivni kineski partner i lider u Jugoistočnoj Evropi kada je u pitanju primena inicijative “One Road, One Belt”.

*Ključne reči:* Silk Road, China-EU relations, China-CEEC Cooperation, “One Belt, One Road” initiative, Serbia’s Will and “Regionally-Integrative” role.

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## POSSIBILITIES FOR PROMOTING INTERCONNECTIVITY BETWEEN CHINA AND CENTRAL AND EASTERN EUROPEAN COUNTRIES<sup>1</sup>

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*Abstract:* Since the end of the cold war, during the last two decades of the Twentieth century, became obvious European Union's intention to overcome the image of the political dwarf and economic giant. One could come to conclusion that the EU was successful in that intention: its borders were spread, number of member countries reached 28, its market enlarged, population as well, even the policies for far away neighbours has been created. But, surprisingly or not, although the Union has almost succeeded in weakening the influence that Russia once had over the socialist countries, the European Union is now faced with another challenge. This challenge came with the emergence of the new strategy that was born in China, "One Road, One Belt" aiming to gather all European countries in order to secure better perspective for each. Unlikely most of the European initiatives or policies, this strategy is not based on conditionality. It is based on equality and openness without any hidden intentions. In this analysis, the authors, from the perspective of the non-EU country (although the candidate country for the EU membership), will give an insight into the possibilities for promoting interconnectivity between China and Central and Eastern European countries.

*Key words:* European Union, European policies, China, Serbia, "One Road, One Belt Strategy", Central and Eastern European Countries

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## INTRODUCTION

At the time when the forerunner of the European Union, the European Economic Community was formed, it was very likely that none of its founding fathers were far sighted to tell how bright future their “child” would have. Telling the truth, one could object that they neither were assured for how long that originally peace project would last. Indeed, at that moment the most important was to eliminate the possibility of emerging of a new war on the European soil. The main idea was to direct all resources – human, financial, technological – aiming to create stable economies at the territories of member states for the benefit of their citizens.

Through the following decades, such a goal proved to be achievable. The European Economic Community gradually changed along with the new circumstances and overwhelming need to introduce new institutional bodies that will address the best interests of its new members. Parallel with this process, among the European leaders, at the margins of their summits, more and more frequently could be heard the opinions of introducing a new dimension of cooperation, political one that will follow the existing economic. Somehow, the fact that the economy and politics could not stay separate as they used to be, became obvious. That is why during the eighties (of the XX century), step by step, Europe (meaning the EEC at the beginning, then the EU) started to add new value to its functioning. The European Union’s determination to stop being recognized as an “economic giant, political dwarf and military worm” became conducted during the time of collapsing of the Eastern Bloc and defragmentation of federal communist and socialist states (Statement of then Belgian Foreign Minister, Mark Eyskens, conceded a few days before the Persian Gulf War started). Necessary changes of the Founding Treaties have been made and while the EEC transformed into the European Union, member states were able to start cooperation in the area of Common Foreign and Security Policy. From the EU’s perspective, its position of a reliable USA partner was secured. Along with the new role of the main player on the European ground, EU designed programme for gathering former socialist countries, promising them prosperity and building the new states with economies ruled by the market demands and democratic societies based on the rule of law, justice and equality. Some of the former socialist countries succeed in realizing of the so-called European dream, but many not. This group of countries and Serbia is among them, became conscious of double standards policies and permanent politics of conditionality. Unfortunately, the time of Non-alignment movement has expired and cooperation with the EU for these countries turns out to be not recommended, but necessary, otherwise they would exclude themselves and become marginalized.

In such climate, Chinese government decision to renew the One Belt One Road strategy appeared as a new opportunity for CEE countries. At a first glance, it seemed as a perspective for creating relations based on pursuing mutual interests,

relations that will bring prosperity to all partners involved and above all relations which speed and scope of development is not, unlikely the most of the EU's policies, based on conditionality.

As one might presume correctly, the EU did not perceive revival of an old/new strategy as an advantage but more like a treat that impose the need to rethink current relations with China.

### **CHINA EU RELATIONS – ORIGINS AND DEVELOPMENT: FROM DIPLOMATIC RELATIONS TO STRATEGIC PARTNERSHIP**

Immediately after its proclamation, People's Republic of China has started to build an image of a friendly nation by setting up diplomatic relations worldwide. Among those countries were also the member states of the then European Economic Community (Great Britain 1950, France 1964, the remaining four in 1975). Relations with the EEC were established in 1975. In that year, the first Chinese ambassador was accredited to the EEC. Very soon, in 1983, the mission of Chinese ambassador was extended to European Steel and Coal Community (ECSC) and EURATOM.

That moment stands for cornerstone for developing relations and cooperation between China and then European Community. In the same year, the Commission and the Chinese authorities agreed to hold regular ministerial-level meetings to discuss all aspects of EEC-China relations (Babić, 2010, p. 431). Moreover, ministerial-level consultations between the Chinese authorities and the Community in the context of political cooperation started in 1984. Contractual links in the shape of a trade agreement were established in April 1978 and then strengthened in 1985 with the signing of the Trade and Economic Cooperation Agreement. The agreement was initially concluded for five years and with possibility to be automatically renewed on an annual basis.

This agreement, by its type, can be considered “an open agreement which does not exclude any form of economic cooperation falling within the Communities sphere of competence. Sectors covered in the initial stage include industry, mining, agriculture, science and technology, energy, transport and communications, environmental protection and cooperation in other countries. Proposed cooperation activities include joint ventures, the exchange of economic information, contacts between business people, seminars, technical assistance and investment promotion” (Development of EEC-China relations).

Along with the Trade and Economic Cooperation Agreement, in order to make such agreement operative a specific body was founded – the Joint Committee. This Committee was entitled to meet once a year with a task to overview development

of all aspects of economic relations and other relations that are envisaged in the framework of cooperation programme.

Finally, on October 5 1988, the Commission formally opened its office in Beijing. This act can be seen not solely as the readiness of the European Community to foster further economic development in China under its development programme or confirmation of its willingness to look at the possibility of increasing and diversifying such operations, but even more as the intention to make the Joint Committee functional.

Ministerial-level consultations in the context of political cooperation in 1994 have been transformed into a political dialogue. In that course since 1997, annual summits have been organized alternately in Brussels and Beijing.

In the forthcoming period from 1995 until nowadays, the EU has adopted acts on a phased strategy towards China. Among those acts, it is not easy to decide which was the most significant. With the first one from 1995, “long term relationship” was introduced, in 1998 “a comprehensive partnership” was presented, then the time has come for “a maturing partnership” (2003), to be followed by “a strategic and enduring relationship” (2005) (Xiudian Dai, 2006). At that point, relation that had begun as purely diplomatic grew to the highest point, to strategic partnership.

Considering decades of mutually satisfying cooperation, this outcome of a maturing partnership that incorporates “shared interests and challenges” could hardly surprise anyone. Each partner recognizes long-term interests and decided to nourish them.

At the same time, both partners are aware of their significant differences. In spite of globalization and its driven forces, China is persistent in maintaining international system of the United Nations based on respect of territorial integrity and sovereignty, while the EU does not hesitate to neglect those principles in favor of, often very controversial, protection of human rights. So far, EU politicians acted with wisdom in relations with China and put aside certain human rights issues.

Of course, within the EU borders, there are also those who strongly oppose to partnership with China. Their main argument is that China is not strategic partner, but “strategic competitor” which is syntax of George W. Bush, for whom EU ties with China seems to be “naive and non-realistic” (Xiudian Dai, 2006). It is very likely that George W. Bush did not get a completely wrong impression marking China as a competitor, but referring to China – EU relations as naive and non-realistic is problematic. Position and importance that China has in contemporary international relations is such that bilateral agreements with this country ought to be considered only as an advantage.

Nevertheless, China is important for the EU and its tendency is to develop cooperation both in the fields of economy, trade and politics. One of the signals of such tendency is EU-China 2020 Strategic Agenda for Cooperation.

That importance is based on several facts.

First, China approved to be the second largest economy and now also the world's biggest trading nation. China's growth in 2013 was 7.7 %, and that data gave an impetus to predictions that China may become the world's biggest economy within the next 10 years, with an internal market of 1.39 billion potential consumers by the end of 2015 (Facts and figures on EU-China trade , European Commission).

Second, two decades ago, trade between China and the EU worth almost null, but today they are trading more than €1 billion every day and thus form the second-largest economic cooperation in the world (Facts and figures on EU-China trade, European Commission).

Third, "China has become one of the fastest growing markets for European exports. In 2013 EU exports to China increased by 2.9% to reach a record € 148.1 billion. EU exports have nearly doubled in the past five years, contributing to rebalancing the relationship" (Facts and figures on EU-China trade, European Commission).

From the other hand, China is the EU's biggest supplier, with € 279.9 billion worth of imported goods in 2013 (down by 4% or 11.7 billion compared to 2012). The result of this is a trade deficit of €131.8 billion with China in the same year, down by 10.7% compared to 2012, and down by 22.5% compared to the 2010 record of €170.1 billion (Facts and figures on EU-China trade, European Commission).

In the long term, China's importance as a strategic market for the EU can only increase and therefore deepening of their cooperation is inevitable.

## **THE REVIVAL OF THE SILK ROAD STRATEGY**

It seems that, so called, right moment for revival of an old strategy was the breakup of the Soviet Union and the Central Asian countries independence. The reason behind this shift was the logic of few great powers and their need for logistic support of several countries. In 1995, the European Union launched its own plan based on the United Nations one for the International Transport Corridor Europe-Caucasus-Asia (TRACECA), which was supposed to connect Europe, the Black Sea, the Caucasus, the Caspian Sea and Central Asia. TRACECA represents a complex multi-modal transport system in countries of the region aiming "to develop economic and trade relations and transportation links between countries and regions that is a significant contribution to the revival of one of the most famous historical routes of the Silk Road." Like the "ancestor", new Silk Road also tends to connect different parts and far away regions through a network of roads. The research was mainly funded by the European Union together with the European Bank for Reconstruction and Development, the World Bank, the Asian Development Bank and the Islamic Development Bank. The plan skirted Russia and Iran, and made a direct connection

between the European Union and Central Asia with the aim of integrating the railway that was supposed to go from eastern to western Kazakhstan (Zuokui Liu, 2014). In 1999, that plan was followed by another plan for constructing the railway line China-Kyrgyzstan, which supposed to be integrated with the railway network of TRACECA in Xinjiang. According to experts, that line represented the optimum economic line, but Russia and the United States were the main reasons why it was not realized (Zhiping, 2014). However, project 'Silk Wind', which was initiated in the framework of TRACECA in November 2012 in Izmir, had a better chance of success because it went hand in hand with the American initiative for a 'New Silk Road'. Its main objective is to complete the construction of the Baku-Tbilisi-Kars railway line which realization moved to the end of 2015.

The new plan for the Silk Road renewal was started in 1998 by the International Road Transport Union, and then the UN got involved with its first (2000) and second (2005) Silk Road Regional Project. The United Nations Educational, Scientific and Cultural Organization (UNESCO) and the United Nation Economic and Social Commission for Asia and the Pacific (UNESCAP) also released their own plans (Zuokui Liu, 2014). Another country that has initiated its own version of the Silk Road was Turkey. Turkey's Ministry of Customs and Trade has made public its goal of transport simplification, enhanced security, logistics and customs capacities as well as the renewal of the ancient Silk Road as a link between European and Asian Market at the 2008 International Forum on the Role of Customs Administrations on facilitating and Promoting Trade among the Silk Road Countries in Antalya. It has established cooperation between this project and the TRACECA at the forum in Batumi, Georgia. On that occasion, the participating forum states that were not members of this European initiative are invited to become that by signing a Memorandum of Understanding.

The Russian idea for a modern Silk Road is contained within the Eurasian Economic Union. On 18 November 2011, the presidents of Russia, Belarus and Kazakhstan signed an agreement that led to the creation of economic and political union on 1 January 2015, putting communication and transport infrastructure into the focus. A day later, on 2 January, Armenia joined, and Kyrgyzstan will become a full member in May 2015, after the ratification of the Accession Treaty.

In July 2011, US Secretary of State Hillary Clinton introduced the US 'New Silk Road' plan in New Delhi during her stay at the second India-US Strategic Dialogue. This comprehensive strategy includes Afghanistan, Central and South Asia and its implementation requires constructing a trade and energy corridor linking Europe, the Indian Subcontinent and South Asia. Washington's intention is to dominate the development process of South, Central and West Asia, i.e. to maintain and intensify its influence in these regions after the withdrawal of the army from Afghanistan in 2014, in order to bypass Iran, and to reduce Chinese and Russian influence.

The latest initiative ‘One Belt, One Road’ proposed by Chinese President Xi Jinping in 2013 was an extension of sporadic smaller projects which China implemented along the ancient Silk Road route in the previous period. This ambitious plan consists of land and maritime routes that start at Central and Eastern China and end in Venice, passing through Asia, Africa and Europe and all the seas and ocean along the way. The financing of the project would be entrusted to new institutions – the Asian Infrastructure Investment Bank and the Silk Road Fund, as well as through a new mechanism about to be established, and which will be supervised by the Shanghai Cooperation Organization.

As one could assume, this initiative caused different reactions. Some of them were positive, estimating that this could enable the economic progress of countries on the route of the road, while others were negative. Behind such perception was the fear that China’s enormous economic development, accompanied with enormous military budget, could create a kind of security dilemma. There are lots of them who believe that behind the promotion of this project lay hidden motives aimed to turn China into the main super power.

### **EUROPEAN LEADERS ON ONE BELT, ONE ROAD STRATEGY**

The European Union led by strong political personalities never was too fond to bring China closer. The reasons for such opinion are multi-layered. First, the European Union cannot compare with China neither in territorial nor in the demographical sense. Such vast territory at the same time means a huge wealth in various natural resources that build the solid ground for the productive economy. Even more, this populated country has enough qualified workers that can compete with workers all around the world. And here we come to the point that bothers the Europe the most – much lower prices of goods fabricated in China attract buyers while, at the same time, make European products less competitive. Besides that, Chinese capital offered to be invested in Europe also is not very welcomed because of the fear that Chinese enterprises might take over even traditional European production lines.

Apart from these economic reasons for not fostering cooperation with China, those of political origin also play an important role. Namely, while the European Union can be sure about the support of so-called old member states, the same could not be said for “new member states”. It is well known that quite a number of these countries are far from being satisfied with gains of their long desired EU membership. In general, ordinary people are disappointed because their life standard does not improve as much as expected. Even more, some of them lost “privileges” that had for decades – full health security, fair wages and working conditions. Disappointment is even bigger after realizing that while proclaiming “unite through



diversity” Europe constantly pushes ideas that very often confronts with traditional values of former socialist societies. In that sense, Europe is not keen to welcome political rival within its borders, especially not the rival with a word “communist” in its title.

But, due to the economic crisis that exploded in 2008 and which consequences still exist, surprisingly or not, such perception of China starts to shift. It was inevitable, having in mind growing of the unemployment rate, downfall of GDP, public debt almost uncontrolled growth, constantly decreasing of market demand.... European economics desperately needed fresh capital, which was difficult to secure.

In such climate, revival of the One Belt One Road strategy suddenly got a new value. It became an opportunity to give an impetus to downsized European economics and possibility to refresh European capacities both in political and economic manner. At the same time, European leaders bear in mind necessity not to lose its influence towards its new members, mainly Central and Eastern European countries in which China is particularly interested. In other words, cooperation could not be avoided but should be kept controlled.

### **POSSIBILITIES FOR PROMOTING INTERCONNECTIVITY BETWEEN CHINA AND CENTRAL AND EASTERN EUROPEAN COUNTRIES**

For the past few years, China could be considered as one of the biggest investors in the world, which coincides with the results of its ‘going out’ policy. Based on the assessment of ‘The Financial Times’, in 2009 and 2010, Exim Bank and China Development Bank have approved at least 110 billion dollars of loans to governments and companies in developing countries, which is more than total loans of the World Bank in the same period, and this amount has increased in the last few years (Dyer, Andrelini, Sender, 2011). On the one hand, Africa, Asia and Latin America are interesting areas for Chinese investment while on the other, key markets, where the investments doubled, are predominantly found in the European Union. Driving conclusion based on the statements of some Chinese officials, one could perceive that Europe became more significant for China, and that especially the strengthening of cooperation with the countries of Central, Eastern and South Eastern Europe stands for an important component of Chinese economic policy.

As mentioned before, with the economic and financial crisis that gripped the European Union, more Chinese capital goes to European countries. In order to counter China’s trade and economic offensive, the U.S. offered the project of forming a single transpacific economic zone to this supranational international organization (Zhang Bin, 2011). However, China’s financial support to the European Union provides a solid trading and financial partner. There is an active Chinese support to

Eurozone through the European Financial Stability Fund and the European stabilization mechanism. China has provided assistance of 43 billion dollars through the IMF. Billions of Chinese foreign exchange reserves are invested in European bonds, especially of those countries whose indebtedness is threatening the survival of Euro - Greece, Ireland, Portugal and Spain (Chen, 2015). Also, China has increased imports from Europe, making contracts in Germany, Britain and Spain worth more than 15 billion euros. Trade with the EU reached 560 billion dollars, which is a fourfold increase compared with the situation ten years ago (Chen Xin, 2014).

The primary European region in which China wants to expand its influence is Central and Eastern Europe, whose part is the Republic of Serbia.

At the opening of the Mechanism of Cooperation with Central and Eastern European Countries (CEEC), the 16+ group, in April 2012 in Warsaw, the prime minister Wen Jiabao announced that China has earmarked 10 billion dollars for this region. The basic intention was to envisage fund through which China will lend capital on preferential terms and, at the same time, support the development of energy infrastructure in the region. Besides that, cooperation will be also pursued in other fields such as tourism, agriculture, education, science and culture. In order to maintain the continuity it was decided to arrange meetings of heads of the states and/or Prime Ministers of the CEE countries with the Chinese Prime Minister on annual base. The second meeting was held a year later, in 2013 in Bucharest. The Chinese Prime Minister, Li Keqiang met with the prime ministers of sixteen Central and Eastern European Countries to review the investment of previously approved 10 billion dollars. For this purpose, a Development Fund was established for individual participation of each country. The Republic of Serbia at that time has already delivered 56 projects to the Secretariat of the Mechanism. China granted one third of the loans of the total amount on favorable terms, which means a longer repayment period and lower interest rate than the market rates (the example of such practice is implementation of projects of construction the bridge over the Danube and Kostolac Plant). The beneficiary state, Serbia in these particular cases, is obliged to fulfil certain conditions: not to receive developmental help in the form of concession credits, or if it does that they are in some small amount, to be able to service its public debt, its GDP per capita must be lower than the Chinese (the exception are the countries of higher political importance). Beside the credit line, the Fund for investment cooperation was established in order to collect 500 million dollars. Shortly after Bucharest Summit, in the beginning of December 2013, at the first Sino-Serbian business forum held in Belgrade, the economic attaché of the Embassy of PR China in Serbia Julian Chi pointed out that there is a great chance of increasing the authorized amount from 10 to 100 billion dollars, if the previous money was spent and if there were enough projects.

Serbia is attractive for investments being rich in unexploited stocks of coal, hydro potential and renewable energy sources. There is also the benefit that, with

realization of large infrastructure projects, serves to adjust the Chinese model of operation to the European market, rules and regulations, and to the Chinese managers to learn to understand the rules of operation of local markets. Especially after the failure of China Overseas Engineering Group company (COVEC) to build a highway from Warsaw to Berlin, since most of the states from this region are moving towards the European Union, but are not full members yet.

Strategic Partnership Agreement with the Republic of Serbia in 2009 pointed to China's intention to expand its influence to the Balkans and Serbia, as a key country in the region, and possibility to counteract the influence of the U.S. and other western countries. It gave a framework in which the relations between two countries should develop upwards in the coming period. Except economic, it included the political and security cooperation. Thanks to this, existing cooperation between two countries rose to a higher level, which is especially important because in a time of the lingering impact of the financial crisis that shook the planet, economic cooperation with one of the world's leading economic powers - China, is opening up new perspectives. For Serbia, whose economy is still recovering from the effects of the crisis, the most important is economic cooperation, but no less important are the other two dimensions - political and security cooperation.

Explaining the reasons which led Beijing to establish a strategic partnership, former Chinese Ambassador in Serbia Zhang Wanxue emphasized the similar historical experiences, the complementarity of economic and trade cooperation, common views on many international and territorial issues and opposition to the interference of other countries in domestic politics. According to him, Serbia is a very important Western Balkans country, with significant regional impact on the political, economic, diplomatic and other areas. Promoting continuous development of Chinese - Serbian strategic partnership is not only for the benefit of Sino - Serbian relations, but also for the world peace, development and cooperation. According to him, Serbia has the distinct advantage of geographical position. In addition, acceleration of the process of accession to the European Union and economic development will lead to growing demands for infrastructure construction. The reform and modernization of the industrial structure will also gain traction. According to data of Serbian Ministry of Foreign Affairs, in 2012 trade between Serbia and China amounted to 1.294 billion dollars, of which exports from Serbia were mere 18.4 million dollars. In the first eleven months of 2013, the exchange of goods amounted to 1.39 billion dollars, of which exports from Serbia was 20 million dollars. It is obvious that strategic partnership has not helped to reduce the existing large disproportion in trade between the two countries. Still, comparing the size and number of population of two countries, one should not be surprised by this data. What is far more important is that in December 2014 Belgrade hosted the summit of 16+1 that was highly evaluated by all participants. At the opening ceremony, Serbian Prime Minister described Summit as "a place where economies of East and West meet" and added that it is "the core of this Forum – to

create relations between China and this region” (Nikolić, 2014). Li Keqiang pointed out that entrepreneurs should see “the great potential in China-CEEC cooperation, hold firm to confidence in the market, seize the opportunities and ride on the momentum, working together to promote the bilateral cooperation to a new level.”

In his address to the participants, Prime Minister Keqiang particularly underlined that the construction of infrastructure connectivity contains huge potentials (ports, for instance), industrial cooperation with equipment as the key has a promising future, the establishment of the new investment and financing cooperation framework to provide service for the economic entity has broad prospects and that there is still a large space in promoting the bilateral trade. Each of these points should be addressed carefully in order to succeed in securing successful and mutually beneficial cooperation within the frame of 16+. At that summit, Chinese and Serbian parties concluded several very important agreements related to investment and construction in Serbian infrastructure.

Last year’s summit was convened in Suzhou under the theme of “New Starting Point, New Fields and New Vision” (Zhang Lirong, 2015). During the meeting, Premier Li proposed to set up a “one goal plus six priorities” framework for China-CEEC cooperation, “calling for joint efforts to realize the shared goal of building a new type of open, inclusive and win-win partnership and press ahead with the six prioritized fields for cooperation - defining the roadmap for fostering cooperation, promoting synergy in development strategies, setting up new models of production capacity cooperation, innovating investment and finance cooperation, boosting trade and investment as well as expanding people-to-people exchanges” (Zhang Lirong, 2015). As a result of this summit, two documents were adopted. The first is The Mid-term Plan on China-CEEC Cooperation while the second is The Suzhou Guidelines for China-CEEC Cooperation. Both of these documents are of the highest importance because they were adopted, upon the implementation of Belgrade guidelines for cooperation between China and CEE countries. Suzhou Summit along with its documents created a new milestone in the development of the China-CEEC relationship because of achieving “the important agreement between the Chinese and EU leaders on establishing the China-EU Connectivity Platform, as well as on developing synergies between the Belt and Road initiative of China and the Investment Plan for Europe, and between 16+1 cooperation and China-EU relations”. These documents called upon for the acceleration of connectivity projects to link regional transportation and Internet infrastructure development, but also to expand people to people and cultural exchanges with the China-proposed Belt and Road Initiative. Of course, time will tell if plans will be realized as planned. As Prime Minister Keqiang said, finances are the weakest links in the current structure. In order to secure win-win outcome, all parties should “keep looking for new ways for investments and financing cooperation”.

## CONCLUSION

One of the pillars on which Serbian foreign policy is based is dedicated to cooperation with China. Unlike the vast majority of countries “seduced” by globalization that impose new trend in international relations, based on neglecting the principles of international law, Serbia and China remains faithful to the UN Charter and principles of nurturing good relations and pursuing peace politics.

New One Belt, One Road strategy offers the possibility to expand traditionally good relations to the economic sphere and for the mutual benefit of both countries. China is proven not to be a country that exports revolutions or country that pursues conditionality-based policy and therefore represents the first choice for Serbia, eager to heal its economy and keep traditional values. This goal is of the national interest and therefore Serbian government should put all efforts in engaging leading experts to design projects that will attract necessary green investments. It is not bad to have favourable credit lines for infrastructure projects, but that credit lines will not improve overwhelming economic climate, neither will create new working places, nor raise the ordinary people life standard.

One should be aware that this region, of which Serbia is a part, serves as a form of preparatory or practice field for Chinese companies, where they are gaining the maturity of industrial and technological sophistication required for entry to western markets. Therefore, the Chinese are trying to complete the development of the Balkan energy projects in consistency with the standards prescribed for the countries of the region because they expect that the whole Balkan region will be part of the European Union one day. Also, they expect that these funds will be operational in the energy market because of the liberalization of the entire Balkan market and its integration within the Union. In addition, low taxes, skilled workforce with low salary and direct access to the EU market are additional reasons for cooperation. Serbia is particularly significant for China for having signed a free trade agreement with CEFTA and EFTA countries, Turkey, the Customs Union comprising Russia, Belarus and Kazakhstan, as well as the trade agreement with the EU, which indirectly provides duty-free access to the market with over a billion people. Through such channel, China could easily enter into all these markets.

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Ivona LAĐEVAC  
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## MOGUĆNOSTI ZA UNAPREĐENJE MEĐUPOVEZANOSTI KINE I ZEMALJA CENTRALNE I ISTOČNE EVROPE

*Apstrakt:* Tokom poslednje dve decenije XX veka, u vreme okončanja hladnog rata, došla je do izražaja namera Evropske unije da izađe iz okvira imidža političkog džina, a ekonomskog patuljka. Moglo bi se zaključiti da je u toj nameri uspela: proširila je granice, broj članica se uvećao na 28, povećalo se tržište, broj stanovnika takođe, stvorene su čak i politike za odnose sa dalekim susedima. Ali, iznenađujuće ili ne, iako je uspela u nameri da oslabi uticaj Rusije u bivšim socijalističkim zemljama, Evropska unija se sada suočava sa novim izazovom. Ovaj izazov se pojavio uporedo sa pojavom nove strategije “Jedan pojas, jedan put”, nastale u Kini, namenjene evropskim državama sa ciljem da svima pruži bolju perspektivu. Za razliku od većine evropskih inicijativa i politika, ova strategija nije zasnovana na uslovljavanjima. Zasnovana je na jednakosti i otvorenosti, bez skrivenih namera. Autori ove analize će, iz perspektive ne-EU članice (iako države kandidata), dati svoje viđenje mogućnosti promovisanja međupovezanosti Kine i zemalja Centralne i Istočne Evrope.

*Ključne reči:* Evropska unija, evropske politike, Kina, Srbija, strategija “Jedan pojas, jedan put”, zemlje Centralne i Istočne Evrope.

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## CHALLENGES OF BUSINESS AND FINANCIAL TRANSFORMATION OF CHINA IN NEW NORMAL ECONOMY

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*Abstract:* The Peoples Republic of China has a new Government whose mandate started in 2013, and under which there are undergoing major changes in China both on internal and external level regarding its economy. After almost 30 years of growth that was around 10%, China's GDP rate started to slowly fall down. During previous years, Chinese Governments were aware that some things in China's economic model need to be changed, so it can continue to develop in a steady way. President Xi Jinping stated that there is a need for "New Normal" economy, that will help China's adjusting to a new economic development model which will generate GDP growth rate of about 5-7%. In order to do so, the PRC must implement many changes on its domestic level, but also many changes on an international level within its international economic policies. This paper will present the economic factors that boosted China's economy; why they need to change; what is a New Normal economy and how it will affect China's economy, business and finances. At the same time, it will be shown how new Chinese initiatives on international level: "One Belt - One Road" and Summit "16+1", are part of this New Normal policy on the international business market.

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The final part of this paper will be dedicated to Serbia's place among Chinese international plans, in order to see what Serbia's current projects with China are, what the future plans are and how Serbia can benefit from this new China's plans.

*Key words:* China, New Normal policy, business, finance, New Silk Road, Summit 16+1, Serbia.

## INTRODUCTION

During the previous two years, different activities and news from China's economy had been globally oriented with world-wide scale repercussions in international financial policies and relations among strongest world's countries. At the end of 2014, after more than 140 years, the IMF officially stated that China surpassed the USA as a biggest world economy, measuring in GDP, with purchasing power parity (PPP) taking into account.<sup>3</sup>

Before that, the Government of China proposed foundation of the Asian Infrastructure Investment Bank (AIIB), an international financial institution that is focused on supporting infrastructure construction in the Asia-Pacific region, with Chinese major shareholder role.

As a result of reforms toward market-oriented economy and for boosting slowdown in export activities, People's Bank of China (PBOC) surprised financial markets in August 11th 2015 with three consecutive devaluations of the yuan, losing over 3% of its value. Since 2005, China's currency has appreciated 33% against the US dollar and the first devaluation marked the largest single drop in 20 years. For the first time in recent history, China had its own stock market bubble issue, creating in that way economic turmoil on international scale.

Latest, and maybe most tremendous news refers to the process of further internationalization of China's currency- yuan (renminbi), as a new "member" in IMF's special drawing rights, with first major revision of basket since creation of euro in 1999.

These economic and financial events reflect the new position of China in global geo-political and economic relations, but also they represent signal for moving into a new stage of further comprehensive reforms, in all areas of social and business life. These kind of reforms are (and will be) necessary prerequisite for accomplishing ambitious objectives of a nation's prosperity and overall development. Started almost four decades ago, reform plans have been continuously improving in

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<sup>3</sup> The Chinese economy in that time was worth \$17.6 trillion, slightly higher than the \$17.4 trillion the International Monetary Fund (IMF) estimates for the USA. Without the PPP adjustment, the IMF estimated that China's economy was worth far less - \$10.3tn. Latest data from 2015 shows even more difference between China and USA (\$19.5 and \$17.9 trillion respectively).

achieving long-term goals of modern and developed society, that are part of the New Normal Economy.

At the same time, besides the changes in the Chinese domestic market, China started to promote completely new international economic initiative called One Belt – One Road (The New Silk Road). Chinese President Xi Jinping officially promoted this initiative in 2013 at his meeting with Kazakhstan Government in Kazakhstan. What started as an idea with a relatively uncertain vision, right now is the most interesting project and topic all over the world. The idea of this project is to better connect China with countries in Europe, Asia and Africa by building roads, railways, infrastructure such as ports that can shorten the time for transportation of goods, and then help lower the transportation costs.

Two years before that China started with a smaller project that was only concentrated on Europe. China realized that, although Africa was one of its main strategic regions to invest heavily, there are still many problems that cannot be easily settled there, and that it needs a region with which it can work much faster and with which it can have more benefits. Therefore, after careful consideration, China chose to promote one new initiative that will promote her better relations with countries coming from the Central and Eastern Europe, under the name Summit 16+1. That is a Summit under which China will make plans with 16 countries coming from Central and Eastern Europe to make better relations not only in the field of economy, but also in the field of infrastructure, tourism, technology, culture and education.

In a sense, this summit is a smaller version of One Belt – One Road initiative, but with the more versatile program. The New Silk Road initiative is mainly focused on the road and railroad infrastructure, while 16+1 is broader oriented.

Modifying its own role in global markets, China is combining its New Normal policy on the internal and the New Silk Road initiative (together with Summit 16+1) on the external level, for improving its bilateral and multilateral relations in a function of bigger economic growth and both-side prosperity. On that road China will experience many changes and challenges that she most to overcome in order to stay on her right path.

## **OVERVIEW OF CHINA'S DEVELOPMENT FACTORS**

China's two historic transformations, from a rural, agricultural society to an urban, industrial one, and from a command economy to a specific hybrid one (with elements of both systems), have combined to yield spectacular results. GDP growth averaged 10 percent a year, and over 500 million people were lifted out of poverty (from more than 65% to 10%). China is now the world's largest exporter and manufacturer, and its second largest economy (IMF, 2015). Even with slowing growth in the future, China is likely to become a high-income economy and the

world's largest economy before 2030, notwithstanding the fact that its per capita income would still be a fraction of the average in advanced economies.

Many unique factors lie behind China's impressive growth record, including the initial conditions of the economy in 1978 that made it particularly ripe for change. The spark came in the form of agricultural reforms, including the household responsibility system that foreshadowed sustained reforms in this and other areas over the next 30 years. Key features of the reforms included (World Bank, 2013, p. 4-5):

- Pragmatic and effective market-oriented reforms. By introducing market-oriented reforms in a gradual, experimental way<sup>4</sup> and by providing incentives for local governments, the country was able to discover workable transitional institutions at each stage of development. One key feature of these reforms was their “dual-track” nature — supporting state-owned firms in old priority sectors while liberalizing and encouraging the development of private enterprises (Lin, 2012, p. 3),
- Balancing growth with social and macroeconomic stability. Early reform successes quickly transformed this priority into a national objective that was effectively used to mobilize all quarters of society—individuals and firms as well as local governments—to focus their collective efforts on economic development. The government employed a mix of fiscal, monetary, administrative and employment policies to maintain social stability during a period of rapid economic and structural change.
- Interregional competition. China built on its strong local governments at various levels by allowing them to compete in attracting investment, developing infrastructure, and improving the local business environment. Decentralization policies, including fiscal reforms in 1994 (which significantly increased resource transfers from the central government), gave subnational governments the incentives and the resources to aggressively pursue local development objectives. Officials were rewarded for delivering key reform goals: growth, foreign direct investment, employment, and social stability. The resulting competition between local governments and regions became a strong driver of growth—far beyond the expectations of the authorities.
- Domestic market integration. A key element of the reforms was the dismantling of regional barriers to the movement of goods, labor, and capital and the establishment of a single national market. Major infrastructure investments connecting regions and the interior to the coast helped to create a capital investment with enormous scale. For example, China is home to the world's second-largest highway network, the world's 3 longest sea bridges, and 6 of the world's 10 largest container ports (World Port Rankings, 2009).

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<sup>4</sup> China adapted a strategy known as “crossing the river by feeling stones,” that originates from Deng Xiaoping's phrase and his view on gradual process of liberalization.

- Steady integration with the global economy. With the establishment of special economic zones, Deng Xiaoping's remarks during his famous South China tour, and accession into the World Trade Organization (WTO) as milestones in 2001, China expanded and deepened its economic integration with the global economy. This policy reaped large dividends for China, bringing investments, advanced technologies, and managerial expertise; opening the international market for China's goods and services; and giving a boost to China's internal economic reforms. The proximity of Hong Kong, China, and Taiwan, China, helped, as did a large Chinese diaspora dispersed across the globe.

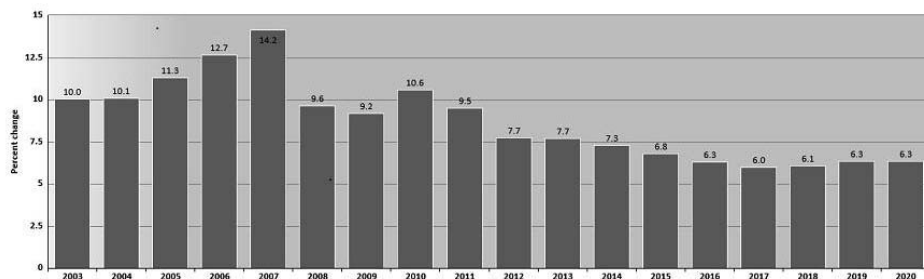
### **CURRENT ECONOMIC SITUATION AND NEED FOR “NEW NORMAL”**

The decade from 2000 was marked by a very dynamic recovery in the Chinese economy, a recovery that was both technological, with sustained productivity gains, and capitalist, with a very high investment rate, especially in capital goods. In 16 years, GDP per capita (in purchasing power parity) in China increased fivefold (from about \$2,500 in 1998 to more than \$12,500 in 2014), with three times bigger wages than just one decade ago (Tradingeconomics.com, 2015). This convergence phase was both longer and more intense than similar phases observed in other Asian countries, such as Japan in the 1970s or Korea in the 1980s.

Even there is many of data showing remarkable results in economic growth and overall development, China is facing new trends and characteristics, especially in the second decade of the 21<sup>st</sup> century. President of PRC, Xi Jinping, said the nation needs to adapt to a “New Normal” in the pace of economic growth, with the aim of shifting focus from the speed to the quality of growth. The Chinese economy can no longer postpone facing and solving a series of structural imbalances. Rebalancing the drivers of growth to change the structure of the economy will require deep economic and institutional reforms. Some of that statement can be seen in GDP results and forecasts in the coming years. Since 2010, when it was last two-digit economic growth, GDP has started to slow down, especially in the 2012-2014 period. At the opening of the annual National People's Congress (NPC), Chinese premier Li Keqiang officially announced that the growth target for China in 2015 would be of “approximately 7 per cent”, considerably lower than in the past, with entering the stage of the new normal, shifting from high speed to medium-to-high speed. By assuming steady reform and no major shock, economic growth will be little more than 6 per cent (Figure 1). After the first two years of Xi Jinping's term, the Chinese economy grew by 7.3 per cent ‘only’ in 2014 – the lowest rate since 1990 – low enough to convince Chinese policy makers to shift to a new policy stance, as they realize previous growth targets are no longer sustainable. The shift to a lower but more sustainable growth target came soon after

the International Monetary Fund (IMF) warned last year that a series of danger signs suggested that China would probably face a hard landing in the absence of crucial reforms.

Figure 1. Previous and forecasting GDP growth in China



Source: IMF, World Economic Outlook, October 2015, [www.imf.org](http://www.imf.org).

Just as growth is expected to slow in some emerging markets over the coming two decades, many signs point to a growth slowdown in China as well. One reason for the slowdown is that much of the growth contribution from shifting resources from agriculture to industry has already occurred. And going forward, the continued accumulation of capital will inevitably contribute less to growth as the capital-labor ratio rises. China's existing comparative advantage in low unit labor costs will shrink gradually. Rapidly rising real wages for unskilled workers in coastal provinces are encouraging firms to relocate to neighboring interior provinces where labor and land are more plentiful and relatively cheap. The rise in wages associated with increased productivity will continue to spur rapid expansion in the ranks of the middle class, which, in turn, will increase consumption of consumer durables and raise the share of consumption in GDP (Table 1). Modernization in the domestic economy will mean major shifting inside the economic structure toward different kinds of services.

Table 1. Projected growth pattern in China

	1995-2010	2011-15	2016-20	2021-25	2026-30
GDP growth (%)	9.9	8.6	7.0	5.9	5.0
Labor growth	0.9	0.3	-0.2	-0.2	-0.4
Labor productivity growth	8.9	8.3	7.1	6.2	5.5

	1995-2010	2011-15	2016-20	2021-25	2026-30
Structure of economy (%)					
Investment/GDP ratio	49	42	38	36	34
Consumption/GDP ratio	47	56	60	63	66
Industry/GDP ratio	46.7	43.8	41.0	38.0	34.6
Services/GDP ratio	43.1	47.6	51.6	56.1	61.1
Share employment in agriculture	36.7	30.0	23.7	18.2	12.5
Share employment in services	34.6	42.0	47.6	52.9	59

Source: World Bank (2013), *China 2030: Building a Modern, Harmonious and Creative Society*, Development Research Center of the State Council, the People's Republic of China p. 9.

In the first half of 2015, the contribution of final consumption expenditure to growth hit 60 percent— 5.7 percentage points higher than the corresponding period of last year—and continued to outperform that of investment. The share of value added by the tertiary industry in GDP climbed 2.1 percentage points over the same period of last year to 49.5 percent, 5.8 percentage points higher than that of the secondary industry, while energy consumption per unit of GDP dropped 5.9 percent on a year-on-year basis (Gang, 2015, p. 3).

New Normal, as a new paradigm in overall policy transformation and society progress, can be summarized in multiple characteristics and key objectives:

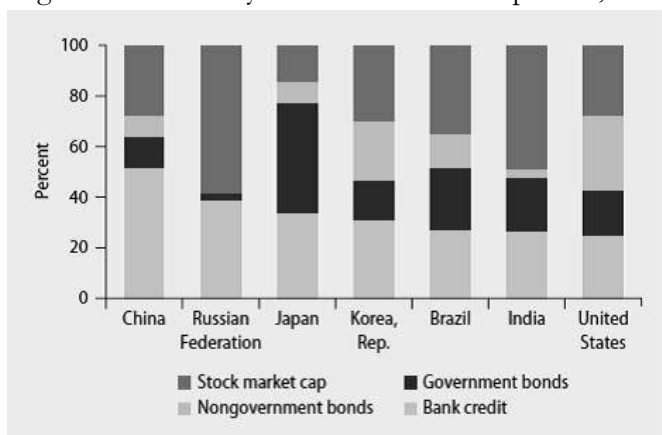
- Give priorities more to qualitative than quantitative aspects of economic growth,
- Shift from the position of “global manufacturer” to more sophisticated economic activities,
- Need for ecological shift with the aim of “going green”,
- Adequate approach to demographic issues and ageing population,
- Achieve balanced and sustainable growth, consistent with market force,
- Promotion of R&D activities parallel with innovation-based economy,
- Further process of decentralisation and reduce social and economic inequality,
- Strengthen the small and medium enterprise sector versus big state-owned companies,
- Further reform in various segments of the financial sector.

## FINANCIAL SECTOR IN NEW NORMAL ECONOMY

A well-functioning financial system is essential in China's drive to become a harmonious and high-income society. Overall, financial sector reform and development have been out of step with the real economy. The current financial system, characterized by bank dominance (Figure 2) and strong state intervention, served to mobilize savings and allocate capital to strategic sectors during the economic take-off, but such benefits are increasingly outweighed by the costs of the accompanying distortions and the resulting buildup of imbalances and risks.

Despite recent efforts to promote direct financing, bank credit still accounts for close to 90 percent of funds raised by the corporate sector. While it is not uncommon for financial systems to be weighted toward banks at China's stage of development, international comparisons show that China's is especially so, with more than 50% of funds in a financial system that comes from bank credit. Another characteristic is the ownership structure of the banking sector and overemphasized role of state activities. The levels of state ownership in the banking and government intervention in the financial system are much higher than in other countries at a similar stage of economic development that later achieved high-income status. Despite changes in the ownership structure of commercial banks from the previous system of exclusive state ownership to the current system of joint-stock ownership, the government continues to dominate in the financial sector. Banks have been used as instruments of the government's macroeconomic and sectorial policy goals and have not always been in a position to lend prudently. While this approach may have helped achieve policy goals, it has also exposed banks to a greater risk of deteriorating loan portfolios, increasing the ultimate costs of such public policies.

Figure 2. Financial system structure in comparison, 2009



Source: World Bank (2013), *China 2030: Building a Modern, Harmonious and Creative Society*, Development Research Center of the State Council, the People's Republic of China, p. 116.



Complexity of banking systems implies necessity for further “marketization” of financial activities, on local, regional and national level. China’s current banking system include various types of banking institutions, such as commercial banks, policy banks, credit cooperatives and foreign banks. These banking institutions can be divided into four levels: People’s Bank of China, as the regulatory department, and the China Banking Regulatory Commission are in the first layer; the second layer includes four state-owned commercial banks<sup>5</sup>; Development Bank, China Export-Import Bank and Credit Cooperatives belong to the third layer; foreign banks belong to the fourth level (Harrison, 2009, p. 239).

Recent events concerning the stock market bubble crash at two Chinese stock exchanges<sup>6</sup> reflected strong government role in financial markets and its fragile nature, together with lack of regulation in some speculative activities. Nevertheless, since the foundation of the Shanghai Stock Trade Market at the end of 1990, China stock had developed at high speed and experienced the process with only over ten years which the advanced national markets has experienced several decades or even one hundred years. The state –owned industries’ difficulties in collecting funds after the reform of investment system had produced direct energy for the development of China stock market. The stock market improves with an anniversary average of 50% and its speed of expansion is much higher than any other industries (Harrison, 2009, p. 269).

After three decades of outstanding economic growth, China’s economy began overheating in 2007 and signs of speculation and over-exuberance started to appear, such as a brief stock bubble that year (Figure 3) and a housing bubble in 2008. The 2008 global financial crisis caused China’s exports to plunge, forcing China’s leaders to abruptly refocus their worries from overheating to a potential domestic economic crisis and its very real threat to social stability. In November 2008, China launched a massive \$586 billion economic stimulus program that was primarily invested in public infrastructure projects, housing, rural development and the rebuilding of areas hit by the 2008 Sichuan earthquake. China’s stimulus plan was successful at staving off a recession and social crisis – so successful that inflation, overheating and overbuilding quickly became a concern again as the newly printed stimulus money sloshed around the economy, creating very alarming distortions and speculative activity.

The dramatic upswing in Chinese equity prices that began in mid-2014 was driven by a combination of factors. Perceptions of official support for equities, a reallocation of household saving from a weaker property market, and optimism

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<sup>5</sup> “Big Four”: Bank of China, China Construction Bank, Agricultural Bank of China and the Industrial and Commercial Bank of China.

<sup>6</sup> There is some estimations that 2015 crash on Shanghai and Shenzhen stock exchange had cost investors \$4 trillion.

about reforms in state-owned enterprises all contributed. The defining feature, however, was the surge in individual investor leverage in the form of margin financing. By early 2015, equity valuations reached very high premiums of about 50 percent over international peers, and even higher in some segments of the market. Daily market turnover rose to 1.7 trillion renminbi (RMB) in June 2015 from less than RMB 0.2 trillion the previous year, compared with a free-float market capitalization of RMB 24 trillion at end-June (GFSR, 2015, p.18). The systemic importance of equities remains limited, but the market's interconnectedness with the rest of the Chinese financial system has grown.

Figure 3. Shanghai Composite Index (2005-2015)



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com)

Composite Index (Figure 3) falls more than 40% (after even bigger rise in first half of the year), the Chinese government needs different, enhanced approach to deliver the basic requirements to investors, who wants to see the same way of progress and transformation like in the real economy. For accomplishing such tasks, financial markets, with whole financial system, will continue constantly to improve themselves. Reforms should focus of the following tasks:

- Full commercialization and rationalization of the financial system, with reorientation of government roles and responsibilities,
- Further process of interest rate liberalization,
- Deepening the capital market with bigger role of equity financing and innovative financial institutions, like institutional investors,
- Upgrading the financial infrastructure and the legal framework,
- Strengthening the regulation and supervision framework.

## CHINA'S NEW SILK ROAD INITIATIVE – “NEW NORMAL” ON INTERNATIONAL LEVEL

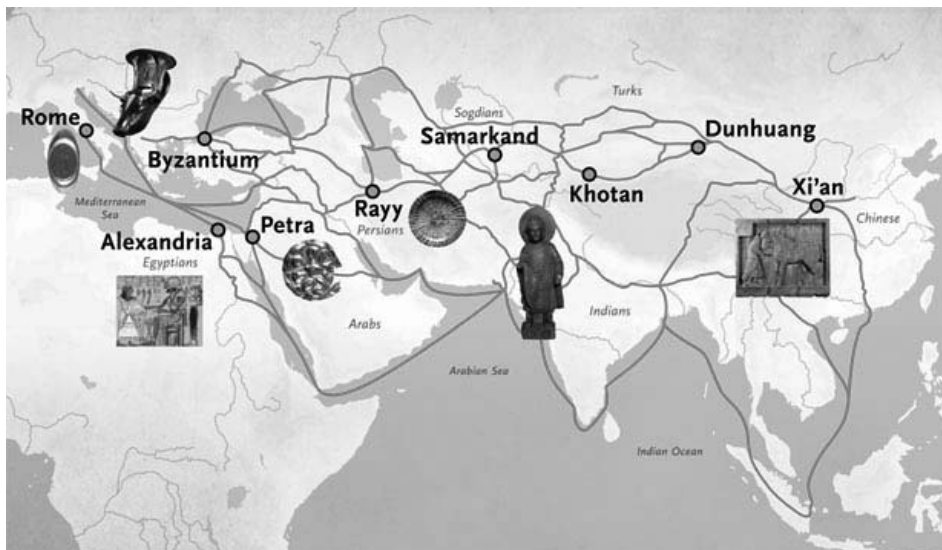
The beginning of the New Silk Road initiative came from Chinese President Mr. Xi Jinping in September 2013 during his speech in Kazakhstan. One month later during his trip to Indonesia, President Xi has widened this initiative and stated that China also wants to establish a Maritime Silk Road. So, what is the main idea behind this project?

In ancient times, The Old Silk Road was actually one of the busiest roads (routes) between 3<sup>rd</sup> century BC and 15<sup>th</sup> AD, through which many merchants coming from China and Europe traded with many goods that were significant at that time, such as silk, tea, salt, silver, porcelain, gold, precious stones, textile, wool, wine etc. Many routes were used during that time, but the main goal was to transport goods from China to Europe (and vice versa):

1. through middle Asia and Middle East by land – Old Silk Road, or
2. to transport goods by ships using South Pacific, then Indian Ocean and at the end Persian Gulf in order to reach Mediterranean sea and Europe.

Many traders not only from Europe and China, but also from all countries lying on that route, made good profit and the results were satisfying to all parties involved.

Picture 1. Old Silk Road – different routes



Source: [http://www.penn.museum/silkroad/exhibit\\_intro.php](http://www.penn.museum/silkroad/exhibit_intro.php)

In a sense, the New Silk Road uses the former glory of this transportation route in a new way. The purpose is to use the knowledge that we have today and to implant it in a new way, so the all countries (that are willing to participate in this project) benefit. The main idea is to try to connect in a better way China with the West of the Europe by more modern railroads and roads on land, and to build modern ports and their infrastructure in order to have better Maritime Silk Road.<sup>7</sup> The focus will be on lowering transportation cost by gaining on time, and by doing that then accelerating capital turnover. For example, there are predictions that the time for the transportation by sea will be shortened from 6 to 4 months to make a complete round from China to Europe and vice versa. Also, by building special high speed railroads the time for goods to travel from China to Europe will be shortened by more than 50%. In a world where time means everything, it is not difficult to imagine, how this project will help all countries involved to have a better economic and development results.<sup>8</sup> Investment in infrastructure will help any country, not only in the field of transportation, but also in the field of transferring technology, education, knowledge. China's leaders, on the other hand, know that if they want to maintain their stable economy, they need to find the markets on which they can invest their financial reserves, so the capital can make its natural flow and return with an interest. Therefore, those two reasons were among those that were most important when choosing to promote this project.

In table 2, there is a list of countries that are participating in this project. In a recent period, Hungary and Serbia signed the agreement to take part in this initiative, and also countries like Albania, Montenegro, Bosnia and Herzegovina and Switzerland, expressed their willingness to become members.

This market has roughly a population of 4.4 billion people, with a collective GDP of 21 trillion US\$. (Rolland, 2015) This means that on this territory, 63% of world population is living, and they are currently producing 29% of world GDP (Yaleglobal, 2015). At this moment, according to the Chinese Ministry of Commerce, China's bilateral trade with countries along the Silk Road represent 26 percent of China's total in the first quarter of 2015 (Yale global, 2015).

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<sup>7</sup> Note: EU is the largest trade partner for China. (<http://ec.europa.eu/trade/policy/countries-and-regions/countries/china>)

<sup>8</sup> Example: Citation: "China has signed an investment agreement of US \$46 billion, about one fifth of Pakistan's annual GDP and 10 times US investment in Pakistan, to connect the two nations by rail, road, pipelines, and optical cables. In April, China's state Xinhua news agency reported that the nation will invest in the Thai Canal, also known as Kra Canal, cutting through southern Thailand to save up to 48 hours to shipping companies transiting routes between Asia and Europe, a route also circumventing the Strait of Malacca." (Yale global, 2015) On this example we see that in case of these two countries what the potential benefits are. The same story goes for all other infrastructure projects and countries.

In order to finance this grand initiative China established a 40 billion US\$ New Silk Road Fund (Kaczmarek, 2015) that will primarily service needs for funds on this project. Besides that, the Asian Infrastructure Investment Bank (AIIB) will also participate in this project with its funds, and there is also an interest from some different infrastructure and investment funds to join this process.

Picture 2. New Silk Road (One Belt – One Road)



Source: <https://www.chinadialogue.net/article/show/single/en/7849-China-s-new-silk-roads-tie-together-3-continents>

Table 2 – Countries are part of One Belt- One Road initiative

Silk Road Economic Belt: 65 Countries		
China	ASEAN (10)	EU (28)
Mongolia	India	Bangladesh
Pakistan	Sri Lanka	Kazakhstan
Kyrgyzstan	Uzbekistan	Tajikistan
Turkmenistan	Afghanistan	Iran
Iraq	Syria	Lebanon
Israel	Turkey	Azerbaijan
Georgia	Armenia	Ukraine
Belarus	Russia	Kenya
Egypt	Tanzania	

Of course, besides many advantages that this project is having, there are also some challenges that need to be overcome:

- Different countries have different pavement rails, trains, systems of transportation, so it will be very challenging to build a railroad system that will be the same on the whole route;
- Different law regulations;
- Various customs and tariffs,
- Many countries have a high level of public debt, so they cannot afford to take any more credit for infrastructure, although they know that this project is good for them,
- Security of transporting goods, especially when using maritime roads,
- At the end, but certainly not something that we can overlook – number of the countries that are involved. Although this number is an impressive one, harmonizing all interests and sometimes even conflicts between countries that are involved, can be very difficult to say at least.

Using this project on an international level, together with New Normal policy on the internal level, China will try to adjust its economy to the changes that are at this moment historically very complex and tough. At this moment, we have very pessimist economic predictions for the year 2016 that are stating that the world is maybe facing a new economic crisis like the one in 2009. So for China, not only that it has a problem of changing the model of its economic development, at the same time Chinese economy needs to adjust to worsening of the economic situation in the world.

Looking from this point of view the initiative such as One Belt – One Road is highly supported in all countries that are affected by the possible effects of this kind of crisis.

## **PERSPECTIVES OF ECONOMIC COOPERATION BETWEEN CHINA AND CEE**

2011 was the first year during which there were the first reports in which the international audience heard about the Chinese strategy to build stronger relations with Central and East European countries. The first step that was done at that time was to organize an economic forum in Budapest in which 16 countries coming from Central and Eastern Europe took part (countries listed in a table 3). This forum summarized the need to establish better economic, politic and cultural relations among countries that were present.

Table 3. Countries that are part of project of cooperation between China and Central and East European countries (so called Summit 16+1)

Countries that participate in Summit 16+1	
1. The People's Republic of China	2. The Republic of Serbia (former SFRY)
3. The Republic of Albania	4. Bosnia and Herzegovina (former SFRY)
5. The Republic of Bulgaria	6. The Republic of Croatia (former SFRY)
7. The Czech Republic (former Czechoslovakia)	8. The Republic of Estonia (former SSSR)
9. Hungary	10. The Republic of Latvia (former SSSR)
11. The Republic of Lithuania (former SSSR)	12. The Republic of Macedonia (former SFRY)
13. Montenegro (former SFRY)	14. The Republic of Poland
15. Romania	16. The Slovak Republic (former Czechoslovakia)
17. The Republic of Slovenia (former SFRY)	

The initiative was developed in a broader sense in 2012 during the Warsaw meeting, and that meeting is being seen as the official start of the Summit 16+1. After that, there were annual meetings of the prime ministers of countries listed above in Bucharest in 2013, then in Belgrade in 2014 and Suzhou in 2015. These meetings showed great enthusiasm and interest from this part of Europe to participate in the opening of these countries towards each other and towards China.

Why Europe, or should we say this part of Europe, is significant to China? As we already stated in this paper, Europe as a market is very important to China. According to the document issued by the European Commission: "The European Union and China are two of the biggest traders in the world. China is now the EU's second trading partner behind the United States and the EU is China's biggest trading partner. ... China and Europe now trade well over €1 billion a day." (European Commission, Trade, 2015) Judging by these numbers, it is no wonder that China is interested in becoming even more successful in this market.

Of course, the numbers are telling us that the biggest trade is between China and Western Europe. China Daily stated in an article from March 2014 that the volume of trade between China and CEE (that are part of the EU) was in 52.9 billion US\$ in 2011, and 52 billion US\$ in 2012, while at the same time the trade volume for all European Union was respectively 594 and 546 billion US\$. That means that CEE region was only involved in 10% of the whole trade volume, and that is not a very good result.

If we now look at the countries that are part of this project, never minding if they are members of the EU or not<sup>9</sup>, this region has a population of 128.3 million people, and their trade with China in 2014 surpassed 60 billion US\$. It means that there is a lot of space to improve this situation, and to try to work in a new way that will bring benefit to all parties involved.

The main reason for countries to join resources and become part of this initiative is to prosper in economic way, and there are many reasons for that. First, this part of Europe has a history of being Communist countries block up until 1989, and it is also seeking the chance to improve its economic development, which is presently not so good. Many of those countries went from the transformation of centrally planned state economies into the capitalist oriented economies. Unfortunately, transformation and privatization process did not go very well in all of them.

Also, many countries started to disintegrate (as seen in table 3), so that in the last 30 years there were a lot of political, social and economic problems, which put back the economic results of countries involved.

Thirdly, these countries were very affected by the global financial crisis that happened in 2009. At that time, the EU was the main investor in this part of Europe. Since the crisis started, the EU had to withdraw and to reduce its investments here. That also affected the development of this region.

Through past three meetings with Prime Ministers of China and CEE countries, there were a lot of agreements, and new initiatives. In this paper, only the conclusions of the latest meeting in Suzhou will be presented.

Xinhuanet in its report from these meetings stated: “China and 16 Central and Eastern European (CEE) countries on Tuesday identified priority areas for cooperation from 2015 to 2020, ranging from infrastructure, finance, agriculture to culture, in a latest effort to make their cooperation develop in an all-round way... Chinese and CEE countries leaders agreed to link China’s Belt and Road Initiative with development strategies of CEE nations, taking advantage of China’s strength in infrastructure construction and finance and meeting CEE countries’ own needs for better infrastructures and connectivity... Li reassured the leaders that the Chinese economy is resilient with huge market potential and will maintain sustainable growth with ongoing structural reforms.” Projects that were given special attention were: building railway link between Serbia and Hungary; renovation of Slovenia’s Kopar port; building of the China-Europe land-sea express passage; agriculture - China will increase import of competitive farm produce from CEE

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<sup>9</sup> Note: we have eleven EU countries (Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovakia, Slovenia) and five are EU candidate countries (Albania, Bosnia and Herzegovina, FYROM (Macedonia), Montenegro, and Serbia).



countries and enhance quarantine with them; language teaching in each other's country or countries and boosting tourism and traveling; more civil aviation cooperation between China and CEE countries with direct flights.

It is also obvious from this report that China is now considering this summit as integral part of the New Silk Road initiative, and that these two projects will go together.

Challenges of this Summit are more or less the same as the ones that we have in “One Belt One Roads” project. Besides them, there is a need to stress some of them that were not part of the problems in the Silk Road initiative:

- Some countries are EU members, and some of them are not, so it implies that they do not have a unified system of law and currency, that would otherwise help a lot;
- Turbulent political background – lots of changes on the political elections in countries involved;
- Unresolved conflicts and political issues with some of the states involved;
- This market is not as familiar to Chinese businessman as EU market is – there are problems with knowledge of languages, different mentality, different cultures (the same goes from the European side).

### **SERBIA'S POSITION AMONG CHINA'S PLANS**

Serbia and China have been good political partners and friends for many years. Serbia inherited these good relations thanks to former Yugoslavia and President Tito. After the separation of the republics in the SFRY, Serbia continued to maintain its good and friendly relations with China.

Although the relations were good, they were not on the highest diplomatic level. Things started to change in 2009 when China and Serbia (President Hu and Tadić) signed the Agreement of strategic partnership.<sup>10</sup> Serbian President Tadić during his visit to China made an agreement with the Chinese Government to start their new relations by building the bridge on river Danube together. That bridge “Mihajlo Pupin” was finally finished in 2014, and officially put in use on December 18<sup>th</sup> 2014, during Summit 16+1 in Belgrade. The bridge was built by China Road and Bridge Company with the help of domestic companies, and the total value of this bridge together with all connecting roads amounted to 260 million US\$. The Chinese Exim Bank financed this bridge by 85%, and the rest of it was financed by the Republic of Serbia and the city of Belgrade. (RTS, 2014)

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<sup>10</sup> Serbia was the fifth country at that time, with which China signed this kind of agreement – after the Russia, Brazil, USA and South Africa. It was a real surprise on international level, and many newspapers and TV crews dedicated a lot of attention to this event.

Overall, we have six years of constant and good development of relations with China. This is very important, because Chinese people highly value long-term relations that are based on mutual respect and friendship. The steadiness together with the upgrading of relations between partners is for them the only way in which they see the benefit of the connections and mutual cooperation.

Serbia has been very active partner of China in this couple of years. Our Government is China's partner in both international initiatives that China is promoting right now - New Silk Road and Summit 16+1. In 2014 Serbia was actually the host of the annual meeting of the Prime Ministers coming from Central and Eastern Europe and China.

At this meeting, Serbia signed 13 agreements and memorandums with China. (B92net, 2014) Agreements were signed in the field of economic and technical cooperation, air traffic and giving the loan for the second stage of the thermal plant in the Kostolac B project, an agreement that will allow each side to open cultural centers in the other country, but the most important one is about building the high-speed railway between Serbia and Hungary. Memorandums were signed for: financial cooperation between these countries; starting a feasibility study on the construction of an industrial park; cooperation on a project referring to a part of the ring road around Belgrade, Bubanj Potok and Vinča; financing infrastructural projects in Serbia; protocol on health standards for exporting Serbian meat to China. Therefore, this Summit had excellent results regarding agreements, and since then some projects already started, such as building the high-speed railway and building the Kostolac B thermal plant. Also, there are various meetings in both countries regarding the start of other projects (e.g. industrial parks and steel factory Železara Smederevo) and the ways of financing them.

Because of these projects, we have presence of several very important companies coming from China that work on our market such as: ZTE, Huawei, China Road and Bridge Company, Sinohydro, Shandong high speed company, CMEC – hydro plants, China International Water and Electric Corporation, Belmax – whole sale of Chinese products and China Development Bank.

In recent times, there are also many initiatives in Serbia coming from both business and academic environment to speak more and write more about Chinese and Serbian cooperation.<sup>11</sup> That is a signal that the people who are involved and

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<sup>11</sup> Institute of European Studies (part of Chinese Academy of Social Science) visited Institute for International Politics and Economics (Belgrade) in April 2015, and there were there at the round table conference about Serbia's place on the New Silk Road initiative. This Institute also published the special edition of its magazine *International Problems* 2/3 2015 that was dedicated to this topic. Serbian Chamber of Commerce together with magazine NIN organized in January 2016 round table conference with similar topic. At this conference important people from Serbian and Chinese political and economical environment agreed that there are a lot of possibilities for Serbia on that road, that the relations between this two countries are best so far, and that both countries are expecting good results.

interested in these projects, coming both from Serbia and China, think that many economic and business goals can be reached on both sides, which will in the end result in a win-win situation.

## CONCLUSION

Deng Xiaoping started reforms in China in 1978, with the opening of Special Economic Zones and the presentation of “Open Door Policy” that historically made the biggest changes in China’s economy. His political ancestors followed his path and made a big success. This time the new generations of Chinese people are reaching once again crucial moment in PRC history. It is a time for a new change.

The old model of development was the right one for that time. The new millennium is bringing changes that need to be sorted in a right way. President Xi Jinping, together with the Prime Minister Li Keqiang, is a leader who will be in charge of pursuing and implementing “New Normal” Policy that will help China to continue to be one of the strongest economies in the world. Besides that, the process of internationalization of Chinese economy, which started with Summit 16+1 and “One Belt, One Road” initiative will help as president Xi said to fulfill “Chinese dream”.

Serbia, thanks to its geo-economic position, efforts of our Government and willingness to participate in China’s projects is also on a right path to recover from its difficult situation and try to have better results in the upcoming years.

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## **IZAZOVI POSLOVNE I FINANSIJSKE TRANSFORMACIJE KINE U "NEW NORMAL" EKONOMIJI**

*Apstrakt:* Narodna Republika Kina ima novu Vladu čiji je mandat započeo 2013. godine, u čijoj vladavini se dešavaju velike promene kako u domaćoj, tako i u spoljnoj ekonomiji. Posle skoro 30 godina u kojima su stope rasta GDP u Kini bile oko 10%, kineske stope rasta su polako počele da padaju. Tokom proteklih godina, kineske Vlade su bile svesne da se neke stvari u ekonomskom modelu

zemlje moraju promeniti, kako bi se ona mogla na stabilan način razvijati. Predsednik Si Đinping je rekao da postoji potreba za “New Normal” ekonomijom koja će pomoći Kini da se prilagodi novom ekonomskom modelu koji će stvarati stope rasta GDP između 5-7%. Kako bi ovo uradila, NR Kina mora da sprovede mnoge promene kako na domaćem tržištu, tako i promene na međunarodnom nivou, u okviru svoje spoljno-ekonomske politike. Ovaj rad će pokazati koji su ekonomski faktori uzdigli kinesku ekonomiju, zašto se oni moraju promeniti, šta je to “New Normal” ekonomija i kako će ona uticati na kinesku ekonomiju, poslovanje i finansije. U isto vreme, u ovom članku će biti pokazano kako su nove kineske inicijative na međunarodnom nivou: “Jedan pojas - jedan put” i Samit “16+1” deo “New Normal” politike na međunarodnom poslovnom tržištu. Poslednji deo rada posvećen je mestu Srbije u kineskim međunarodnim planovima, kako bi se uvidelo koji su trenutni projekti Srbije sa Kinom, koji su planovi za budućnost i kako Srbija može imati benefit od ovih novih kineskih planova.

*Ključne reči:* Kina, “New Normal” politika, poslovanje, finansije, Novi put svile, Samit 16+1, Srbija.

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## ECONOMY OF CHINA AND GLOBAL FINANCIAL RELATIONS

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*Abstract:* In the second decade of this century, the current international financial order is changing. China is becoming more generous lender of last resort for a large number of financially impoverished countries around the world by offering them generous support in yuan (the official name is renminbi) due to geopolitical reasons. China and Russia in the field of economic development strongly complement each other: the scope of cooperation is very broad, and there is a great potential for the establishment of the second worldwide currency, which would suppress the dollar as the dominant currency in global commodity and financial transactions. The financial crisis is shattered by the policy of rapid additional printing of money. Fight for increasing the competitiveness of its own state, at the expense of others, continues in the era of the deepest financial crisis in the world. Currency war is being undertaken by the “export rival” states which, explicitly or implicitly, devalue the value of its currency to profit in foreign trade, i.e. increase exports. The devaluation of the renminbi causes confusion in the financial markets, raising the value of the US dollar, with a simultaneous sharp decline in the value of currencies in Asia, as well as shares of companies that export goods to China, with the new knockdown of oil and gold prices. Cheap oil destroys the current global financial system. The global currency war could encourage geopolitical tensions and affect the economic growth of others.

*Key words:* economic crisis, influence, changes, structure, functioning, currency war.

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## INTRODUCTION

The growing engagement of China in the international arena, the devaluation of the renminbi (due to increased exports) and Chinese hunt “for runaway foxes” (corrupt officials) have resulted in the China being referred to as a latent force and power of the “red dragon”. In mid-August 2015, the National Bank of China has further lowered the value of the renminbi (by 1.6 per cent against the US dollar) only a day after it had announced a one-time devaluation of the national currency (1.9 percent) with the aim of strengthening the role of market in determining the exchange rate of the currency of the second strongest economy in the world. The decision on the radical devaluation of the renminbi was ensued in a situation when China’s economy was threatened by the biggest decline of economic growth in the last 25 years, causing stock markets to suspect that China joined the undeclared “global currency war”. So, the unexpected devaluation of the renminbi, followed by the “correction” caused some panic in the financial markets, a cautious support of the IMF, the restrained reaction of the United States, but also dissatisfaction of American financiers. First, the stock markets of Asian business partners of China (from Indonesia and Malaysia to Australia, South Korea and New Zealand) immediately recorded a new decline in the value of shares and local currencies. Precipitous decline in value of shares quickly spread across Europe, so German car manufacturers and luxury goods industry recorded the largest decrease in the value of shares due to perceptible increase in prices of products supplied to the Chinese market. However, given the international and Chinese financial opportunities, for now, there is no basis for the continuous decline of the exchange rate of the renminbi, believe the Chinese financial experts, although this is the biggest single devaluation of the renminbi since 1994. Therefore, experts say that the renminbi devaluation brings the threat of deflation to the global economy. On the other hand, China believes that these changes are another step towards a greater role of the market in determining the exchange rate of its national currency. The United States and Japan are the biggest opponents of the idea that Chinese money should be included in the global “basket of currencies”. World financial circles believe that the increase of China’s gold reserves, on the one hand, and encouragement the market formation of value of the national currency (on which also insists IMF), is part of the strategy of Chinese financial experts in order to internationalize the renminbi. China’s economy is huge, one of the largest in the world, and there is hardly any national economy that it is not linked to it by multiple tiers of foreign trade and investment. That is why it is so important what is going on its capital market, because that market reflects the condition the entire economy.

## **BREAKTHROUGH OF RMB ON GLOBAL FINANCIAL MARKETS AND A NEW STAGE OF CHINESE DEVELOPMENT**

For decades, many experts have questioned which currency could replace the dollar as the “world currency” i.e. whether there is a replacement for the dollar. With the advent of the euro, everything has been done in order for it to be the dominant currency in international financial flows. However, in the second decade of the twenty-first century, the question arises whether the forceful breakthrough of renminbi on international financial markets endangers the dominance of dollars.<sup>3</sup> At issue is the willingness to restructure the international finances directed by this country with about 3,890 billion dollars of foreign exchange reserves. However, if China becomes a Russian lender of last resort, it would gain the opportunity to further express the strength of its currency in international financial relations and processes. In fact, for many years the question arises of what kind of global financial rights (and obligations) should have China - a country with 4,000 billion dollars in foreign exchange reserves and 1.35 billion people? On the other hand, in the year 2015 China recorded a dramatic drop in exports. Penetration of renminbi on international financial markets, and then its devaluation, many experts interpreted as a currency war against the United States. Therefore, many Americans have suggested that the IMF, as a universal financial institution, denies China access to “global currency basket,” which the Chinese desired for a long time, because using devaluation of the currency can bring “an unfair advantage to exporters” from China, i.e. has devastating consequences for the US economy.<sup>4</sup> In fact, for many years there has been an issue of the imbalance in China-US trade, which is deepened by the new exchange rate of renminbi. On the other hand, the new economic momentum of China is based on a solid financial structure, which suggests that the funding will provide the Asian Bank (with 60 member states) for investments in infrastructure (AIBB) which, in some ways, is a counterpart to the World Bank. At issue is the routing of the new Silk Road, which is the biggest project of its kind in history, with the ambition to strengthen economic cooperation between the Far East and the rest of the world (Politika, 23.08.2015, p.1). The plan includes the construction of roads and railways, as well as the creation of a strong network port for maritime traffic (among others linking China to the Persian Gulf and the Mediterranean Sea). To a large extent, the Chinese economy depends on trade seas.

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<sup>3</sup> In fact, China and Russia in 2014 signed two key agreements: the thirty-year energy cooperation (weighing about 400 billion dollars) and three-year replacement of currencies excluding dollar calculation (nominated at about \$ 24 billion, with the possibility of enlargement and extension). China has otherwise, by the end of 2014, triggered a total of 28 currency arrangements signed by the countries across the world.

<sup>4</sup> The signal for the start of a new phase of opening China to the world, has given at the end of 2013. Chinese president Xi Jinping when he launched the idea of a new Silk Road, whose route will stretch from the Pacific to the Baltic Sea.



China imports large quantities of raw materials, but also exports large quantities of finished goods, primarily to the United States. China's exports go mainly through the ports in Shanghai and Hong Kong. Chinese central bank, in mid 2015, in order to stimulate China's tired economy has introduced new measures of which two were most important: the lowering of interest rates and the mandatory reserve requirement. Both measures are designed as a possible stimulus for the economy because theoretically increase the amount of money that banks can allocate for the loans and borrowings.

View No. 1 The most important indicators of the Chinese economy

Serial number	Indicator	Index
1.	The economic growth	7 percent a year
2.	Inflation	1.4 percent
3.	Public debt	45 percent of GDP
4.	State reserves	3.690 billion
5.	SHIBOR (the equivalent for the LIBOR and EURIBOR)	1.879 percent
6.	VAT	6 percent, and 3 or 4 percent for small and medium-sized enterprises. Micro companies - tax-free
7.	Among the 500 largest companies.	106 from China, 128 from the United States and 54 from Japan
8.	One dollar is worth 6.4 renminbi (yuan)	01.09.2015.

Source: Eurostat, 02.09.2015.

Among the 500 largest Chinese companies remains a larger number of public than private ones, but the number of private is growing. Then, SHIBOR (SHANGHAI INTERBANK OF FRED RATE) is at a high level of 1.879 percent, which is proof that China is printing less money without coverage.

The effort of China to enter the European market is interpreted as another sign of the opening of this industrial giant to the world. In this context, global attention lately attracted the establishment of Asian Bank for investment in infrastructure (AIIB). In late 2014, representatives of 21 countries signed the Memorandum on the establishment of this bank.<sup>5</sup> AIIB received support from the

<sup>5</sup> By the middle of 2015 there were 57 founders, including the 37 countries of the region and 20 outside it, of which 18 are European.

World Bank, the Asian Development Bank and other international development banks. The macroeconomic impact of the inclusion of the Chinese currency will be multifaceted and will be reflected in the increase of trade in renminbi, the changing structure of the world's largest foreign exchange reserves of central banks (or, according to some estimates, the change will be more symbolic), better the impact of the Chinese economy in the world trade, but also “the stronger” voice of China's foreign policy.

### THE IMF AND CURRENCY WAR

International financial order, by introducing the Bretton Woods institutions, is being controlled by the United States, for now not through the United Nations but through the dollar as the “world currency”. As the global transactions mainly take place in dollars, the US may exclude the disobedient country from the financial flows, which is now called the geo financial war<sup>6</sup>. However, the vulnerability of America lies in the fact that the drop in oil prices caused a disproportionate rise of the dollar, while the currencies of other energy producers declined rapidly, and their dollar debts are growing - with an uncertain end. Therefore, this unknown, huge amount in dollars burdens Western structures that hold these debts. Because of the devaluation, the money invested in emerging markets, while they were giving a higher yield, turns into bad and doubtful loans. This means a currency war is happening, which fluctuate daily, and the value of shares is falling. More and more countries are trading outside dollar basis. This will impose on some countries to decide whether to remain in the dollar system, move to non-Western financial system or try both, and risk remaining under the US pressure. On the other hand, with the imposition of sanctions against Russia, the United States threatened the European partners, since the expensive energy decreases the competitiveness of the European economy. Race on reducing the domestic currency rate means that China does not devalue its currency, but simply does not allow it to become strong. It is an expression of political will. The exchange rate of the Chinese currency against the US dollar - is determined by the government (The Economist, 2015, p. 4). The Chinese have a strong exchange rate relative to Americans, which means that the course has minimal fluctuations. Once a month, the exchange rate is slightly corrected, but in any case, the government or the ministry of finance, makes decisions that are the responsibility of the central bank. The Chinese side maintains relations between the two currencies by purchasing or selling US government bonds. However, in the mid 2015 the IMF welcomed with restraint the decision of the

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<sup>6</sup> This US Treasury compares with a “neutron bomb” a weapon more powerful than conventional, which is applied on Russia over the Ukrainian crisis. However, we should bear in mind the bad mood in the EU, because while EU exports to Russia are declining, US exports is growing.

National Bank of China to allow the market a greater role in determining the value of the renminbi, but it was pointed out that the exact consequences of such measures would depend on the way the reform is applied in practice.<sup>7</sup> The IMF believes that the decision on devaluation as a reform measure will not have direct consequences on other decisions of the IMF. On the contrary, the IMF believes that China can and should seek to achieve an effective floating exchange rate in the following period. Nevertheless, China has pointed out during the announcement of the official commencement of the Asian Bank for investment in infrastructure and BRICS Bank Group, that future loans (from April 2016) cannot be nominated in US dollars, but in renminbi. According to some announcements, the two new international banks could, in due course, combine action on the world stage.

### **RENMINBI IN THE “CURRENCY BASKET”**

China has consistently, for many years, been trying to internationalize the renminbi, despite the announcement of the IMF that China’s currency, at least until mid-2016, will not be included in the “global basket of currencies.” For this, the IMF, as a leading global institutional lender, cites two reasons: its current failure to meet all financial criteria of the IMF for such status, and the time that would be necessary to adapt the world financial markets to the possible novelty. At the same time, the next regular revision of the current composition of the currency basket (which are: the US dollar, British pound, Japanese yen and euro), that is currently done every five years, should be made not in 2020, as previously planned, but four years earlier, in September 2016.<sup>8</sup>

So, the question is not whether the renminbi will be included in the basket of currencies, but when it will happen. However, activities of China for renminbi to be included in the Special Drawing Rights by the end of 2015, have slowed down this year under the influence of direct opposition of the US and Japan to the global promotion of Chinese national currency. In doing so, the IMF believes that China has for a long period maintained artificially low exchange rate of its currency, albeit discreetly entered into negotiations (informal and in phases) about the possibility of internationalization of the renminbi by connecting it to “currency basket”, which normally serves as the denominator of the monetary reserves of the world. US experts believe that China needs to reduce the influence of state regulations when it comes to cross-border investment and domestic interest rates for yuan to qualify

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<sup>7</sup> China has fixed the value of the renminbi at 6.39 US dollars, in August 2015.

<sup>8</sup> This is the essence of the proposal contained in the report of IMF experts, which was presented in early August 2015 to the Board of Directors of the IMF, before the session in fourth quarter of 2015. They consider that the IMF needs to postpone any action in connection with joining the renminbi currency to basket until after September 2016.

for entry in the “basket of currencies”. Experts of the IMF and of China, during 2015 are at a standstill, though they insist the renminbi today is far more used in international trade, largely in Asia, but only to a modest extent in North America. Four currencies, composing special drawing rights of the IMF, are still far more free in trade than renminbi. Experts believe that the entry of renminbi in “currency basket” requires freer access of foreign investors to the Chinese bond market, particularly transactions of government securities. The pressure of the strongest global economy (in purchasing power of money) for the internationalization of the renminbi has, though, changed a part of IMF regulations and led to checking of functioning of the current basket of currencies. It should be borne in mind that in November of 2016 China will for the first time host the G-20, and therefore hopes and strives to previously make renminbi an integral part of the “basket of currencies”, together with the four existing ones.<sup>9</sup> It is obvious that the US, under new plans for the development of China and Russia, and all the BRICS countries, is placed in a certain way to a side, which is absolutely in line with the current international situation and construction of a new global financial architecture, by calming of global financial and general global economic crisis.

### **CHINA’S GOLD RESERVES AND THE US DEBT**

In mid-2015, China has stabilized renminbi exchange rate and also became the sixth largest owner of gold bullion in the world.<sup>10</sup> Officially, according to the statement of its National Bank, China’s reserves amount 1,677 tons of gold, which put China in front of Russia on the world-ranking list (behind the US, Germany, the IMF, Italy and France). In doing so, it is estimated that since 2009 China has produced 2,000 tons of gold and through Hong Kong has imported another 3,000 tons of gold, so that its reserves are considerably greater than reported. However, if China wants the renminbi to be included in the “basket of currencies” determined by the IMF, she, according to the existing rules of the game must publish information about its gold reserves. China’s step forward in the global financial market contains another key element. The China has been aggressively selling off the US debt since mid-2014, which she had systematically purchased in the form of government securities years back.<sup>11</sup> China (the largest owner of the US debt

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<sup>9</sup> At this point, “drawing right” was formed by 41.9% of the US dollar, 37.4% - euro, 9.4% - the Japanese yen, and 11.3% - the British pound. It was officially stated that the next revision will be held in 2016.

<sup>10</sup> At the world’s largest stock exchanges is been estimated that China’s gold reserves are at least two to five times higher than the official confirmation of China. For example, in 2012 China’s reported possession of 1,054 tons of gold.

<sup>11</sup> Foreign exchange reserves of China in mid-2015 have been reduced from about 3.694 billion to about 3.651 billion dollars.

parked in bonds) has, since the middle of 2014 to the middle of 2015 sold out US bonds worth about 180 billion dollars. US Treasury notes that China now has US bond worth about 1.48 billion dollars. At its peak in purchase at the beginning of 2014, China possessed bonds worth 1.65 billion dollars. Foreigners through this stock exchange instrument control 6.13 trillion of the US debt. On the other hand, the decline in the price of oil and shortage of oil dollars in the world (western) financial market and possible separation of the US currency could have unforeseeable consequences for the global financial system. Investors in the US were severely miscalculated because they believed for too long that what is happening in Russia, Turkey and Indonesia does not need to have an effect on the shares of companies registered in the United States, but they realized that China's slowing economy threatens the economic growth in the United States. The gradual slowing of the Chinese economy, the ongoing "correction value" of shares in 2015 at overvalued Chinese financial market, too strong dollar, precipitous drop in oil prices and the decline in foreign profits, the sum of these factors lead to earthquakes on the stock exchanges, and even crashes. This was reflected in US index of futures trading in Asia. Meanwhile, investors determined to get rid of doubt, in the mid-2015 rushed to invest in safer currencies, namely the euro and yen markets.

Vigorous strengthening of dollar began with the beginning of 2014 when the US Federal Reserve (due to signs of strengthening US economy) could raise the reference interest rate, and then the dollar rose relative to other world currencies and caused tides of cheap dollar loans which were used to fund worldwide investment in real estate and generous spending. Profitability of the equity capital of the US, during this period, rose to a record 8.7 percent, while the yield of capital at the same time in Brazil fell to 45 percent, in Russia 43 percent, Indonesia 26 percent, Turkey and South Korea 25 percent, Mexico 22 percent, etc. General economic and financial crisis present, in fact, the reduction of values on a stock exchange capital market to the right measure. Many experts believe that slowing China could lead to slower world economic growth and weakening demand of the US economy.

Longing for extra profit from cheap labor in Southeast Asia, the United States have made two strategic mistakes, actually causing the emergence of economic warfare. The first is that they transferred production to China. In fact, not only there: American factories have sprung up in Taiwan, Malaysia and Singapore, but most were still built in China. The second error is the decline in industrial production in the United States and the transition of its economy to post-industrial model, in which the basis of GDP consists mostly of consumption and services.

On the other hand, it can be said that these decisions increased profit of the USA. In principle, they had, but the amount of money has not increased only in America. Today, the total monetary mass of the planet amounts 71.5 trillion dollars, of which 70.4 trillion goes to the 50 largest economies of the countries: China - 22

trillion, United States - about 12 trillion, Germany - 2.8 trillion, Great Britain - 2.4 trillion, France - 1.9 trillion, Italy - 1.4 trillion, Spain - 1.1 trillion, Russia - 0.58 trillion. In fact, China has as much money as the United States and the European Union together (total - 23 trillion), although only six years ago it had twice as less.

The Western world, especially the United States, back in the early 90's, under the slogan of the benefits of globalization, in rapid pace tore down transnational financial boundaries and formed a single financial space. This was necessary to facilitate the inflow of their money in weak economies, and to simplify the subsequent pulling out of profits. But now it turns out that 31.25% of all the money in the world - has China, and that the US share barely exceeds 17%, whereby is still falling, while Chinese - is growing. And it is growing fast, despite the decelerated growth of its economy. Because, even slowed down, even if at the end of year growth would be lower than anticipated 7%, this still means an increase of 1.23 trillion dollars, which is almost like creating another economy the size of South Korea, Saudi Arabia, Iran or Australia.

### **COOPERATION BETWEEN CHINA AND CENTRAL AND EASTERN EUROPE**

At the beginning of the twenty-first century China intensified cooperation with the countries of Central and Eastern Europe. After the first summit in Warsaw in September 2012, a meeting of state coordinators and representatives of China and the sixteen countries of Central and Eastern Europe, among which was Serbia, was held in Beijing (when it was constituted the Secretariat for the cooperation between China and these 16 countries). Following Beijing, a new summit, in the same composition, was held in Belgrade in December 2014. All forum participants agreed to set up joint mechanisms for cooperation between China and the countries of Central and Eastern Europe. China has singled out 12 concrete measures for the development of this cooperation and the establishment of special credit lines worth over \$ 10 billion, with a focus on projects of cooperation in the field of building the infrastructure, high technologies, green economy and other areas, establishing the "Investment Fund for Cooperation". For example, of more than 70 countries covered by the initiative of the New Silk Road a quarter belongs to the countries of this part of Europe.<sup>12</sup> China wants to demonstrate what it can do in the field of infrastructure in order to use those platforms to open new business relationships by investing in these corridors across Central and Eastern Europe, which are essential for economic expansion of Cina. On the other hand, the uncertain consequences of the shakes in China and other countries with emerging economies encourage debate whether too strong dollar turns into a burden for the US economy.

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<sup>12</sup> Also known as "One belt - one way."

On the other hand, it should be borne in mind that, in mid-2015, China and Russia signed even 32 agreements or contracts to further deepen mutual cooperation, bearing in mind that the American advantages in certain parts of the world, especially in the sphere of industry and energy, are not so strong. What is most important in the Russian-Chinese agreements is the idea of connecting two major projects - the Eurasian Economic Union, whose leader is Russia, and China's economic zone - "Silk Road" in the joint project. What kind of perspective would have such a project that would be stretched over the entire Eurasian space is not difficult to predict. The rest of the world would have to respond to the emergence of a new economic-political-military giant<sup>13</sup>. This applies especially to the European Union, which, no matter how harmonious looks, over the past few years is struggling with huge problems: the possibility of bankruptcy of individual members, increased percentage of the unemployed population, the fact that her safety, and therefore the bulk of foreign policy action continues to be tailored exclusively by Washington, no consistency in the approach to problems (that afflicts individual members), the problems of asylum seekers, to the idea of a possible disintegration or Europe in the so-called. "two-speed" or "two rounds of" countries. However, all those things do not mean that Russia or China will reduce the extent of cooperation with other countries, including the European Union, but the strategic actions will be designed differently and will go in a different direction. Taking into account the good relations between Russia and China with the countries of the South American continent the door for new projects in the economic sphere and in the sphere of security are beginning to open on that side. There is no doubt that China and Russia have decided to change the current world relations, in finance and the general economic sphere, primarily at its own rate. China nurtures the traditional friendship with Serbia, values Chinese - Serbian strategic partnership. The political trust is continuously deepening and cooperation in economic, cultural and other fields constantly expanding, particularly in the area of infrastructure, cooperation on new projects are still continuing and expanding. Modernisation of "fast railway" from the Greek port of Piraeus to Budapest will expand Chinese-European trade, there will be a rapid development of Serbia and the countries of Central and Eastern Europe, which will bridge the regional gap and promote balanced development within Europe and enrich the overall strategic partnership relations between China and the European Union. China has sufficient capacity for the production of equipment, can invest in improving factories in Serbia, support local infrastructure and promote economic development of Serbia, while in the meantime improving transport conditions.

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<sup>13</sup> The exchange between Russia and the EU fell in 2014, to 3.2 percent, while with China increased to 3.4 percent. And although the EU remains the largest Russian business partner, the strongest single partner in this respect remains China.

## CHANGE OF CHINESE DEVELOPMENT POLICY

The basic characteristic of the Chinese development policy is the gradualness. In China, nothing was done and realized overnight and in a hurry, but everything is subject to change.<sup>14</sup> With its record high foreign exchange reserves (over four trillion dollars), with increasing military spending and increasingly frequent diplomatic initiatives in Asia and Africa, China began to emphasize its interest far beyond its borders. The growing engagement of China in the international arena also encourages the heated debate about its global role and potential for rivalry with the United States. The increasingly rapid Chinese growth and growing political force might cut America's overall advantage.<sup>15</sup> However, in 2015, there was a "slowing momentum" and the reactions of world stock exchanges to the bad economic news from China are instant (especially is sensitive the Shanghai composite index of the value of shares on the strongest Chinese stock market, but also on the second strongest market Shenzhen). However, in the arena of the faltering global economic growth, strengthening protectionism and geopolitical tensions, Beijing has already indicated its future domestic and international economic and financial moves. China announced structural reforms in the form of economic transition towards a new model of growth: the economic support to the manufacturing sector towards strengthening domestic consumption and service industries. Which part of the current foreign exchange reserves, of about 3,600 billion dollars, will Beijing direct into this plan, and whether it will be able to meet the habits and needs of the population, it is still uncertain. On the other hand, according to some phenomena, two new international banks (AAIB and BRICS bank) could, in due course, to combine action on the world stage.

These new global financiers based in Beijing and Shanghai will have, soon, a new recipe for recovery both the Chinese and global economic growth. Meanwhile, China's central bank, in mid-2015, invested more than 200 billion dollars on the domestic stock exchange, buying shares to stop the "mass running" of investors insecure in further course of Chinese economy as well as paying off foreign debts

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<sup>14</sup> For example, although the language of globalization is English, Chinese is rapidly expanding. There are two economic reasons: (1) China has the largest open market and a huge economy in which annually flows hundreds of billions of dollars of foreign investment, and foreign companies doing business with China are working successfully if in addition to the Chinese who speak English, have their own people speaking Chinese; (2) high orientation of the Chinese economy on exports. Large foreign importers of Chinese goods can easier do business if they know Chinese.

<sup>15</sup> Experts predict that China is already in 2025 going to reach the United States, and for the next 25 years, in 2050, its gross domestic product (GDP) will be a third higher than the US. In the middle of this century, China will have a GDP of nearly 50,000 billion dollars, and the United States about 38,000 billion dollars.



(from 2007 to 2014, the total debt China has risen from \$ 7 trillion to 28 trillion or 282% of GDP). Many experts are wondering where China's economy and finance are going, whether the US central bank is really going to raise interest rates and thus make loans to China's economy more expensive. However, one should bear in mind that China is not over indebted country as China's foreign debt amounts to about 45 percent, and total debt of China, which includes both domestic and foreign creditors comprises a total of 282 percent of GDP in mid-2015.<sup>16</sup> China stands excellent not only when it comes to sovereign debt, but in the categories of mortgage loans - citizens are less indebted than in the western developed world, and in the banking sector, which is slightly below the average of indebtedness.

View No. 2 Total external debt of selected countries 31.08.2015

1. China	45.0 % GDP
2. Germany	74.4% GDP
3. France	97.5 % GDP
4. United States	103.0 % GDP
5. Japan	245.0 % GDP
6. Greece	168.8% GDP
7. Italy	135.1% GDP

Eurostat, according to „Politika“, Beograd, 02.09.2015., p. 11.

The biggest difference between the indebtedness of developed western economies and China (in addition to its much smaller government debt) is that the classic commercial companies have significantly higher debt than those in developed western countries. The main reason is that these companies are primarily in the financial sector, and China's are primarily in manufacturing. Another difference is that in China there is a large volume of foreign investors in the real sector, so part of that debt actually goes to companies owned by foreigners. On the other hand, local governments in China are indebted because the government has granted loans at much lower interest rates and thus facilitating them to meet their obligations, of

<sup>16</sup> The rest of the debt structure, the difference between 45 % of government debt and the total amount of 282 % are debts of local authorities, banks and other financial institutions, mortgage loans (citizens for real estate) and the economy. Local authorities owe something more, but for their debts is not responsible China as a country. More precisely: for one part of the debt directly corresponds the state, but it is only one part which is approved by the Minister of Finance. Local governments have borrowed over the approved amount, inventing legal entities that would borrow and for that part the overall risk is borne by creditors.

course, for part of the debt for which they sought and received approval. Essentially, there is no indebtedness of the economy until growth is maintained at the current seven percent, measured in July 2015 compared to July 2014. Neither the state nor the banking sector have a problem, as measured on any grounds. However, the Chinese economy has other problems. For example, in illegal banking flows in China has already been discovered around 67 billion dollars, which shows that there is a huge black market that is trying to be neutralized. Then, major weaknesses were detected in the expenditure of state money in construction tenders, public procurement, rents for state-owned land and ore rents. Regarding this was adopted a program of introducing a unified platform for all four areas, all levels of government, until mid 2017. The aim is a substantial reduction of corruption, optimal use of state resources, the allocation of capital, the greater efficiency of all stakeholders and complete transparency in real and financial markets.

### **CHANGE OF CHINESE FOREIGN POLICY**

In the second decade of the twenty first century, great changes are taking place in China's foreign policy. The main initiatives of Chinese external policy, which mark the efforts of its diplomacy in the new era are: joint construction of economic zone of the Silk Road and the Maritime Silk Road for the 21th century. In fact, for thousands of years the spirit of the Silk Road - "peace and cooperation, openness and inclusiveness, mutual learning and benefit" - was transmitted from generation to generation, promoting the progress of human civilization and greatly contributing to the prosperity and development of the countries on its route.

Symbolizing communication and cooperation between East and West, the spirit of the Silk Road is a historical and cultural heritage shared by all the countries of the world (Politika, 2015, p. 2). Initiative for Economic Belt of the Silk Road and the Maritime Silk Road aims to promote the connection of Asian, European and African continent and help to harmonize and coordinate the development strategy of countries on the itinerary of these two roads, to use the trade potential of the region, promote investment and consumption, create demand and employment opportunities, accelerate cooperation among nations and cultural exchanges as well as mutual learning among people of relevant countries, to help them understand, trust and respect each other and live in harmony, peace and prosperity. The Silk Road and Maritime Road pass through Asia, Europe and Africa, connecting on one end economic circle of East Asia, which is full of life, with a developed economic circle of Europe at the other end, including countries with high potential for economic development. The Economic belt of the Silk Road focuses on bringing together China, Central Asia, Russia and Europe (Baltic countries); on connecting China with the Persian Gulf and the Mediterranean through Central and West Asia; and linking China with Southeast Asia, South Asia and the Indian Ocean. The

Maritime Silk Road in the 21st century is designed so that it extends from the Chinese coast to Europe through the South China Sea and the Indian Ocean on one route, and from the Chinese coast through the South China Sea to the South Pacific on the other. Although the initiative for the Belt and the Way is proposed by China they represent the common aspiration of all countries in these areas. It is necessary to take advantage of opportunities that this initiative offers, by promoting openness, communication and integration among the countries to a greater extent, per higher standards and lower levels, while at the same time is taking into account the interests and aspirations of all participants.

### **CHANGE OF ROLE IN INTERNATIONAL FINANCES**

The establishment of Asian Bank for investment in infrastructure (AIIB) received great support from Asian countries, reflecting the enormous need for infrastructure construction in Asia. Investing in infrastructure is the basis for economic growth and represents great potential for trade and a strong driving force for all types of investment (initial capital of 50 plus \$ 50 billion, with the largest share from China). Active participation of countries that do not belong to the Asian region, especially European countries, show that these countries are expecting to boost their own development through participation in infrastructure development of Asia as well as to participate in the profits. The establishment of this bank is not only rare opportunity for development and wide market for member countries, but also helps in expanding the overall global demand and promoting the sustainable development of the global economy. However, many Western countries believe that AIIB represents competition to western financial institutions, and that it was intended to be a counterweight on an international financial market. China, on the other hand, assures that the bank will cooperate closely with other multilateral and bilateral agencies, and shall promote regional cooperation and build partnerships in order to improve development. China believes that AIIB and other international financial organizations have the same goal and the relationship between them will not be competitive or relationship of creating balance on the global financial market. Since the middle of 2015 officially the largest economy in the world, China, has long been dissatisfied with its status in the management system of the World Bank and the Asian Development Bank. The forceful economic rise of China, since the beginning of the millennium, and the global financial crisis initiated by the United States, forced the West to reform the voting system in the executive management of the World Bank. The United States as a crucial country among the founders of the World Bank, after World War II and the only one in that institution with the mission “to reduce poverty in the world”, has the right to veto any decision of members. At the other end of the world, in the Asian Development Bank (ADB), Japan and the US, as the largest shareholder among the 67 member states combined

have 26 percent of voting rights, and China has 5.47 percent of the votes, until the middle of 2015. The ADB (founded in 1966) has a total capital of 174 billion dollars, which is quite insufficient to cover the “development appetites” of the growing Asian economies. In fact, to maintain the current trend of economic growth (far ahead of the rest of the world) Asia will in the next 10 years need 8,000 billion dollars for infrastructure development. The loan procedure at ADB takes, on average, seven years, and to the countries with rapid development such pace of considering the international financial decisions no longer suits, so they must adapt to the new relations in the international financial market.

### **THE ROLE OF THE STOCK MARKET**

The role of the stock market, particularly in economies that are rapidly evolving is enormous. On them could be found the largest and most valuable companies, not only national, but on those larger, also the global ones. The stock exchanges are used for trading national currencies and the most important commodities, from energy over metals to grains. However, the stock market is not to blame for what is happening there - they are simply places where all good, but also all the bad things about the economy can be seen. Layoffs are not caused by stock markets, but the poor performance of the company: stock market is not the cause of excessive borrowing, neither the European economy lags behind of the US in the recovery because of the dishonest game of American financial magnates, it is because the euro project is unfinished, and monetary policy in Europe is not accompanied by fiscal policy. The stock exchange is only reflecting the state of an economy both in real and in the financial sector. Thus, one should take into consideration the fact that China's economy for many years has a high growth rate. Therefore, many economists, perhaps rushed to ascertain how a new economic model has been created, which may be superior to those based on the free market, motivated mainly by profit. In doing so, they have forgotten the postulates of overheated conjuncture, that an economy grows until it reaches its limits at any given time. These limits are bounded precisely by the basic elements of the economic model, but also by the whole order of society. In an economy dominated by the role of the state, i.e. a final decision-making center, we can provide high growth over the many years. However, what cannot be, it is that such a model becomes sustainable. This requires a system based on personal motivation, rather than the central editing. All this is necessary to bear in mind when trading on the stock exchange, but nevertheless it is not possible for a longtime high growth to become a permanent and continuous trend. This means that it is not possible by investing in the Chinese economy, through the local securities, always record growth. In such a big economy, certainly, should be invested, but with protection against the risk that China's stock exchanges also enable. In any case, one should not blame the stock exchange for what is

happening there, because they are just mirrors of the economic situation. Capital market reduces everything to its right measure: cold, precise and accurate. Play in the capital market is not for the greedy, nervous and impatient. It requires the expertise and commitment, and above all demands following the movement of capital, its cycles, rates of return and the prospects for expansion of certain enterprises or economic activities. That is why the game is on the stock market impersonal and there is simply no room for feelings, and therefore is effective. The capital market is the cheapest and most effective way of directing investment from languishing into prospective and profitable activities, or from the market whose society needs structural reforms, to those who do not have these problems.

### **FUNDS AND SHARES MARKET IN CHINA**

In the Chinese market of funds and shares during 2015 have occurred big turbulences and drops, which many Chinese as regard to a “hybrid war” against their financial engagement on the world market (all started with an official request from the CB of China to the IMF to include the Chinese renminbi in basket of reserve currencies of the world financial system) and financial aspects of the paradigm of the IMF (i.e. the US Federal Reserve) with China, in a situation where it has become a leading world economy. Normally the Chinese authorities intervened and with all strength give support to the national market (they massively temporarily halted trading instruments, obligated government brokers to allocate resources to stabilize markets, mobilized funds that control the purchase of securities, etc.) Beijing this time had no intention to directly interfere in the situation on market of funds and shares. Although the Chinese market of funds in absolutely huge (\$ 8.2 trillion at the end of July 2015, or 80% of GDP in 2014) it actually has little to do with the economy of the country. “No matter how decline in fund markets looks dramatic, it continues to play an incredibly small role in China. The current generation of Chinese leaders led by Xi Jinping set a task to turn the stock market into a source of funding the companies and improving the living standards of the population” (The Economist, 2015, p. 5). Now, however, the Chinese authorities have found themselves facing a dilemma: although there are those who fear the decision to not support the market carries risks to the banking system of the country, others believe that its rescue costs too much, and that it is inadmissible luxury in the conditions of the slowing economy, in which the stock market plays a relatively small role<sup>17</sup>. In circumstances where the State Council (Government) the PRC is trying to reduce to a common denominator two contradictory tasks - weakening control of the market and supporting the financial stability, the policy

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<sup>17</sup> “Government interventions have decreased significantly,” - confirmed Leung Michelle, Managing Director of Hong Kong’s Xingtai Capital.

will, most likely, be dictated by reformist members of the government who are committed to the concept of self-regulation of the market. The importance of the Chinese stock market for its own and the global economy is very excessive. It is relatively small, if it is quantitatively compared with GDP of China and plays a much more modest role in the economy of the fund markets of other countries. Capitalization of Chinese shares available for trading on the Stock Exchange (General capitalization of public companies without shares which were in the hands of long-term strategic investors) was 40.5 trillion renminbi (according to the Shanghai and Shenzhen Stock Exchange since the end of July), or approximately 60% GDP of China in 2014. It's not so much if we take into consideration that in developed countries this indicator exceeds 100% of GDP.

The stock market is not the main source of funding Chinese companies which prefer to lend through state-owned banks or to use undivided profits. Funds market has a share of below 5% of corporate financing in China. Also, the population is not yet ready to invest in the stock market: less than 7% of the urban population of China is investing in shares. Although for the past decade, investment activity in of China market of funds increased several times, owning shares in a country where there are over 90 million individual investors is as it was in the past - not a rule but an exception (unlike, for example, the United States, where more than half of the population is trading shares). Also, the behavior of the majority of private investors has unsystematic character: in deciding they are more guided by the opinion of a friend or advices of state media, instead of weighing strategies. In the current situation, or in other words: for the China, market funds rather than having economic significance usually have only political. And its global importance is exaggerated; it is possible that makes sense to panic due to the slowdown of China's economic growth, but not due to collapse of the local market shares. Increase in prices of shares of Chinese companies, which began last year, had a speculative character and was not a result of fundamental factors - the balloon definitely had to burst. This will directly hurt only foreigners who have Chinese actions, and that makes less than 1.5% of investors in the Chinese market. Here are the figures for the Chinese market funds:

- a. 10.27 trillion dollars represents the aggregate capitalization of the company with a listing from stock exchanges in mainland China - Shanghai and Shenzhen - state since the end of May 2015 (before the market decline);
- b. \$ 8.15 trillion - the stock exchange capitalization at the end of July 2015;
- c. 2.8 thousand companies traded on stock exchanges in mainland China at the end of July 2014;
- d. 32% from June 2014 to June 2015 increased capitalization of the Shanghai Stock Exchange;

- e. 43% fell the main Chinese index Shanghai Composite since 12.06.2015. (beginning of its fall) until August 25;
- f. less than 7% of the urban population of China performs a variety of investment through funds market (to compare - 55% of Americans are investing through the stock exchange).

By interventions in June and July 2015, the Chinese authorities have led to a doubt in the obligation of weakening control of the financial markets, which was taken in November 2013. Collapse of Shanghai Composite forced leaders of the country to take a whole series of measures to prevent crash of market funds: the temporary suspension of trading in shares of more than 1400 companies is sanctioned, large shareholders are forbidden to alienate actions, it was decided to postpone the IPO of some companies, and also - it has been allocated \$ 4,480 billion for interventions at the market funds.

The steps that have provoked fleeing of foreign capital from the Chinese financial markets, have not gone unnoticed by the IMF, of which China expects soon to include the renminbi into the SDR basket (“special rights for a loan”, unit of account of the fund). Politicians - reformers use that goal to every time justify the proposed weakening of state control of the market. The IMF (US Fed) has already called on Beijing to refrain from interventions in the funds markets. As a result - in mid-August the Commission for regulation of the securities market of the PRC said it would start with intervention only in the case of anomalous volatility or systemic threats to the financial branch.

If the Chinese authorities refrain from regulating the market, the Shanghai Composite may fall another 12% because the market is still overpriced. According to the data of 22 August 2015, the shares in the funds market in mainland China were 61 times more expensive compared to published profit of their issuers - it is the highest indicator in the ten largest markets of the world. The Chinese authorities should stimulate the economy, and not saving funds markets, because in that way one of the ultimate effects will become increasing of share value. Measuring incentives, financing infrastructure projects and projects for the conservation of nature will be more effective means to increase profits of Chinese companies, although this does not apply directly to the support of the stock market. In this case the Chinese authorities could expect victory in the conflict of Chinese dragon and Anglo Saxon eagle.

## **COOPERATION BETWEEN CHINA AND AFRICA**

China treats the whole Africa as a strategic partner and should continue to strengthen political, security and, in particular, economic relations, with emphasis on investments (Politika, 2015, p. 3). For example, China in November 2015 with

the Republic of South Africa signed 26 business agreements “heavy” about \$ 6.5 billion, including the one on the strengthening of cooperation in the production of nuclear energy, although the details of the agreement were not disclosed. China competes with Russia, France, the US and South Korea for the job of building new nuclear power plants of South Africa, “heavy” about 50 billion dollars.<sup>18</sup> On the other hand, it should be borne in mind that China is the largest trading partner of Africa, with a trade volume of 220 billion dollars and investments of 32.4 billion (2014). In 2014 and 2015 China has approved to Africa over \$ 35 billion, but its investments in the second half of 2015 are about 40% lower compared to the year 2014, which also sets the question of whether China will continue to approve loans bearing in mind slow growth of the Chinese economy. For example, China has with the Republic of South Africa already contracted the construction of one of the largest car factories in Africa, and lent the electric power industry of the country half a billion dollars to modernize the plant. It should also be borne in mind that the energy products and ores make up 85 percent of African exports to China. For example, the Chinese company “Sinohidro Corporation” came with \$ 1.5 billion in business to expand the capacity of thermal power plant “Hwange” in Zimbabwe.

## CONCLUSION

For the past 30 years since China has started adopting the policy of opening to the world, and taking large steps has gone from poor country to a global economic giant. China notably affects the change of a unipolar world in which the United States twenty years ago had the undisputed power. However, each pushing on the global peaks can't go without Russia. The relationships in this triangle will in future determine the trajectory of the world. The economic boom that launched China into the world's top finance influenced the growth of living standard of citizens.

On the other hand, the current economic crisis has affected all the world's national economies, except, to some extent those in Asia. However, China's economic boom has slowed since mid-2014. Therefore, China has decided, in the mid-2015, to “float” its national currency. Western analysts believe that China artificially maintains the exchange rate of its national currency to strengthen domestic industry, penetrate its exports to the world market and internationalize the renminbi. Until then, the National Bank of China from time to time determined the exchange rate by the system discretionary law, contrary to the expectations of investors, by weakening or strengthening the renminbi. On the other hand tremors

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<sup>18</sup> Beijing and Pretoria arranged the details of nuclear technical cooperation at a time when South Africa is preparing plans to build eight new nuclear reactors, in order to resolve the chronic problem of lack of electricity in the country with about 53 million inhabitants. The contractor will be the Chinese company CGN (China Nuclear Electric).



in the financial market of China and breakdowns on the Chinese stock markets have caused a series of reform measures that China started to implement (for example, the lowering of interest rates and the reserve requirements of banks) failed to convince the stock markets around the world that China is curbing the crisis on the financial market. However, the Chinese economic model is evolving.

The Chinese have adopted the view that it is not enough to allow personal motivation in a limited, channeled and supervised part of society, even in the whole economy. In order to achieve the flexibility to easily overcome periodic crises, the whole society should be based on individuality. With market economy and private property there should be a wide range of personal and political liberties, because only in this way and in such environment the market economy can provide a maximum to the entire society. The devaluation of the renminbi and stock exchange shocks opened a new chapter in the continuing process of reform in China's economy. Sooner or later the stock market bubble had to burst in order to partially correct the value of shares on the stock exchange.

After renminbi, in the middle of 2015, the Chinese indices began to fall precipitously, to the extent that the entire international community, and therefore the Chinese government, asked a question about the necessity of further transformation of the financial sector. Active participation of the Chinese state, with its financial institutions, in the artificial maintenance of a large volume of trade could send the wrong message to those investors who will be totally reliant on the state action every time when certain signs of the crisis appear. Undoubtedly, China's economy is closely linked to the world economy. China will remain committed to the basic policy of opening (to build a new pattern of all-round opening) and will be integrated deeper into the world economic system. Initiative in China's foreign policy, which refers to the Economic Belt of the Silk Road and the Maritime Silk Road, will enable China to continue to expand and deepen its opening, as well as to strengthen cooperation, to the benefit of all the countries in Asia, Europe, Africa and other parts world. Basically, China is committed to taking over more responsibilities and obligations within its capacity, as well as providing greater contribution to peace and development, even at the global level.

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## EKONOMIJA KINE I GLOBALNI FINANSIJSKI ODNOSI

*Apstrakt:* U drugoj deceniji ovog veka, sadašnji međunarodni finansijski poredak se menja. Kina postaje velikodušan investitor za veliki broj siromašnih finansijski zemalja širom sveta nudeći im nesebičnu podršku u juanima, zbog ekonomskih i geopolitičkih razloga. Kina i Rusija u oblasti ekonomskog razvoja snažno se međusobno dopunjuju: obim saradnje je veoma širok, i postoji veliki potencijal za uspostavljanje druge svetskog valute, što bi moglo da potisne dolar kao dominantnu valutu u globalnoj trgovini robom i finansijskim transakcijama. Finansijska kriza je ubrzana politikom brzog dodatnog štampanja novca. Borba za povećanje konkurentnosti svoje sopstvene države, na uštrb drugih, nastavlja se

u eri najdublje finansijske krize u svetu. Valutni rat se sprovodi od strane "izvoznih rivala" država koja eksplicitno ili implicitno, devalviraju vrednost svoje valuteu cilju da profitiraju u spoljnoj trgovini, tj povećaju izvoz. Devalvacija renminbi (juana) izaziva konfuziju na finansijskim tržištima, podizanje vrednosti američkog dolara, uz istovremeni oštar pad vrednosti valuta u Aziji, kao i akcije kompanija koje izvoze robu u Kinu, sa novim padom cena nafte i cena zlata. Jeftina nafta uništava trenutni globalni finansijski sistem. Valutni globalni rat mogaobi da podstakne geopolitičke tenzije i utiče na ekonomski rast drugih zemalja.

*Ključne reči:* ekonomska kriza, uticaj, promene, struktura, funkcionalna, valutni rat.

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## CHINESE RESPONSE TO TRANSATLANTIC TRADE AND INVESTMENT PARTNERSHIP AND TRANS PACIFIC PARTNERSHIP<sup>1</sup>

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*Abstract:* Among other things that were changed in the last decades, we would like to point out China's dynamic economic growth and re-strengthening Russian influence in international relations. These changes jeopardized the USA position as the only world power. The European Union is the most successful and largest economic integration in the world, but is falling behind the USA in political influence. The USA recognized growing Chinese economy as a major threat to its world dominance, and is trying to limit its spread. Among others, the USA is conducting trade negotiations which will cover, if they are successful, two large regions in the world- Atlantic and Pacific region. A series of trade negotiations are being carried out, mostly in secret, between the EU and USA in order to form a bi-lateral trade agreement - Transatlantic Trade and Investment Partnership (TTIP). On the other side, the USA is ending negotiations on the Trans-Pacific Partnership (TPP), a trade agreement among Pacific Rim countries. What is indicative is that China is excluded from these negotiations. Chinese response to this USA moves in the international field was a complex one. China is focusing in several directions and levels and building connections with other emerging economies. It is important that China's projects are financially very well-funded. The most important and biggest project is the revival of the Silk Road. The New

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Silk Road should uplift Eurasian economy, include large bilateral investment arrangements and produce a significant expansion of FDI. In this paper, we will present arguments to suggest that the Chinese response could be a successful one.

*Key words:* China, USA, Russia, trade, energy, New Silk Road, TTIP, TPP.

JEL Classification: F21, L71, Q32, Q41

## INTRODUCTION

Struggle for supremacy, either on local, regional or global level, takes place from the earliest times. Although in this sense, a little has changed throughout the history, the last century brought an important change - the world has become globalized, and the impact of interconnection between the countries has increased. Even there has been a long time ago since old empires held large territories and had huge impacts in the world, today there are tendencies to rebuild that kind of influence. After decades of the bipolar division of power in the world, since the early 1990s the United States remained the world's only superpower. In the last decade, there have been a numerous factors that had influenced the world to move towards multi-polar division of power, such as: the 2007–2008 global financial crises, which in many ways affected the individual countries and the whole regions; a dynamic economic growth of Chinese and Indian economies, as well as the resurgence of Russia. Today, in place is the gradual repositioning of the largest countries on the scale of world power.

This paper consists of following parts: 1) Introduction, 2) section reviews old and new alliances in the world; 3) section considers relations and strategies in the Asia-Pacific Region; 4) initiatives of the United States; 5) Chinese response and FTAAP; 6) the New Silk Road; 7) Supporting activities of Chinese response; 8) Sustainability of the new growth model of the Chinese economy, and; 9) Conclusion.

## OLD AND NEW ALLIANCES

The end of the World War II and the process of decolonization in the 1960s had established a structure of power and alliances in the world, which is largely held to this day. The processes of integration and disintegration, in different parts of Europe, and also dynamic economic development of a large number of Asian countries changed that pre-established structure in the world. Thereby an economic power of a number of countries does not always correspond to their political importance and influence. The United States is still the leading country in the world with its overall power. The strength of the European Union's economy is not followed by its political significance.

Within the European Union, the United Kingdom has always had a stronger alliance with the United States than with other European countries. The time when

France had a dominant political influence in the Europe has passed due to strengthening of Germany's economic power. Germany has never had enough political force, even within the European Union and certainly not internationally. The same can be said for Japan, whose international political influence is still limited. In short, the United States continues to have dominant political influence in large parts of Europe, Latin America, the Pacific Region and in a part of the Middle East.

On the other side stand Russia, China, India, Central Asia and a part of the Middle East. Russia has managed to restore some of its power in the political, economic and military sense. Extremely high abundance of a natural resources, energy, and clean water are essential elements of its stability and future development. Russia has maintained its former influence in Central Asia, a part of the Middle East, and it has also developed a very good cooperation with China, India, and Iran. Multi-decade dynamic economic growth and the expansion of Chinese exports are the main reasons for large importance and influence that China has nowadays in the international level. At the beginning of 2016, we were witnesses that the dynamics of the Chinese economy has had a global impact and the repercussions on all economies in the world. That kind of influence until today was reserved only for the United States.

## **ASIA-PACIFIC REGION: RELATIONS AND STRATEGIES**

The Asia-Pacific Region is a leader for decades because of its economic dynamics. In addition to the extremely dynamic economies of Japan, Taiwan, South Korea and Southeast Asian countries, a dominant role in that region also have economies of the United States and China. Between those two countries, there is a major rivalry in the region. "While there is a certain degree of distrust between the two powers, there is also a shared understanding that their interests are best served through diplomatic appeasement and mutual agreement for coexistence in the Pacific. Although the two powers have divergent strategic interests, their economic interests are deeply integrated through mutual dependency." (Ratuva, 2014, p. 419) This position is supported by the fact that among Asian and Pacific countries and economies there are still a large and complex relationship and ties: trade, investment, technology, infrastructure, and culture. The role played by the United States after the World War II in the economic development of Asian and Pacific countries in recent years has taken by China, which has emerged as a regional economic power and become a global one. "Due to close inter-linkages and inter-dependencies China's rapid economic ascent has had a discernable effect over the neighboring Asian economies." (Das, 2014, p. 228)

In general, we can say that all the great world powers have similar or identical strategies: to expand and increase its influence or dominance as more as possible. Explanations for that strategies and implemented methods may be different, but ultimately they have the same goal. With economic development and growing

ambitions of China, the rivalry between the United States and China has grown, which is one of the factors that jeopardize unipolar position of the United States. Despite the fact that the United States is dominant in many areas, and has abundant of resources, its international position gradually deteriorates. There are opinions that the foreign policy of the United States had led to decline of international reputation. Also, Russia took over the leading role in the Far East and the Arctic, especially in military terms.

In addition, it should be noted that there are territorial disputes in the South China Sea between neighboring coastal countries. In addition to the important maritime routes, there are significant reserves of crude oil and natural gas. China seeks to secure its dominance and control in this area, among other things through the construction of military bases and facilities on artificial islands in South China Sea: Spratly Islands, Paracel Islands, and Natuna Islands. Also, disputable are maritime boundaries in the Gulf of Tonkin.

## **INITIATIVES OF THE UNITED STATES**

For decades after the World War II, the United States considered the entire Pacific as its zone of influence and control. The United States recognizes a military strengthening and growing ambitions of China as a threat to its dominance in the Pacific. It is normal to expect that the United States will defend its current position by all means. “The US’ return to Asia-Pacific strategy targeted at China has resulted in its endless moves aimed at building a circle of containment around China.” (Zhiping, 2014) The United States has taken two trade and economic initiatives to achieve this objective: Pacific and Atlantic.

### **Trans Pacific Partnership - TPP**

The Trans Pacific Partnership – TPP is an agreement concluded between 12 countries of the Asia-Pacific Region; from the Eastern, American Pacific shore: the United States, Mexico (both states are NAFTA members), Chile, and Peru; Pacific insular countries: Japan, Australia, New Zealand, and Brunei; and following Asian coastal countries: Malaysia, Singapore, and Vietnam. In November 2009, the President of the United States Obama has announced an intention of negotiation the agreement, and it has been concluded in Honolulu, Hawaii two years later, on November 12, 2011.<sup>4</sup> Japan was the last country that joined the TPP negotiations, on July 2013. “The TPP is the leading US trade policy initiative of the Obama

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<sup>4</sup> TPP is preceded by the Trans-Pacific Strategic Partnership Agreement – TPSEP of 2005, which was initially started by Chile, New Zealand and Singapore. From 2008 and 2009 the United States and the countries listed above were joining the negotiations on the conclusion of the agreement.

Administration and a pillar of its efforts to ‘rebalance’ US foreign policy priorities toward the Asia-Pacific region by playing a more active role in shaping the region’s rules and norms.” (Jelisavac Trošić, 2015, p. 148)

As usual, in similar situations, declared goals were very ambitious. TPP should facilitate and enhance trade and investment flows, innovation, and economic development and create new jobs in such huge market area. It would be difficult to challenge the real base of such declared goals if we take into account the economies of the member states. The United States have a strong interest for successful realization of this agreement since this group of countries accounts for 44% of total merchandise exports, 85% of total agricultural exports, and 27% of private services exports. “The US plan for TPP is that it will provide new market access for made-in-America goods and services, strong and enforceable labor standards and environmental commitments, groundbreaking new rules on state-owned enterprises, a robust and balanced intellectual property rights framework, and a thriving digital economy.” (Jelisavac Trošić, 2015, p. 147) In any case, TPP represents a significant success of the United States in the international diplomatic field.

A number of authors have many critical comments on the provisions provided by the TTP. For instance, Stiglitz and Hersh (2015) claim that this agreement is not what it seems and that it has a different nature and essence. “The reality is that this is an agreement to *manage* its members’ trade and investment relations – and to do so on behalf of each country’s most powerful business lobbies.” (Stiglitz & Hersh, 2015) Still, as a general conclusion, the “provisions in the TPP would restrain open competition and raise prices or consumers in the US and around the world – anathema to free trade.” (Stiglitz & Hersh, 2015). These authors provide their arguments stating the main troublesome issues: intellectual property rights, pharmaceutical industry, tobacco industry, etc.

### **Transatlantic Trade and Investment Partnership – TTIP**

The negotiations on the Transatlantic Trade and Investment Partnership - TTIP between the European Union and the United States began in mid-2013. Although negotiations should already be concluded, they are still in progress.<sup>5</sup> It is basically a free trade agreement (FTA), which also should reduce restrictions on investment: to eliminate tariffs and facilitate investment activities for both sides. Standards and regulations in the United States and the European Union would be harmonized, which should reduce the current costs of companies, increase consumer choice and level of safety standards.

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<sup>5</sup> Official positions, the negotiations, the objectives and the rest of TTIP are available on the portal of the European Union: <http://europa.eu/>



Bearing in mind that on the joint US-EU territory live over 800 million people, with high level of development and living standards, it is clear that such a unified market offers great opportunities. The agreement should help the two major economies in the post-crisis period to strengthen, stabilize growth and increase the level of international competitiveness.

The main areas that the agreement should cover and regulate are the following: elimination of almost all customs duties on industrial and agricultural products, trade of services facilitation, participation in public tenders, free access to natural resources, as well as infrastructure and renewable energy, environment protection, etc. Officially, the European Union will not modify its regulations in the fields of human health, health of plants and animals, the environment and consumers. It remains to be seen what will be the final text of this agreement.

On the technical level, the negotiations are led by Commissioner for Trade of the European Union, with an additional team of negotiators and specialists in various fields to which the agreement applies, while on the other side stand the United States Trade Representative with his negotiating team. The negotiations are conducted in rounds, and take place every few weeks.

The European Union has lower public support to conclude TTIP than the United States. “The biggest issue in the talks and the focus of the growing opposition to the pact is a touchstone for all these inchoate fears – investor protection, or the system known as investor-state dispute settlement (ISDS), which allows companies to bypass national courts and sue governments for damages on lost investments in extra-territorial arbitration panels.” (Jelisavac Trošić, 2015, p. 155) The 2015 refugee crisis, which has hit Europe and is threatening to escalate, shows all the weaknesses of political cohesion of the European Union. An additional difficulty is that Great Britain is reviewing its own position in the European Union. In addition to earlier, these are factors that will impede the single European response to the American initiative.

## CHINESE RESPONSE

There are plenty of rational reasons in China’s and other Asian leader’s warnings that TPP could lead to the fragmentation of this large Pacific market. The TPP could be in conflict with existing agreements. For example, only APEC has signed 150 trade agreements.<sup>6</sup> “The Chinese responses to the challenge of the TPP have suggested that the path of an ‘anybody but China club’ may force China to establish a parallel or even competing international order, represented by the BRICS

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<sup>6</sup> All TPP member states are members of APEC, which makes up about half of the total number of APEC member states.

Development Bank at the global level, the New Silk Road Economic Belt at the Eurasian continent level, and the Shanghai Cooperation Organization, the China-India-Bangladesh-Myanmar economic corridor, and the China-Pakistan Economic Corridor at the regional level. In addition, China has also engaged itself in a dogfight style competition in the traditional battleground—maritime Asia.” (Gao, 2013, p. 19) The overall response of China to the United States’ initiatives has several levels and directions, whereby internal reforms and restructuring of the economy, together with the external economic relations, should ensure the effectiveness of such a response. It can be argued that the mentioned United States’ initiatives only intensified and accelerated the already planned and ongoing China’s foreign strategies.

In contrast to the TPP, China supports the establishment of the Free Trade Area of the Asia-Pacific - FTAAP in which it could be involved. The idea of creating FTAAP was conceived in 2006, and to a certain extent elaborated in 2010 by APEC countries. FTAAP should be realized outside of and parallel with APEC, to be common frame, and that does not conflict with existing FTAs in the Asia-Pacific Region. In any case, in a situation where there are numerous completed FTAs, FTAAP should prevent the overlapping of existing FTAs and harmonize small-scale FTAs in the region. This concept should provide support to this idea. APEC Leaders have endorsed the Beijing Roadmap for APEC’s Contribution to the realization of FTAAP in November 2014, which provide the Collective Strategic Study on Issues related to the Realization of the FTAAP to be concluded by the end of 2016. In The 23rd APEC Economic Leaders’ Declaration (Manila, Philippines, Nov. 19, 2015), they reiterate their commitment to achieve the Bogor Goals by 2020 and the eventual realization of FTAAP.<sup>7</sup>

Many studies have already been done on the possible effects that deliver FTAAP. Examining the necessary conditions for positive net trade creation effects, the authors of one study have come up with results that “the overall welfare gain for all subject economies range from US\$55 billion to US\$284 billion and US\$149 billion to US\$636 billion under static and capital accumulation models, respectively.” (Kim, Park, & Park, 2013, p. 22) Applying an advanced general equilibrium model to estimate rough benefits for the main Asia-Pacific ongoing FTAs, authors get the following result: “potential gains increase sharply with the scale of integration. For example, expanding the TPP from 12 to 17 members would triple benefits from US\$285 billion to US\$893 billion in 2025. Since that expansion would include most large economies in the FTAAP, overall gains would be similar. Moreover, gains will depend on the quality of the template; in other words, we show that global FTAAP benefits would be US\$2.4 trillion with a TPP-style template versus US\$1.9 trillion with the intermediate template.” (Petri & Plummer, 2014, pp. 83–86) As much as it

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<sup>7</sup> The Bogor Goals are the set of targeted long-term goals for realizing free and open trade and investment in the Asia-Pacific Region agreed by APEC member states in 1994 in Bogor, Indonesia.

is difficult to give a precise assessment, the results of these and similar studies suggest that the potential economic benefits from the FTAAP are very large.

### **NEW SILK ROAD**

The idea of connecting China and the Far East to Europe has its roots in the ancient network of roads stretching in that direction which was called the Silk Road. Contemporary ideas and initiatives to connect Europe with Central Asia, the Far East and China with trade and transport land corridors represent a revival of the ancient and medieval Silk Road. Such ideas were even more in the recent two decades, and their creators and drivers were the United Nations, the European Union, the United States and Turkey. Before the New Silk Road, there were some less ambitious initiatives in a play. We will mention the following one, which began with the signing of the Basic Multilateral Agreement on International Transport for Development of the Europe-the Caucasus-Asia Corridor - MLA TRACECA in 1998 in Baku by twelve countries, which in 2009 joined Iran.<sup>8</sup> It was preceded by the initiative of eight countries of the Caucasus region and Central Asia in 1993 in Brussels. This project was supported by the European Union. Its basic idea was gradually improvement and construction of a transport corridor for multimodal transport, which would be linked with the Trans-European Transport Networks / TENs. In accordance to the officially announced route, this corridor should begin in European countries: Bulgaria, Romania and Ukraine, and that passing through the territory of Turkey. It would be continued in the Georgian port of Poti across the Black Sea, through the transport networks of the South Caucasus countries and on the other side would be stretched by land from Turkey to the South Caucasus. The corridor would be linked with the railways of Turkmenistan and Kazakhstan by ferry lines across the Caspian Sea (from Baku to Turkmenbashi and Aktau), and continues to Kyrgyzstan, Uzbekistan and Tajikistan. The main problem for the realization of all these ideas and initiatives is that the largest and most influential countries of Eurasia were not included: China, Russia and Iran. “However, when it comes to Eurasia, all US attempts to provide economic alternatives to the Chinese leadership proved to be very weak.” (Arežina, 2015, p. 48)

Although we are witnessing the very large projects in the world, almost nothing can be compared to the New Silk Road. The main reason for this claim is that this is not only a transport corridor as, for example, the Trans-Siberian railway and a large network of railways and highways in the United States are. It remains, of course, to bring in the realization of at least a good part of the New Silk Road. Chinese President Xi Jinping announced in September and October, 2013 two parts

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<sup>8</sup> For detailed informations see: <http://www.traceca-org.org/en/>

of his plan called “one road and one belt”: New Silk Road Economic Belt in Astana (Kazakhstan), and the 21st Century Maritime Silk Road in Jakarta (Indonesia). It is envisaged that all projects will be completed by 2025.

Land route of the New Silk Road begins in Xi’an in Central China, heading West through Lanzhou in the Province of Gansu, passing Province Xinjiang through Urumqi and Khorgas on the border with Kazakhstan; through Central Asia (Almaty, Kazakhstan - Bishkek, Kyrgyzstan - Samarkand, Uzbekistan - Dushanbe, Tajikistan) passes through the northern part of Iran, through Iraq, Syria and Turkey to Istanbul; continues through Bulgaria and Romania to Moscow, Germany (Duisburg) and to Rotterdam, from where it goes down to Venice, where it meets the sea route.

Maritime Silk Road of 21st Century begins in Fuzhou, and continue beside Quanzhou in Fujian Province, Guangzhou - Guangdong Province, Beihai - Guangxi Province, Haikou - Hainan provinces, Hanoi (Vietnam) to the Malay passages; from Kuala Lumpur (Malaysia), Jakarta (Indonesia), Colombo (Sri Lanka), Calcutta (India) exceeds the Indian Ocean to Nairobi (Kenya), where it goes to the North next to the Horn of Africa, the Red Sea, the Suez Canal, Athens to Venice.

### **Land and maritime routes of the New Silk Road, originally presented on the website of the Chinese agency Xinhua**

Will the announced routes stay just like this, or there will be some changes, it will depend on the cooperation between the countries on whose territories it must pass. In any case, the key directions should remain as provided for, since it was taking into account the existing transport infrastructure, geographical and technical conditions and possibilities to improve it, or the construction of new sections, and also environmental issues.

Although there is a transport infrastructure on the planned land route of the Silk Road, its completion will require extremely large resources and capital. If we omit the geopolitical aspect of this large-scale project, and keep our attention only on the trade field, then a crucial factor is transportation costs. Transportation costs play an important role in the international trade, and depending on their amounts, can make a trade business very profitable or even meaningless. The main trade and cost logic of the Silk Road land route consists in the following facts. It takes up to 60 days for maritime transport of goods from Chinese ports to Rotterdam, Antwerp or Hamburg. The transport of goods by road and rail from Chongqing in the Southwest of China, through Kazakhstan, Russia, Belarus, Poland, and to Duisburg (Germany), on the route of 10,800 kilometers long lasts 14 days. When transport costs are concerned, a maritime transport is still without competition: maritime container services on this line cost about US\$ 4,000, and, for now, the railway

transport cost about US\$ 9,000. The large gap in costs should be narrowed, according to expectations, by making a return tour, from the West to the East, for the shipping of high-value goods, such as ICT products, luxury cars or expensive components.

According to officially proclaimed goals, the central idea is the cooperation with the neighboring countries along the New Silk Road. Its development concept or the main elements have not yet been defined. Since this is a long-term project, they will certainly be formulated, and for now it is the subject of debate and seeking common denominator for all countries involved. (Ze, 2014) At the core of this idea stands the connection between people, through the removal of existing bottlenecks and the construction of new infrastructure and main networks.

A financial support for this great project is a serious network of financial institutions: BRICS Development Bank, the Asian Infrastructure Investment Bank – AIIB, and the Silk Road Infrastructure Fund. At the APEC summit in Beijing in November 2014, 22 Member States have approved the creation of the Asian Infrastructure Investment Bank (AIIB), while against this proposal were three countries: Japan, South Korea and Australia. The projected capital of the new bank is US \$50 billion, and the main financiers and shareholders are China and India. In addition to this, there is BRICS Development Bank, which was established with the aim of funding the energy, telecommunications and transport projects. Also in November 2014, President of China announced the establishment of the Silk Road Infrastructure Fund, with a capital of US\$40 billion, primarily for the construction of transport infrastructure. It is a very large investment fund, which will have a decisive influence on the implementation of the announced projects.

On this particular plan, China is currently in negotiations on high-speed lines to 28 nations, most of which are along the route, with a total length of over 5,000 kilometers on the agenda. The basis for these negotiations lies in the Chinese experience in the construction of high-speed railways in the country, their own equipment and Know-How. Although the development of high-speed railways in China initially was leaning on the transfer of technology from abroad (Alstrom, Mitsubishi, Siemens, Bombardier), China won the independent production of the high speed railway locomotives and trains. Since the opening of the High Speed Railway network in 2007 China has built up roughly 19,000 kilometers of HSR track by the end of 2015 and intends to double or triple it.<sup>9</sup> Large sums of investment capital value of tens and hundreds of US\$ billions have been provided

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<sup>9</sup> The first was Qinhuangdao–Shenyang High-Speed Railway in 1999. German *maglev* technology (derived from: magnetic levitation) is applied in the construction of Shanghai Maglev Train in 2004, which became the world's first commercially operated high-speed maglev railway. Most of Chinese high-speed railways applied the high-speed trains with wheels that run on conventional standard gauge tracks.

for the full development of the planned High Speed Railway network. China has announced the expansion of the HSR network to 50,000 kilometers by 2020.

For now, the existing transport corridors from China to Europe have shown their effectiveness and efficiency, which is an additional argument for the implementation of large transport and infrastructure projects along the New Silk Road. Although China planned to introduce a freight train line China-Europe since the early 1990, the idea was realized in 2008. It uses the so-called Northern Eurasian Railway Corridor, which is linked to the Trans-Siberian Railway.<sup>10</sup> From the starting line in 2008, today it came to ten direct railway container and intermodal train lines: Hamburg (3), Frankfurt, Duisburg, Poland (2), the Czech Republic, and Madrid. All these lines operate effectively despite the fact that the length of some of the lines exceeds 13,000 kilometers.

### **SUPPORTING ACTIVITIES OF THE CHINESE RESPONSE**

In addition to the FTAAP and the project of the New Silk Road, China already has a well-developed bilateral and multilateral cooperation in the Eurasia, as well as the intensive investment activity abroad. Perhaps the most important fact is that all existing forms of cooperation, both multilateral and bilateral are compatible with the project of the New Silk Road. BRICS, Shanghai Cooperation Organization - SCO, cooperation with Iran and the Central Asia Region, provide a broader framework for the implementation of large infrastructure and development projects.

For the future development of Eurasia and the implementation of the New Silk Road the crucial relations are China with Russia, the countries of Central Asia and Iran. “Without a positive response from Russia, the concept of the Silk Road Economic Belt will be hard to realize.” (Zhiping, 2014) The overall Sino-Russian relations are being intensively developed in the last decade as a result of the consent of mutual interests and development needs as well as certain antagonism towards the United States’ and the European foreign policy. For Russia, “a significant deepening of relations with China is unavoidable. The antagonistic policies of the West do not leave an alternative.” (Lukin, 2015) To the maximum extent, we can agree with the statement that China and Russia have a common interest in solving the following items: mutual economic interest, breaking the unipolar world system, maintenance of the international law system, solving of regional conflicts, cross-border economic cooperation, Central Asia, and anti-separatism battle. (Lukin, 2015) Russia is without doubt the strongest ally in confronting the United States

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<sup>10</sup> There are three routes that connect China with the Trans-Siberian Railway: via Mongolia, via Zabaikalsk, and via Kazakhstan. In addition to the Northern Eurasian Railway Corridor, it exist the Central Eurasian Railway Corridor. In the future it is planned the establishment of the Southern Eurasian Railway Corridor.

on a global scale, especially in military terms.<sup>11</sup> Russian military technology is still the basis on which China's military industry based its accelerated development.

The economic and political interests of China and Russia in this region are largely compatible, which has been reflected in the finished and also planned energy and infrastructure projects and agreements. (Antevski, 2016, pp. 124–126) “The Russian economy is largely dependent on oil and gas exports: natural resources account up 65% of total Russian exports, whereby crude oil account up 33% of Russian exports.” (Antevski, 2015, p. 55)

The dynamic economic development has the extremely high energy consumption in China, and consequently large imports of crude oil and natural gas. In the Eurasian energy sector, Russia is the largest producer and China is the largest consumer. As a source of China's supply of crude oil, Russia overtook Saudi Arabia and became China's largest supplier of crude oil. A drastic drop in the price of crude oil in 2015 has largely reduced Russian export revenues. Since the price of natural gas is linked to the price of crude oil, Russia's natural gas exports also suffered significant losses. On the other side, China has made a record import of crude oil in 2015 and thus complements its strategic oil reserves. There are three major Sino-Russian energy projects: Skovorodino–Daqing spur oil pipeline linked to Russian ESPO oil pipeline, and two gas pipelines, the Power of Siberia gas pipeline (Eastern route), and the Altai gas pipeline (Western route). These three huge energy projects will contribute to the stability of China's supply and stability of Russian exports.

“General characteristic of the Chinese energy strategy is avoiding overdependence on any one energy supplier. That is why China has largely sought to geographically diversify its sources of energy supplies and transport routes. Permanent activities of China in strengthening energy security are: investments in energy and mining sectors abroad, foreign investment in shale deposits and alternative energy sources, concluding long-term agreements for energy supply, capacity building to ensure the safety of maritime transport routes, as well as the creation of strategic oil reserves which began in 2001.” (Antevski, 2015, p. 56) In addition, China is continuously trying to improve the energy efficiency and develop alternative energy sources. Thus, China has overtaken Europe and become the largest producer of electricity from wind energy. Regarding the above, it should be noted that China is planning to build a first overseas naval base in Djibouti, near the Bab el-Mandeb Strait. Since 2008, China has already been very active in anti-piracy escort missions in the Gulf of Aden and the waters off the Somali coast.

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<sup>11</sup> Although China's military forces is modernizing and equipping very intensively in the last decade, developed its own production of the most modern weapons, China still lags well behind Russia and the United States in military power.

Chinese exports of industrial and agricultural products to Russia have a good growth prospects, as well as the implementation of major infrastructure projects also in Russia. In early September 2015, China and Russia have reached an agreement on joint financing of the construction of high-speed railway between Moscow and Kazan, a distance of 770 kilometers, which is planned to be opened in 2020. Each of the two sides will invest half of the total of €30 billion. Afterwards it is planned to extend lines to China and link Moscow and Beijing over Kazakhstan.

The next important region along the New Silk Road is Central Asia. “Central Asia was once the hub of the Silk Road and if a Silk Road Economic Belt is realized it would be so again.” (Zhiping, 2014) This is an area of mutual interest for Russia and China, but Russia has managed to maintain its dominant influence on the countries of Central Asia. “Russian politicians have always taken Central Asia as their back-yard, brooking no outside ‘interference’.” (Zhiping, 2014) The Eurasian Economic Union – EEU was finally been formed through the various forms of economic integration since 2000. Although the total population of Central Asia is only around 60 million, and all countries are economically underdeveloped, this region has an important geo-strategic position and large deposits of crude oil and natural gas. Thus, in the mutual trade within the EEU energy resources account for almost half. It can be expected that Russia will maintain its dominance in the region regarding military and security area, but the economic impact of China will strengthen, since Central Asia is the important source of China’s energy supply. China National Petroleum Corporation - CNPC, the largest Chinese oil and natural gas producer and supplier, has become the largest buyer of natural gas from Turkmenistan instead of Gasprom.

China and Russia had a well-developed economic cooperation with Iran before the sanctions were lifted in July 2015. “Russia and China once enabled and supported Iran’s nuclear program. Russia has built the nuclear complex at Bashher and China supplied the main components for centrifuge program. When it comes to weapons and military equipment, it can be expected in the future significant Iranian purchases from Russia and China to modernize its army.” (Antevski, 2016, p. 133) In addition, Russian companies have already contracted important joint projects in energy and transport infrastructure in Iran. It is certain that China will increase its orders of crude oil from Iran and its investment in the energy sector.

China has extensive experience in the implementation of major infrastructure projects in the country, and transfers some of these activities abroad, when it has a strong financial support of large state-owned banks. (Downs, 2011) There is an increased activity of Chinese companies in the energy sector in last year, so we can list several recent projects: the agreement with Argentina on the construction and financing of two nuclear reactors worth about US\$15 billion; the announcement of the investment and construction of a nuclear power plant in the southwest of the United Kingdom worth about US\$9 billion; expansion of hydroelectric power



plants Hwange in Zimbabwe by Chinohidro Corp. worth US\$1.5 billion; possible participation in the construction of nuclear power plants in South African Republic.

Activities of the Chinese state and private companies in the Middle East are particularly intensified in the last decade. There are several factors that encourage these activities: first, about half of China's oil imports come from the Middle East; second, China is already well positioned in Africa; and third, underdeveloped infrastructure in the Middle East opens the way for Chinese companies, which have good experience in the implementation of infrastructure projects. We mentioned several current projects: the second-stage construction of a high-speed railway from Ankara to Istanbul, Turkey; the light rail project in Mecca, Saudi Arabia; 72-km expansion of the Suez Canal, Egypt; and finally, new business hub Silk City (Madinat al-Hareer) in northern Kuwait, whose completion is expected by 2035.<sup>12</sup> Unlike Russia, the United States and developed European countries, which in addition to economic and political have geo-strategic interests in the Middle East, the Chinese approach, which is planned for a long time, is focused on economic cooperation and development. One can speak of a common approach in cooperation with other regions and countries, based on mutual benefits and development. Such Chinese policy has proved very successful in Africa.

If we looked at the geographical map of current and planned infrastructure projects initiated by China in cooperation with partner countries, it is easy to conclude that they are located on the main or related routes along the New Silk Road. In this way, China supports the construction of infrastructure networks, especially transport networks. We can mention several ones: the lease of Terminal 1 and 2 and part of Terminal 3 of Piraeus Port by Cosco Pacific Ltd. in 2009; construction of the bridge Zemun-Borča on the Danube river; planned construction of another bridge across the Danube river near Vinča; the high-speed railway Belgrade-Budapest; ongoing construction of the highway Bar-Boljare in Montenegro, as well as a number of investment in the energy sector of the Western Balkans. In addition, Chinese companies are also interested in leasing the Thessaloniki Port, the Port of Igoumenitsa, and the state railways of Greece.

### **SUSTAINABILITY OF THE NEW GROWTH MODEL OF CHINESE ECONOMY**

Let us start this section with the following dramatic statement: “China is in big trouble. We are not talking about some minor setback along the way, but something more fundamental. The country's whole way of doing business, the economic system that has driven three decades of incredible growth, has reached its limits.” (Krugman, 2013) Is that entirely true? The slowdown in the growth dynamics of

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<sup>12</sup> Referred to: <http://www.globaltimes.cn/content/964439.shtml>, Accessed January 20, 2016.

the Chinese economy during 2015, continued decline in crude oil prices, and the adjustment of the renminbi yuan exchange rate are factors that certainly contributed to the low level of growth dynamics of the world economy.

The fact is that China has reached two Lewis turning points in 2004 and in 2010.<sup>13</sup> Functional mechanism is as follows: “As a result of aging population, the working population stopped its growth and the dependence ratio no longer decreases; eventually, the demographic dividend will cease to exist. Labor shortage, diminishing return on capital and a decline in the savings rate will lead to a slowdown in economic growth.” (Cai & Lu, 2013, p. 2) The demographic dividend as a source of economic growth is exhausted.

In the current debate about the sustainability of China’s growth model, it is useful to recall that the Chinese State Council in September 2011 announced the change of the growth model. (Antevski, 2013a) In short, a new model of economic growth is conceived as a complex and comprehensive, so that it would not be based only on investment and exports, but rather on consumption, investment and exports. Although the potential growth rate is determined by supply-side factors, it now includes both supply-side factors and demand-side factors. “Demand-side factors, although unrelated to the potential growth rate, can help to make economic growth more sustainable and the macro economy more balanced.” (Cai, 2015, p. 18) Encouraging the growth of domestic demand, especially consumer demand can bring significant economic and social benefits. In addition, significant progress has been made in improving the business climate, as well as the more liberal participation of private capital in the services sector. “Recent growing investment and participation of private firms in financial and banking activities show positive signs of financial resource allocation.” (Chu & Song, 2015, p. 72)

If the Chinese investment abroad and exports are seen as foreign demand, and the growth of investment and exports are seen as growth in overall demand, one can expect its positive impact on the pace of economic growth. Previously mentioned Chinese investment abroad, which link the export of goods and services, as well as internal reforms underway, should enable the viability of a new growth model. Finally, if we compare the forecast growth rate of China’s GDP in 2016 from 6.5% to 6.9% with growth rates of leading industrial countries, then we can talk about stabilizing the dynamics of growth at a sustainable level.

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<sup>13</sup> William Arthur Lewis, 1915–1991, British and American economist, Nobel laureate in economics in 1979. In his most important paper from 1954, *Economic Development with Unlimited Supplies of Labor*, Lewis has developed the model of a dual sector, or Lewis model. The essence of his model is as follows: the growth of the industrial sector is based on the unlimited labor supply from non-industrial sectors (rural), which provides, in the early stages of development and for a longer period: first, keeping wages and household consumption at a very low level; and secondly, the high returns, reinvestment of profits and further employment growth. The result is, in a certain period of time, high rates of economic growth and economic development.

## CONCLUSION

Comparing the United States' two initiatives and the Chinese response – the New Silk Road, for us the second is more convincing. One of the more important reasons is that it is a long-term strategy of development for the whole region, and not only one more trade agreement. Supporting argument for the expected success of the New Silk Road in a long run is that it serves the interests of the region and countries that are going to be involved in the realization of that huge project. We should bear in mind that there is a sufficient degree of matching between development needs and resources of the countries in Eurasia. If we consider the fact that even though the most of the involved countries have a parliamentary democratic system, they are largely centrally controlled countries, so we can conclude that it will speed up the realization of this huge project.

The Chinese approach is focused on mutual economic benefits of the whole region, economic cooperation and development. One can speak of a common approach in cooperation with other regions and countries, based on mutual benefits and development. Unlike the United States, which has commercial and geo-strategic approach to cooperation in the Pacific, Chinese approach is broader because it includes part of the Pacific Region and Eurasia, and has developmental and a long-term character. In addition to extensive experience in the implementation of infrastructure projects in the country, domestic equipment, qualified experts, know-how, and large financial support of Chinese development banks, China has a number of already implemented and contracted infrastructure projects in Eurasia. That kind of experience is a big plus. Developments of infrastructure networks have proven to have stimulating effect on the trade growth and growth of related production and overall economic activity.

The implementation of this project will result in lowering transport costs, which will greatly contribute to raising the competitiveness of products of countries through which the New Silk Road going through. In addition to the great potential of the New Silk Road and related projects, if it comes to finalization it going to reduce the significance of US dollar dominance in the world, because China and Russia will make calculation of mutual transactions in national currencies.

Although one should not have illusions about the global ambitions of China and Russia, it should be recognized that the Chinese approach to economic and political cooperation is now well accepted in many countries along the New Silk Road. Because of common interests and the activities with mutual benefits, we believe that the Chinese response will encounter a good support in many countries and will be successful.

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Miroslav ANTEVSKI  
Sanja JELISAVAC TROŠIĆ

### **KINESKI ODGOVOR NA TRANSATLANTSKO TRGOVINSKO I INVESTICIONO PARTNERSTVO I TRANSPACIFIČKO PARTNERSTVO**

*Apstrakt:* U poslednjih nekoliko decenija bilo je velikih promena na međunarodnom planu. Mi ovde želimo da istaknemo dinamičan privredni rast Kine i ponovo jačanje ruskog uticaja u međunarodnim odnosima. Te promene ugrožavaju poziciju SAD kao jedine svetske sile. Iako je Evropska unija najuspešnija i najveća ekonomska integracija u svetu, ona u političkom uticaju zaostaje za SAD-om. SAD su prepoznale ubrzani rast kineske privrede kao glavnu pretnju svojoj dominaciji u svetu i pokušavaju da ograniče širenje kineskog uticaja. Između ostalih poteza SAD vode trgovinske pregovore koji će, ako budu uspešni, ovuhvatati dve velike regije u svetu Atlantsku i Pacifičku regiju. U toku je niz trgovinskih pregovora, uglavnom u tajnosti, između EU i SAD u cilju formiranja bilateralnog trgovinskog sporazuma - Transatlantsko trgovinsko i investiciono partnerstvo (TTIP). Sa druge strane SAD završavaju pregovore o Trans-pacifičkom partnerstvu (TPP), sporazumu o trgovini sa 11 zemalja na Pacifiku. Ono što je indikativno je da je Kina isključena iz ovih pregovora. Kineski odgovor na ove poteze SAD na međunarodnom planu je kompleksan. Kina se fokusira na nekoliko pravaca i nivoa, kao i u izgradnji veza sa drugim privredama u razvoju. Ono što je važno istaći je da su kineski projekti finansijski veoma dobro zasnovani. Najznačajniji i najveći projekat je oživljavanje puta svile. Novi put svile treba da podstakne evroazijsku ekonomiju, uključuje velike bilateralne investicione aranžmane, kao i značajnu ekspanziju investicija. U ovom radu ćemo predstaviti argumente koji ukazuju da bi kineski odgovor mogao biti uspešan.

*Cljučne reči:* Kina, SAD, Rusija, trgovina, energetika, novi put svile, TTIP, TPP.

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## THE NEW SILK ROAD AND RUSSIAN INTERESTS IN CENTRAL ASIA

Nataša STANOJEVIĆ<sup>1</sup>

*Abstract:* The main research topic is the impact of the Chinese New Silk Road project on the Russian interests in one of the zones of its strongest traditional influence – Central Asian countries. The first part analyses the main benefits of this giant project for China, such as keeping the high growth rate by new investments, increasing export, stable and diversified energy supply and additional internationalization of its currency. The second part studies the position of one by one Central Asian country spreading between China and Russia. Here the statistics are given about the international trade of these countries with Russia and China during the last 15 years. In the same part of the research data about volume, direction and gains from Russian and Chinese investments into Central Asian countries are analysed and compared. This analysis clearly shows a decline of Russian influence in Central Asian countries caused by much greater benefit of China as a partner. The third part explores the reasons for the absence of Russian resistance to the project. Besides plenty of Chinese concessions to Russia, large investments, advantages in AIIB, favourable long-term gas deals, probably a more important reason for Russian approval of the Silk Road is its geopolitical position. After the crisis in the Russian relations with the EU, China has become its most reliable partner in all terms. Also, both countries are aware of a much higher priority of common goals: raising BRICS to the position of a globally important subject and keeping the region out of reach of the third parties.

*Key words:* The Silk Road, China, Central Asia, Russia, energy network.

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## INTRODUCTION

The original Silk Road, one of the most frequent trade routes of the ancient world, began to develop during the westward expansion of China's Han Dynasty (206 BC–220 AD). Valuable Chinese silk, porcelain, spices and other goods were transported to Europe, while China received gold and other precious metals, glass and other products from the west. Those routes eventually extended over four thousand miles to Europe, with the longest part of these trade networks passing through the Central Asian region. "Central Asia was thus the epicentre of one of the first waves of globalization, connecting eastern and western markets, spurring immense wealth, and intermixing cultural and religious traditions." (McBride, 2015).

An impressive economic rise of China in the late 20th and early 21st century, mostly based on export, renewed the need for transport routes to the west. In 2013, the New Silk Road concept was first presented in public by the president of China, Xi Jinping. It is a network of infrastructural connections (railway, including high-speed railway, roads, and oil and gas pipelines) between China and Europe, as one of the most important Chinese economic partners.

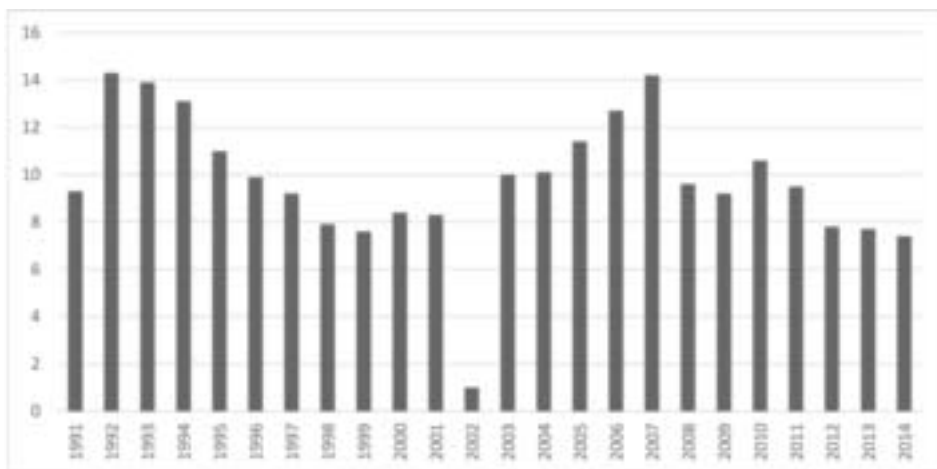
As in the past, an inevitable part of the New Silk Road will pass through the countries of Central Asia. Today these are the states of Kazakhstan, Uzbekistan, Tajikistan, Kyrgyzstan and Turkmenistan. New roads, pipelines and railways, by default, have very positive implications for the development of all included economies - by increasing international trade, engaging the workforce, earning profits of invested capital, etc. Thus, significant benefits will be certainly realized from the New Silk Road by China, Europe, the countries of Central Asia and other countries through which the road passes...except Russia! Despite the fact that one part of the Silk Road was planned to pass through Moscow, Russia is the only country whose economic benefits of this project are likely to be smaller than the harm to its economic, political and security position and influence.

## THE MAIN FEATURES OF THE NEW SILK ROAD AND ITS BENEFITS FOR CHINA

The Chinese rise, similar to other East Asian economies, is strongly based on exports and investment. Exports are often considered the "engines of growth", and are usually seen in conjunction with the investment, because these two mechanisms have enough power to pull the whole economy forward and in addition to provide spillover benefits to the rest of the economy. For China, this economic growth was extraordinary, around 10% during almost three decades (Graph 1).



Graph 1. The growth of Chinese economy 1991-2014



Source: Author according to World Bank data

China still has one of the fastest economic growth rates, but the period of 10% growth per year is probably over. It started to slow down after 2010. In 2013, China's GDP growth was 7.7%, in 2014, 7.4% (Graph 1), and, according to the World Bank report from September 2015, GDP growth continued to slow to 7% (WB Group, 2015, p. 3).

One of the most important sources of slowing down growth in China is the downswing in fixed investment (Magnus, 2012, p.4). As it has been mentioned, the investments are one of the most powerful engines of economic growth, with an especially important role in East Asian countries. Many times, for example, Japan has succeeded in boosting its slow growth with large investment, mainly in giant infrastructure projects. The strong link between investment and economic growth, especially in Asia is indisputable (Rodrik, 2015, 323.7).

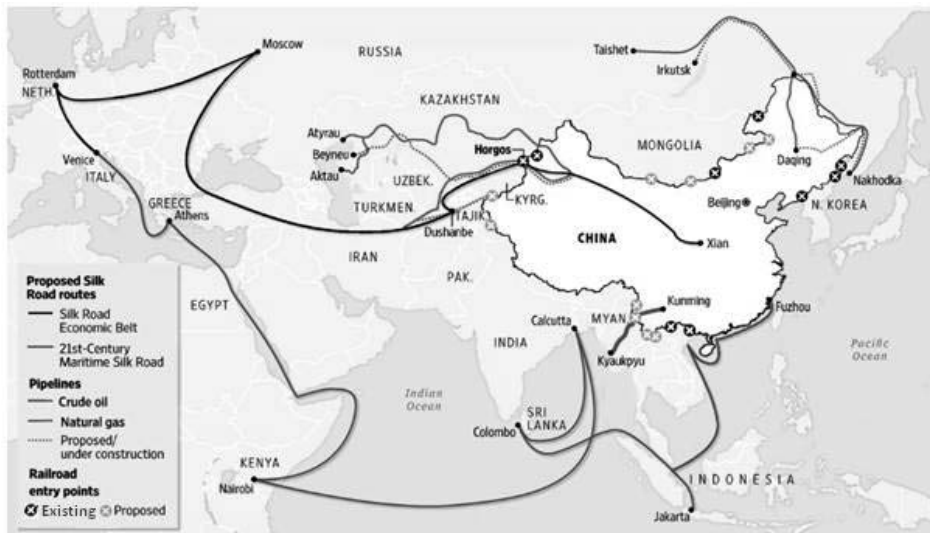
The other, not less important reason of growth rate decline is that manufacturing, the main initiator of Chinese growth, has been slowing down for a few years with "exports and imports contracted in 2015, both falling by over 8 percent from a year earlier" (WB Group, 2015, p. 3).

The project of the New Silk Road could be an efficient means of keeping a relatively high growth of the Chinese economy. It could provide a new dimension to the same mechanism which has already raised it – *investments* and *exports*. Apart from that, the important benefits for China involve stable energy supply.

The China's New Silk Road strategy is conceived as a two separated projects. The first is the overland infrastructure development through Central Asia, named the "Silk Road Economic Belt". It has the Central Route, which is intended to

cross the Caspian Sea through the ports of Aktau and Baku and then continue to Turkey through Azerbaijan and Georgia, while the Southern Route will go through Turkmenistan and then on to Iran. The second refers to the expansion of maritime shipping routes through the Indian Ocean and the Persian Gulf - the “Maritime Silk Road” (Map 1).

Map 1. The New Silk Road



Source: In Focus - <http://infocusrevue.com/2015/01/31/chinas-new-silk-road-strategy>

Both projects imply huge investments. For the implementation of the New Silk Road, Beijing has established a fund of 40 billion USD. Also, the Asian Infrastructure Investment Bank (AIIB), which was founded in 2014 by China, with 37 regional and 20 non-regional Prospective Founding Members (including all the states lying on the routes of the New Silk Road), will provide an additional 100 billion USD for financing this giant infrastructure venture. China’s domestic industries, with excess capacity in building machine, steel and cement, will be able to access new markets.

The Silk Road will contribute to an increase of Chinese exports in two ways. First, the new land routes, with new arrangements with the countries to which routes lead, will enable China to conquer new export markets and maintain or expand the existing ones. Also, the Silk Road will significantly accelerate, as well as reduce the cost of delivery of Chinese goods to Europe across Central Asia, and the countries in the maritime route, which will have a positive impact on increasing exports of Chinese goods.

In addition to the benefits from the increased investments and exports, the New Silk Road will ensure more certainty in energy supply to China. Like all countries dependable on energy import, China makes serious efforts to diversify its import markets. China is heavily reliant on Middle Eastern oil imports, but Central Asia provides to China more security, because this is politically a more stable region. In addition, energy can be imported directly overland from a friendly country.

Above all, the New Silk Road will promote renminbi (RMB – Chinese currency) internationalisation. As an important step on its path of development, in 2010 China announced the strategy of internationalization of its currency, and from that year until the end of 2014, the RMB rose from the 35th to the 5th place of the most traded currencies in the world (SWIFT, 2015). Since both the BRIKS Bank and the AIIB have a provision for lending in RMB, this will highly contribute to renminbi internationalization. In a similar way, the IMF and World Bank contributed to the internationalization of dollar.

Therefore, China has plenty of reasons to invest in Central Asians infrastructure, which would make the easiest and a cheaper link to European markets and, at the same time, give China an increased access to the region's markets and rich natural resources.

### **CENTRAL ASIA BETWEEN RUSSIA AND CHINA**

Despite possessing great economic potential and vast natural resources, Central Asia remains one of the least integrated regions in the global economy. After several decades of joint functioning in the USSR, the economies of newly independent republics became completely interdependent, complementary and closely intertwined. Most Central Asian states were specialized in a production of just a few sorts of goods, while the rest of the necessary products and services were provided by highly-centralized distribution. As the disintegration of the Soviet economy did not change the structure or other important characteristics of economies of member states, most of them remained heavily dependent. Therefore, many of them were forced to stay in some forms of mutual economic, and security cooperation and strong dependence on Russian Federation (Stanojević, 2014, p. 229).

The great Chinese investment and planned initiatives under the New Silk Road project gradually integrate this region with China and decrease its dependence on Russia. Russia's influence and the mentioned Soviet legacy are declining in some areas (particularly economic) and giving a chance to Central Asian states for the expansion of the infrastructure and the development of relations with new partners involved in the region.

The New Silk Road can promote economic growth throughout the region on the same bases as the growth of the Chinese economy: investment and trade. This means the integration of Central Asia into the world economy by high (Chinese) investment, especially in infrastructure, and second, the increase of the trade volume, which is expected to be multiplied in all countries on the Silk Road.

Therefore, the benefits of this grandiose project are obvious for China, Central Asian countries, Middle East, Europe (which can be supplied with cheaper goods). The only country which can, and probably will have negative consequences of the construction of the New Silk Road is Russia.

Russia and China are strategic competitors in Central Asia, and it is believed that the Silk Road Economic Belt is a counterbalance or an alternative to the Russian integration projects in this region – The Eurasian Economic Union and The Customs Union. In the long run, China is likely to replace Russia as the dominant power in Central Asia's energy sector, causing the Kremlin to perceive another “encroachment” (Eder, 2014, p. 13). In some countries of the Central Asia, Russia has neither been the main investor, nor the most important trade partner for several years now. In other countries this has change happened more recently, but as data will show, Russian economic influence in this region is definitely undermined. The former Soviet republics of Central Asia are increasingly turning toward China for trade and investment.

In terms of international trade, China, gradually and methodically, has suppressed Russia as the region's most important trading partner. For energy producers in the region (Kazakhstan, Turkmenistan and Uzbekistan), China has become the major destination for their exports (primarily oil and gas), for countries that have no energy deposit, the main import partner. At the same time, the relative weight of Russia as a trading partner has continued to decline, and that will be demonstrated by the statistics for every particular country in the Central Asia.

Concerning Russian vs. Chinese investments in Central Asia, the situation is quite complex. In the Soviet times, Central Asia, as well as other regions of the Soviet Union received extraordinary investments from Russia in industry, energy, infrastructure and transportation. Almost all of the investments were targeted to connect the Soviet peripheries with Moscow and keep the Soviet economy growing.

Today, Central Asia is still heavily dependent on infrastructure developed during the Soviet times: all railways, roads and pipelines lead from and to Russia. Contemporary Russia, similar to Soviet Russia is “using investments as a tool to both support its own growth and also increase its power in the region” (Tarnea, 2013, p. 33). Particular Central Asian countries with valuable natural resources, such as Turkmenistan and Kazakhstan, achieve great benefits from large Russian investment.

However, the current Russian policy towards Central Asian states, as noted by Fedorenko (2013, p.15) “is not focused on new developments and investments in infrastructure; it is focused rather on securing the Soviet legacy,” which usually means just the maintenance of the existing infrastructure that connects these countries with Russia. The lack of new investments and excessive focus on rebuilding dominant position in the region opened the way for China to suppress the Russian position in Central Asia. In all five states of Central Asia, dependence on Chinese investment involvement becomes more apparent (Brown, Hall, 2014). China National Petroleum Corporation (CNPC), China’s largest oil and gas producer and supplier, and a globally reputed contractor in engineering construction, is highly involved in building or reconstructing roads all over Central Asia. This results in the big reorientation of transport flow from north to east (Horak, 2014, p. 274).

By analysing the changes in:

- value of trade between every country of Central Asia and Russia and China,
- volume and gain of Central Asian countries from Russian and Chinese investment,
- we shall get the real picture of the consequences of rising Chinese influence on Russian strategic interests in this region.

### **Kazakhstan**

Kazakhstan is the key country in the Chinese Silk road project. It is very rich in natural resources, and the whole of its economy is based on them. After the reform of Kazakhstans`oil sector, which was carried out mostly with foreign investments, the percentage of oil export in the total export increased to 60%. (Stanojevic, Jovancai, 2015, p. 297).

As this country is located on the transit route of the pipeline, it traditionally exports oil to the Russian Federation (Stanojevic, 2014, p. 230). However, in 2008 China became the main export partner for Kazakhstan with 7.68 billion USD, since export to Russia was 6.22 billion USD and that trend has continued since today (Table 1). In 2010 Kazakhstan’s export to China was three times bigger than export to Russia.

Russia remained the main import partner, with 41% of total Kazakhstan`s import (Trading economics, 2014). The structure of Kazakhstan`s import from Russia involves mineral products (over one third), machinery, equipment and transport vehicles, chemical products and rubber (Stanojevic, 2014, p. 230). China surpassed Russia as Kazakhstan’s biggest trading partner (export and import) in 2010 and 2012 (Table 1).

Table 1. Kazakhstan trade with Russia and China (billion USD)

Period	Export to Russia	Export to China	Import from Russia	Import from China
2000	1.71	0.67	2.34	0.15
2002	1.50	1.02	2.55	0.31
2004	2.84	1.97	4.81	0.76
2006	3.73	3.59	9.06	1.92
2008	6.22	7.68	13.75	4.57
2010	3.01	10.12	5.47	3.96
2012	6.75	16.48	17.11	7.50
2013	5.88	14.37	17.97	8.36
2014	5.18	9.82	13.73	7.37

Source: Author according UN COMTRADE - <http://comtrade.un.org/>

Among the Central Asian states Kazakhstan is the most impressive example of Chinese penetration by means of investments. As in the other countries of former USSR, Russia has until recently been the most important investor. The main sectors are oil and gas, with almost a third of total investment (Stanojevic, 2014, p. 233).

Chinese economy, characterized by a shortage of energy, started to invest in Kazakhstan's energy sector in 1997, long before Silk Road project, when China and Kazakhstan signed a pact forming the Sino-Kazakh Oil Pipeline Co. This joint venture had, as its stated goal, a pipeline running from the Caspian Sea to Xinjiang. An initial investment was 700 million USD for the 962 km section of the pipeline, and it first started pumping 10 million tons of oil per year in May 2005 (Fishelson, 2007). The capacity of Kazakhstan-China oil pipeline increased in 2012 to 14 million tons of oil per year.

In October 2005, the state-owned Chinese National Petroleum Company (CNPC) purchased the Canadian-based PetroKazakhstan Inc (4.2 billion USD worth deal). In September 2013, President Xi Jinping, signed an additional 15 billion USD oil deal, for investment in a new gas pipeline to run from the southwest to the southeast and start working from 2015 (Brown, Hall, 2014).

Except investment in the energy sector, Kazakhstan's infrastructure will have great benefits of China's investment, because this is one of the territories for a future high-speed rail bridge between China and Europe. Kazakhstan also plays an important role because as many as three of the planned Silk Road routes pass through the country (Map 2).

Map 2. The New Silk Road routes through Kazakhstan



Source: AAPAC Group - <http://www.aapacgroup.com/china-kazakhstan-second-rail-link.html>

Over and above, China provided \$10 billion in loans to Kazakhstan in 2009, including a \$5 billion loan to KazMunaiGas, Kazakhstan's national oil and gas company (Fedorenko, 2013, p.13).

### **Turkmenistan**

Turkmenistan was the poorest country of the former Soviet Union. It possesses certain oil and gas reserves, while other natural resources of this country are coal, magnesium and sulphates. The role of Turkmenistan in Soviet economy was supplying other republics with raw materials like natural gas, oil and cotton (Stanojevic, Jovancai, 2015, p.298). The focus on these raw materials left other economy branches undeveloped, so that the economy strongly depends on the import of food and other consumer goods. More than 40% of the workforce is involved in agriculture, but this does not satisfy the domestic demand, because it is focused on cotton production. Turkmenistan is one of the greatest world exporters of cotton fibres, and together with oil and gas, it represents the whole product range of this country.

As in other Central Asian countries, at the beginning of the XXI century China was not an important trade partner of Turkmenistan. The volume of their trade was symbolic. Export of Turkmenistan to Russia slowly decreased over the years or remained at the similar level, while export to China increased rapidly in 2010.

In only one year export increased from 38 to 1044 million USD, then to 4693 million USD in 2011, 8763 million in 2012, and it continued to grow (Table 2).

Table 2. Turkmenistan trade with Russia and China (million USD)

Period	Export to Russia	Export to China	Import from Russia	Import from China
2000	472.78	4.06	130.00	12.10
2008	100.29	28.44	808.93	801.94
2009	45.06	38.49	999.00	915.70
2010	148.02	1044.52	717.54	525.12
2011	142.58	4693.14	1116.90	784.36
2012	183.76	8763.38	1210.64	1699.12
2013	139.42	8893.26	1429.90	1137.64
2014	45.69	9516.16	368.16	954.28

Source: Author according UN COMTRADE - <http://comtrade.un.org/>

Export of Turkmenistan to China has obviously multiplied since the pipeline that transports Turkmen gas to China via Uzbekistan and Kazakhstan came into use (Map 3). The gas pipeline that transports Turkmen gas to China via Uzbekistan and Kazakhstan is one of the most important energy deals between Central Asia and China. It was built with the investment of CNPC running from the second largest gas field in the world and its length is 1830 km.

Before this Chinese investment, owing to the lack of other export infrastructure, almost all gas from Turkmenistan had been exported via Russia's (Gazprom's) pipeline network for years (Stanojevic, 2014, p. 232). Russia didn't have interest to invest in the energy infrastructure of Turkmenistan, given that Gazprom was earning great intermediary profits only by the periodic renewal of the existing infrastructure.

China demonstrated completely opposite approach to this country. In addition to large investments, China provided Turkmenistan with generous loans. In 2009, it provided about 4 billion USD to develop its Yolotan-South Osman gas field.

Probably all Chinese activity in this country was the main source of the extremely high growth rate of Turkmenistan, which amounted to 9.2% in 2010 (World Bank). Since 2010 Turkmenistan has had a growth more rapid than in other former Soviet republics, and in return, economic growth has increased



export potentials of this country (Stanojevic, Jovancai 2015, p 298.). Thus, it is understandable that Turkmenistan has been strongly drawn into China's sphere of influence.

### Uzbekistan

Until recently, Russia has been the main trade partner of Uzbekistan with about 30% of the total foreign trade. Russia exports to Uzbekistan machinery, equipment and vehicles, metal products, wood and pulp and paper, while food products and agricultural raw materials, textile products and footwear dominate Russian imports from Uzbekistan. Russia and Uzbekistan also have a large number of joint projects in vital economic areas. Investments of Russia were mostly (about 60%) directed to the oil sector (Stanojevic, 2014, p. 233).

In 2000 export to China was only 12 million USD, while export to Russia was fifty times bigger, around 663 million USD (Table 3). Over the years, the situation gradually changed in favour of China as a trading partner, but there were not any dramatic changes until 2010, when there was a sudden jump of trade with China. Export nearly quadrupled compared with 2008, and import was three times bigger than in 2008 (Table 3). Export to China exceeded export to Russia in 2013, and import in 2014 (Table 3).

Table 3. Uzbekistan trade with Russia and China (million USD)

Period	Export to Russia	Export to China	Import from Russia	Import from China
2000	663.40	12.03	274.42	39.43
2002	344.17	27.40	453.42	104.37
2004	613.35	403.07	766.63	172.44
2006	1290.42	565.94	1086.96	406.15
2008	1298.01	328.88	2066.91	1277.81
2010	1513.47	1300.78	1663.52	1181.02
2012	1390.90	1091.83	2324.71	1783.34
2013	1256.88	1938.09	2803.91	2613.36
2014	843.03	1597.73	1888.91	2678.26

Source: Author according UN COMTRADE - <http://comtrade.un.org/>

There is a striking coincidence that the increase of Uzbekistan's export to China happened in the same year as export of Turkmenistan. The cause is probably the same - the mentioned pipeline from Turkmenistan to China via Uzbekistan and Kazakhstan, which came into use in December 2009.

The additional increase of export to China from the three countries on the route is expected in 2015.

Map 3. Silk Road from Central Asia



Source: [www.rfa.org/english/commentaries/energy\\_watch/gas-12052011115914.html](http://www.rfa.org/english/commentaries/energy_watch/gas-12052011115914.html)

### **Kyrgyzstan**

The economy of Kyrgyzstan is not economically self-sustaining; it depends on Russia, China and the Central Asian neighbours. Export to Russia and China has slightly changed over the years. In Kyrgyzstan there has not been a spectacular export increase to China as in the other countries in the region. Actually, it is still lower than exports to Russia (Table 4). The main reason lies in the fact that Tajikistan has nothing to export to China, it has no energy deposits and it is not located on the road between China and the countries that export oil and gas.

But, the import from China increased enormously, more than in the any other country in the Central Asia, and it is four times bigger than import from Russia, of which it is import-dependent in terms of energy (Table 4).

Table 4. Kyrgyzstan trade with Russia and China

Period	Export to Russia	Export to China	Import from Russia	Import from China
2000	88.64	67.44	102.92	110.17
2008	491.46	121.33	1310.96	9212.05
2012	195.74	89.02	1634.06	5073.52
2013	110.13	62.35	2029.44	5075.35
2014	87.60	55.35	1743.96	5242.70

Source: Author according UN COMTRADE - <http://comtrade.un.org/>

The issue here is actually about the re-export. One of the major sources of income of this country comes from the export of Chinese products to other countries of Central Asia, even to Russia. (Stanojevic, 2014, p. 231).

But China did not leave this country outside the Silk Road routes. In 2013, China approved the construction of a new railroad from China to Kyrgyzstan and Uzbekistan, the investment into railroads being 2 billion USD.

In September 2013, China signed inter-governmental agreements with Uzbekistan, Tajikistan and Kyrgyzstan respectively on Line D of gas pipeline from Turkmenistan (Map 3). This means that not one Central Asian country is left out of energy networks of the New Silk Road. The construction of Kyrgyzstan's section of Turkmenistan-China gas pipeline will start in 2016 and will be completed in three years. Kyrgyzstan is expected to earn \$80 million annually from the transit of Turkmen gas to China.

Also, in September 2015 a joint Kyrgyzstan and China Cooperation Program for the years 2015-2025 was signed, which promises multiple investment and construction projects.

### Tajikistan

Tajikistan is one of the poorest countries in the world, with a very low degree of self-sufficiency. One of the unsolvable obstacles is the fact that only 7% of the land is arable, so this country is forced to import food. Apart from that, within the Soviet Union, this area specialized in the supply of raw materials for the textile industry because its most important produce was cotton. That developed almost no other productive activities, so that Tajikistan is forced to large import. (Stanojevic, 2014, p. 231).

Russia has long been a major import and export partner. Tajik imports from China were symbolic at the beginning of 2000, less than 7 million USD. It started

growing slowly in 2007, and then almost tripled in 2008 to 1500 million USD (Table 5). China is currently Tajikistan's second export partner after Turkey and the first import partner. Bilateral trade exceeded 2.5 billion USD in 2014.

Table 5. Tajikistan trade with Russia and China (million USD)

Period	Export to Russia	Export to China	Import from Russia	Import from China
2000	237.32	10.38	55.92	6.79
2006	126.03	18.00	377.43	305.78
2007	162.57	10.28	606.06	513.76
2008	210.45	20.24	793.94	1479.68
2012	67.70	108.83	678.83	1747.87
2013	37.88	88.75	724.36	1869.36
2014	34.61	47.70	703.54	2468.23

Source: Author according UN COMTRADE - <http://comtrade.un.org/>

CNPC signed two agreements with Tajikistan respectively on the construction and operation of the Tajikistan section of Line D of the mentioned Central Asia-China Gas Pipeline.

Tajikistan was connected internally with China by road leading to the Tajik-Chinese border in the Pamir Mountains. This road is being improved on both sides of the border with the finance from the Chinese Silk Road fund. (Horak, 2014, p. 174).

## THE RUSSIAN RESPONSE

Many see the China's Silk Road Economic Belt initiative as an attempt to displace Russia out of the region, while Moscow is trying to promote its own integration project, the Eurasian Economic Union. It is widely believed that it is just a matter of time before clashes occur between the two integration projects (Eden, 2014, p. 12). However, Russia did not protest against China's rapid expansion into Central Asia. In 2015 Russian President Vladimir Putin gave the Silk Road his approval, practically showing acceptance of China's new dominant economic role in the region, and tried to achieve as many Russian interests as possible in the framework of the Chinese project.

*We are broadening our cooperation with the People's Republic of China in the interest of creating a common economic space. This May, we signed a joint statement on combining the development of the Eurasian Economic Union and the Silk Road Economic Belt. In essence, we are talking about new approaches to cooperation between the Eurasian Economic Union and China, about broadening cooperation and implementing major joint infrastructure projects, about simplifying trade, and strengthening cooperation through various financial instruments. (Putin, 2015).*

EEU was mandated by the presidents of Russia, Kazakhstan, Belarus and Armenia to start negotiations on a trade and investment agreement with China. This means not only a more genuine partnership between Moscow and Beijing, but China's arrival, with Russia's support, as a truly Eurasian power (Gabuev, 2015b).

The consent of Russia to a dominant position of China in Central Asia has complex causes, and indicates a carefully chosen strategy of both countries.

Firstly, after Russia's isolation from Europe since the crisis in Ukraine, China has remained the Russian main economic and political alternative.

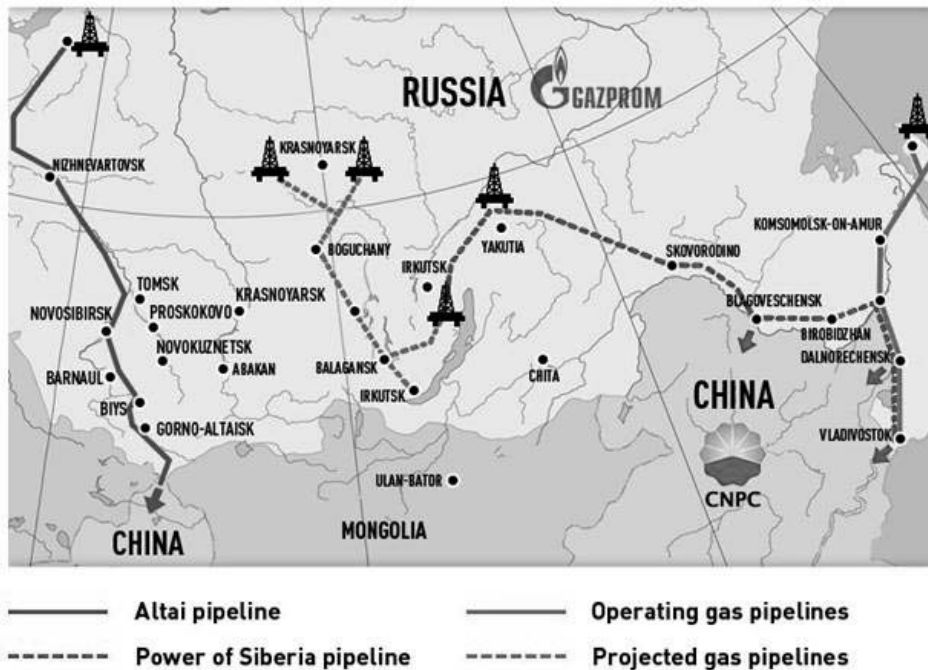
Secondly, even without the EU sanctions, China and Russia have shared more important, global objectives and a strategic partnership within the framework of BRICS. The internationalization of the yuan has already been mentioned, but that is not all. On the BRICS summit in 2012 a memorandum between the countries of the Group was signed, which provides that BRICS development bank may grant loans in national currencies, and that national currencies can be used in the trade between the members. Such arrangements are already of major importance for stimulating trade between the BRICS member states and increasing the role of their currencies in international financial transactions (Milenkovic, Spalovic, 2013, p. 41). This directly reduces the amount of US dollars circulating, which is one of the main levers of domination of the US economy (Milenkovic, Spalovic, 2013, p. 47).

For its part, China has made a significant effort to treat Russia as an essential element of the New Silk Road, instead of treating it as a competitor, with the aim of reducing Russia's resistance and counteraction of the project.

Thus, Russia achieved many important benefits:

- Russia got a privileged status in the ABII, as a representative from Asia, but at the same time Russia has its share of the vote and managerial positions as a representative from Europe;
- Long-term (30 years) 400 billion USD worth gas deal by eastern route – Siberian pipeline (38 billion cubic meters of gas per year), and additional deal of 30 bcm per year by western route - Altai (Map 4);
- Russia is one of the largest consumers of Chinese products, and a part of the route goes directly through the Russian capital;

Map 4. Russia-China gas pipelines



Source: Gazprom

- The main Russian integration project – EEU will be linked to the Silk Road project, and the advantages of that are probably higher than the risks, so this is certainly more useful than competing with it. China agreed to invest 5.8 billion USD to extend the Moscow-Kazan high speed railway in China (signed on May 8, 2015);
- What poses serious damage for Russia is an inevitable decrease of the importance of Trans-Siberian Railway. The New Silk Road will certainly undermine the chances of the Trans-Siberian Railway becoming the major land link between the markets of Europe and Asia. In order to reduce the damage, China met Russia and agreed to include the Russian Trans-Siberian railway network in the project. One of the key stretches of the new high-speed rail will follow the Trans-Siberian Railway with Moscow as a key node (Map 5).
- The Silk Road can help develop the Russian Far East (Hongzhou, 2015, p. 11);
- Negotiations between China and Russia about the establishment of a Free Trade Zone are in progress, what open new business opportunities for both countries.

Map 5. The Silk Road and Trans-Siberian railway



Source: Energy post - [www.energypost.eu/new-china-europe-connection-chinas-new-silk-road-strategy-will-change-face-world](http://www.energypost.eu/new-china-europe-connection-chinas-new-silk-road-strategy-will-change-face-world)

## CONCLUSIONS

The Silk Road is becoming one of the most important economic routes of the global economy again. It will enable China, as the main initiator and investor, to increase exports, place its sufficient capital, conquer new markets, internationalise its currency and provide additional security of energy supply. The countries of Central Asia that occupy a key position on the Silk Road already enjoy a number benefits from foreign investment, new infrastructure and new, large Chinese market.

However, the whole project of the Silk Road means deep Chinese penetration into the traditional Russian sphere of influence. China has already built substantial economic relations with all Central Asian nations. It is a major investor in Kazakhstan's oil industry and the biggest importer of gas from Turkmenistan. Today, more than one-fourth of China's crude oil and over half of its gas imports come from Central Asia.

China is gradually taking over the dominant position from Russia by offering better prices in energy deals and low-interest loans for the related infrastructure. As the trade statistics shows, all Central Asian countries with energy deposits export to China far more than to Russia. Kazakhstan and Uzbekistan export two times more, and Turkmenistan 200 times more to China than to Russia. In the

two countries without energy resources, import from China is on average three times bigger than import from Russia.

In general, Chinese plans in Central Asia do not formally interfere with Russia's plans for further formalized integration such as Eurasian Economic Union and Customs Union. China is trying to expand the New Silk Road through the integration with Russia and EEU, instead of competing with them. Thus, political, military and cultural aspects of Russian "space" are not threatened. But, according to this research, China's economic advantage in Central Asia is obviously achieved at Russia's expense, while Russia has not resisted.

Despite the economic competition in the Central Asian region, China and Russia carefully chose strategies and continue to build a strong relation based on mutual respect and compromise. China, as a compensation for taking advantage in the Russian interest zone, makes a plenty of concessions to Russia (large investments, advantages in AIIB, favourable long-term gas deals etc.). Russia does not have the means to resist China's progress, and strives to achieve its economic goals by keeping China as the most powerful partner.

Their common global goals, such as the rise of the BRICS to the position of a globally important subject and the weakening of American domination, have much higher priority than the tension over the dominance in a rather economically marginal region such as the Central Asia. Russia and China together are achieving the one very important common goal – keeping the region out of reach of any third parties.

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Nataša STANOJEVIĆ

### **NOVI PUT SVILE I RUSKI INTERESI U CENTRALNOJ AZIJI**

*Apstrakt:* Glavna tema istraživanja je uticaj kineskog projekta Novi put svile na ruske interese u jednoj od oblasti njenog tradicionalno naj snažnijeg uticaja – zemljama Centralne Azije. Prvi deo rada analizira najvažnije benefite koje će ovaj gigantski projekat doneti Kini, kao što su: održavanje stope privrednog rasta na relativno visokom nivou na osnovu novih investicija, povećanja izvoza, stabilnog i diverzifikovanog snabdevanja energentima i dodatni stimulans internacionalizaciji kineske valute. U drugom delu je iskazana rastrzanost pojedinačnih država Centralne Azije u odnosima prema Kini i Rusiji. Ovi odnosi su objašnjeni komparacijom statističkih podataka o spoljnoj trgovini, o obimu, pravcima i koristi koju države Centralne Azije imaju od ruskih i kineskih investicija. Analiza jasno pokazuje opadanje ruskog uticaja u zemljama Centralne Azije do čega dovode mnogo veće prednosti od Kine kao strateškog partnera. Treći deo objašnjava uzroke izostanka ruskog protivljenja realizaciji kineskog projekta Novi put svile. Pored obimnih koncesija koje je Kina dala Rusiji, velike prednosti koju je omogućila RF u AIIB, povoljnih dugoročnih gasnih sporazuma, verovatno najvažniji razlog za rusku podršku Putu svile je njen geopolitički položaj. Od krize u odnosima Rusije i Evropske unije, Kina je postala najvažniji i najsigurniji ruski partner u svakom pogledu. Pored toga, obe zemlje su svesne da mnogi od već ustanovljenih zajedničkih ciljeva imaju veći prioritet od uskih pojedinačnih interesa: uspon BRIKS-a na poziciju globalno važnog subjekta i očuvanje regiona Centralne Azije izvan domašaja trećih sila.

*Ključne reči:* Put svile, Kina, Centralna Azija, Rusija, energetska mreža.

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## **THE CHINA'S SHADOW BANKING: ISSUES AND POLICY RESEPNES**

Gongpil CHOI<sup>1</sup>

*Abstract:* The purported risks in the Chinese shadow banking are not properly assessed. Given the silver-lining in parts of the shadow banking in China, which fills the gap between the growing demand for better financial services and products, a particularly prudent and balanced policy efforts seem necessary. Unlike the popular belief that stronger regulatory efforts are necessary to stem the negative spillovers of regulatory arbitrage, policy efforts need to concentrate on controlling specific vulnerabilities and fostering a forward-looking financial ecosystem. Better supervisory and regulatory efforts need to be combined with installing infrastructures to develop financial markets and to satisfy the growing needs for safe assets. (JEL E44, E50, E61, E62, E65, E66).

*Key words:* Shadow Banking, Regulatory Arbitrage, Supervision and Regulation.

### **INTRODUCTION**

The core issue of the China's shadow banking has deeper roots in the lack of asset choices in China. Despite the huge size of potential asset allocation needs, there are relatively few opportunities available, especially reliable and safe choices. In fact, shadow banking issues globally have close links with the lack of safe asset supply and inefficient allocation (Gourinchas and Jeanne, 2012; Moreira and Savov, 2014). And the supply of credit has been on the rise in various forms, notably in TSF (Total Social Finance) to ease the crunch generated by tightening grip on bank credit after the global financial crisis. While it has some cushioning effect, it only

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added to the rising gap between the growing allocation needs and the lack of legitimate opportunities, which has been the backdrop for fast growing shadow banking sector in China. In fact, the central authorities globally are printing money in response to the needs for financial stability largely as a stop gap measure for not being able to supply enough safe assets. The consequences appear as strengthened regulatory measures on the banking sector, which led to even bigger shadow banking globally that led to even more serious policy challenges going forward.

There have been lively discussions on shadow banking in China, largely in terms of strengthening regulatory and supervisory oversight to contain systemic risks (Zhang, 2013; Zhang and Chen, 2013). From the supply side, strengthening of the supervisory and regulatory system for banking makes sense since the global financial crisis has its roots in the lax supervision of core institutions. However, it is not so clear whether this approach would bring about financial stability in an integrated network environment because ultimate risk management needs to be carried out by markets, not by the authorities. Further, the growing demand for sophisticated asset allocation and various financial services can neither be met with overly regulated banking system nor with unregulated shadow banking system (Claessens et al. 2013; Pozsar et al. 2013; Pozsar, 2011). While containment of risks is important after the crisis, the crucial link for credit intermediation and supply, i.e, securitization and collateral intermediation of modern day finance, is broken with extensive ring-fencing efforts by authorities around the world (trend decline in velocity; Figure 1). Further, the intended policy efforts may easily backfire to precipitate unintended consequences via endogenously generating further opportunities of regulatory arbitrage. As such, the most controversial case related to the regulation of the extended financial system can be found in the Chinese shadow banking. Inherently, it is a challenging issue to oversee a dichotomized financial system with different backgrounds, especially when the banking sector is overly regulated and shadow banking is not even properly monitored. The China's shadow banking is a showcase for the authorities in other countries to think seriously their post-crisis engagement. For all these troubles, financial stability with greater access and choices for a large population remains a tricky agenda.

Even with remarkable economic achievements, China is still heavily bank dependent and financially underdeveloped. With weaker capital market and overly regulated banking sector, debt financing has become the rule of the game, especially when external global demand for the perpetual credit machine is waning. This is the background for the increased reliance on shadow banking in China (Table 1, 2). With tighter restrictions on traditional banking, there has been a relatively strong demand for services and products associated with shadow banking, especially those related with bond financing and trust companies' wealth management. In fact, shadow banking in China has been quite instrumental in bridging the financial gap between demand and supply of credit in a rapidly changing environment (Dang,

Wang, and Yao 2014; Arian, Ashcraft, and Cetorelli, 2013; Li, Hsu, and Qin, 2013). It partially performs quasi-capital market functioning in a manner that is different with securitized shadow banking in the U.S (Huang, Chang and Yang, 2012) (Table 3), which has been largely self-serving. The question is about the sustainability of shadow banking beyond its stopgap function.

For a while, this new form of banking seemed to work fine, but warning signs are beginning to appear: Ponzi-like WMPs (Wealth Management Products), increased debt burden across sectors, concentration of credit in certain bubble-prone sectors, and sporadic defaults are some of the recent incidents. It proves again that even the socially-motivated and economically-justified financing cannot replace market functioning on a sustainable basis. Above all, quasi-capital market functioning makes it more difficult to control systemic risks. Market participants become increasingly addicted to the lures of higher return that hinges on implicit bank involvement. Solid returns are crowded out with bogus guarantees that hinge on unsustainable projects with obscure accountability. When higher returns are channeled from distorted financial markets, the beneficial effect of shadow banking is bound to be questioned. Overall, shadow banking is largely a temporary phenomenon given increasingly sophisticated financial needs and the unavoidable prevailing limitations. And regulatory efforts to prevent it from outgrowing cannot replace the needs for well-developed, properly-regulated financial system. Despite all the bells and whistles, it is time to seriously engage in tackling shadow banking issues in China with a balanced perspective. The following chapters assess the overall situation in China, and summarize the diagnostics. It is followed by case studies on Korea to extract possible policy implications for China. Summary and conclusion with policy suggestions will be included in the final chapter.

## **DIAGNOSTICS**

In this chapter, routine analysis on the Chinese economy is followed by checks on potential vulnerabilities and its implications. The results, together with the policy lessons from the Korean experience in the following chapter, would help the authorities formulate future actions regarding shadow banking activities in China.

### **Caveats**

Currently, there are widespread concerns that Chinese financial market situation may cause a serious crisis or a financial bottleneck that would lead to a hard-landing of the economy. If anything like financial crisis should happen in China, it is likely to be preceded by warning signs among a set of common crisis factors: high leverage, asset price hike and a significant growth slowdown (Lu, Ting, and Zhi, 2013; Zhang, Chen, 2013). However, there are controversies over the right

measurement of credit in a highly regulated and narrowly defined financial system. For instance, domestic credit to GDP (DCG), changes in DCG, or 5-30 rule (leverage ratio rising sharply by 30% of GDP in a five year period) are often applied as measures to detect potential anomalies, if any. Even with some controversies, TSF (total social financing)-augmented DCG or TSF is suggested as a leading candidate for government policies in China and they indeed signal some warning signs (Figure 2, IMF 2014). This is hardly relevant since China is a different economy with a unique set of infrastructures and intricate governance structure.

Some caveats are in order. It seems that the macro approach to figure out the problem based on conventional indicators may not be enough in a different setting like China. The Chinese financial system is essentially not market-based but authority-controlled. In fact, this unique governance feature instills some confidence as well as concerns among analysts and investors because the authority-mitigated risk management practices are hard to evaluate *ex ante*, but it works. Given their cautious and gradual approach, the Chinese authority is making efforts to put a price mechanism in place. Basically, they allow partially functioning market environment without getting the banking sector explicitly involved. Banks operate behind, providing a necessary backup of implicit collateral without being explicitly tied with shadow banking operations. Accordingly, credit measures would provide only a limited picture and the usual risks associated with credit to GDP tell a partial story. It may involve other risks that cannot be measured or it could actually imply that the counter-cyclical nature of credit after the crisis can be quite beneficial. Given the conflicted role of the authority in applying policy measures for stability and growth, corner solutions *à la* Abenomics (i.e., first two arrows of monetary and fiscal expansion) may not be quite relevant in reality. In fact, the social financing could have helped ease the indicator problem, but we would never have a full picture with limited data access. By the same token, with capital account not fully open, interest rates cannot be liberalized and the pressure to seek higher yields can only be moderated with trust companies pampering wealth management products (WMP). To prevent large and sudden capital outflow from a growing arbitrage gap and to sustain growth dynamics, it is understandable that the authority allowed various WMPs to avoid drastic changes associated with the capital outflow (Figure 3). In short, some of the shadow banking activities can be regarded as a set of alternative policy backups.

Even though no exact risk measures are available, given the near-threshold level of systemic risks as evidenced by a heightened sense of risks among investors (Lu, Ting, and Zhi, 2013; Zhang & Chen, 2013), it is clear that the potential risks need to be monitored and controlled going forward. In recognition of complicated and tenuous transmission channels in China, policy measures need to be combined with other complementary non-market efforts to produce the desired outcome. And there are always extra needs for comprehensive monitoring during the deleveraging

process. Reining in rapidly expanding shadow banking without initiating drastic economic downturn would require even more careful and gradual rebalancing efforts by the authority. It would require some institutional reform efforts as well as macro-prudential adjustments whose combined effects on the economy are hard to assess but need to be monitored. As such, there are some caveats in monitoring financial development in China.

Specifically, besides data issues, there are on-going systemic changes in China. Above all, it should be clearly noted that basic pillars of shadow banking activities in China have recently shown signs of waning: land prices, which mainly served as collateral for credit creation by local SOEs, are now turning into developers' nightmare. Further, the potential growth slowdown is an unprecedented fundamental change in China, challenging the input-driven growth paradigm. Almost all factors of production that supported China's high growth, e.g., labor, capital, and productivity, show signs of moderation (Lu, Ting, & Zhi, 2013; Zhang & Chen, 2013; Figure 4) and put pressure on the existing growth paradigm. The QE related wage increase in a de-facto fixed exchange rate regime has eroded its competitiveness in terms of ULC (unit labor cost; Fig. 5). As a result, it remains to be seen whether the productivity growth engine would remain intact during the adjustment toward a more balanced growth paradigm. This implies serious risks of maintaining the collateral base for all kinds of shadow banking. In contrast to the favorable effects of shadow banking, which were observable against the backdrop of a high growth period, it is not certain whether the same buffering effect can be expected during the post-crisis adjustment period, when some of the fundamentals show a trend decline. Specifically, it is uncertain whether the shadow banking can adjust itself under the mounting pressure for reform and adjustment.

Further, given the importance of shadow banking during the transition, it remains to be seen whether the system itself becomes the source of instability as it continues to incur serious maturity mismatches. That is, shadow banking that has served as a conduit for funding investment projects of local governments could no longer be utilized in rebalancing efforts by providing more credit for consumption oriented activities. On the other hand, if the regulatory oversight is strengthened on WMPs, shadow banking may drastically recoil from the current role, causing a drastic curtailment of credit to consumption and asset allocation. Therefore, in addition to the usual checks pertaining to debt levels, asset price hike and growth slowdown, we need to examine other risk factors in the credit intermediation system that would only later show up in the balance sheets. Given that the current drive for structural reform involves significant changes, it still remains uncertain how much of these changes are related with shadow banking activities.

Overall, there are conflicting signs that Chinese shadow banking shows some stress. Since a significant part of recent economic activities is related with shadow banking, any changes related with it may also entail unexpected real changes. In

addition, conflicting signs show that there is a growing need to take precautionary measures, which would still remain difficult since markets, participants, and products all operate in a murky environment that would not allow easy assessment from the outside. Granted that this is the reality, the current policy stance that hinges on macro measures to control credit and stronger regulation of the banking sector would lead to an unexpected policy outcome. Policy efforts need to concentrate on checking for vulnerabilities.

With the inherent limitations, it is initially observed that serious risks are mostly attributed to exist in the less-regulated non-banking sector, such as trust, and guarantee companies. This bears resemblance to the Korean Trust runs in 1999 (Choi 2003). However, the main risks still stem from local governments, and property developers, which are increasingly debt dependent, yet not subject to usual market scrutiny like trust companies. As expected, according to National Audit Office, local government debt in China rose by 70% from 2010 to reach 17.9 trillion RMB in 2013, among which 40% matures in 2014, suggesting a potentially serious maturity mismatch associated with investments of local governments that increasingly rely on debt-financing. The so-called local government financing vehicles (LGFV) investments seem to be in trouble, even though they would remain solvent because of the expected support by the authority. As expected, when land sales began to decline, the reliance of LGFV on bond-financing was on the rise. In fact, these pressured groups began to resort to unconventional and innovative market measures to raise funds, which would create bigger problems later. The most visible entity, local government itself, has been involved in the credit creation process via shadow banking and its market exposure has been on the rise. As such, privileged and protected entities accumulating on greater exposures in the market are causes for concern. This trend again makes the implicit support of the authority even more difficult to continue.

Specifically, recognition of vulnerabilities is important to figure out possible impact of any changes in circumstances or policy measures. Given that China has an indigenous transmission channel of policy shocks, extrapolating macro variables would not be enough to figure out nonlinear market responses of crisis episodes. That is, when the common macro factors for financial crisis begin to emerge, we need to look at vulnerabilities more closely in favor of symptoms. Based on many studies on this topic (Zhang, 2013; Lu, Ting & Zhi 2013; Zhang, Chen, 2013), we can identify three major institutional weaknesses of the Chinese economy: (1) Moral hazard on the part of local government officials and SOEs who are accustomed to easy credit without accompanying accountability, including LGFVs (2) Various WMPs offered by trust companies (TC) remain the potential vulnerabilities in the financial sector (3) Dominant and unchallenged position of the authority as a risk manager can be a problem if situations call for a governance reform toward a more market-oriented, democratic economic system. With these features, however,



market-based checks and balances for systemic risk management in a tightly controlled, yet fragmented environment cannot be expected. Essentially, Chinese financial system comprises a large part of shadow banking that is uniquely run by LGFV, TC and the government tripartite structure. Balancing act requires these vulnerabilities be carefully controlled.

### **Chinese shadow banking**

For all its limits and problems, it is also important to recognize the positive spin on the Chinese shadow banking situation. Most notably, China's shadow banking utilizes internet and IT technique to deliver financial services in a new space of endogenous arbitrage opportunities. An e-commerce giant Alibaba (e.g., Ali-Pay) actually plays the role of modern day banking by taking advantage of current interest rate differential between the restricted bank rate and a more lucrative choice, using its own cash pool. In fact, it became a pseudo bank with less regulatory oversight. The endogenous advent of these new players can pose serious problems in protecting financial customers as they begin to recognize these products as lucrative opportunities with implicit government backup. The particularly worrisome situation is the link between LGFV and trust companies as they can channel massive, unchecked credit for longer-term investment with greater maturity mismatch and the potential for a huge asset bubble. Further, the practice of utilizing Union Pay as unofficial vehicle for capital outflow can be a source of even more serious problem, even with its implicit bearing on the RMB internalization driven by the Chinese authority. As such, excessive reliance on authority can actually backfire to result in uncontrollable situations. In fact, those financial pillars that are not subject to usual market scrutiny can foster and provide channels that would ultimately harm its position. Therefore, these key players (trust companies, LGFV) have a higher chance of turning into major vulnerabilities of the Chinese shadow banking.

The existing vulnerabilities that are related to institutional weaknesses can be summarized as three aspects: One is related to increased volatility because the increased reliance on capital market features of shadow banking (balloon effect) would entail even more serious risks that cannot be controlled without straddling over legitimate legal boundaries as shown in the Korean ITC crisis. Another issue that has close resemblance with the Korean ITC run in 1999 is a liquidity risk that could be propagated through the WMPs due to the fact that WMPs tend to attract short-term deposits to invest in longer term products with a maturity mismatch. When maturity transformation runs into trouble, it could have a major influence in short-term growth of the Chinese economy. The third feature associated with vulnerabilities is the over-reliance on policy measures to overcome the market instability, which would further interfere with private participation and smooth market functioning. Given this set of

vulnerabilities, even best policy efforts of the incumbents could turn into chronic financial repression and serious tail risks. (Fig. 6, 7)

The Chinese shadow banking is essentially the market-based byproduct of policy objectives. It is much more complex and involves many market players which remain insensitive. Further, unlike the case of Korea, the Chinese local government set up LGFVs to raise funds for the project via WMPs and trusts (Guilford, 2014). Shadow credit taken out by LGFVs has been a huge force driving up local government debt and it remains as one of key vulnerabilities. Overall, the Chinese case involves a more widespread application of shadow banking activities for various purposes, including the asset management needs that were observed in the Korean ITC case. While the Korean case is partly driven by the capital market development initiative by the authority via promoting asset management activities, the Chinese case involves the use of shadow banking for post-crisis rebalancing tool of local governments as well as asset management choices for the wealthy. Modern day shadow banking assumes a much bigger and complex role than its counterpart that existed in Korea in the 1990s (Fig. 8). As such, despite all the potential problems, it is undeniable that shadow banking has become an integral part of the Chinese economy, the source of funds for all kinds of companies who cannot get support from banks, and it cannot be just cut off without an alternative or a reform (Schuman, 2014). Therefore, the real difficulty with the Chinese shadow banking is its multifaceted features with both pros and cons, which makes it hard to apply uniform measures; the current regulatory setup cannot deliver effective responses in controlling the system to provide better services. In the future, new risks and regulatory challenges will emerge as the shadow banking landscape evolves, and the authorities will continue to support both the formal and shadow banking sectors by adopting relevant policies, regulations and financial infrastructure. Since existing infrastructures and governance may not be adequate to deal with changing financial landscape, it is important to maintain a balanced stance and measured steps to deal with the shadow banking issue.

## **LESSONS FROM THE ITC CRISIS IN KOREA**

Since the focus of future policy efforts lies in controlling risks associated with Ponzi-style market noise, it bears resemblance to the Korean case when the country experienced quasi-bank runs in 1999. Looking deeper into the Korean ITC crisis could provide some insights for the Chinese situation as the former essentially represents modern shadow banking issues and ex-post policy responses. Essentially, the modern day shadow banking started in Korea, where the first non-bank run took place in 1999 after the Asian crisis in 1997. Some of the features and responses in modern China bear similarities that were observed during the post-Korean experiences. A detailed account of what really happened before the ITC failure

would help shed light on potential repercussions in the Chinese shadow banking. In fact, China and Korea share some of the institutional features of underdeveloped capital market and the government supremacy.

In Korea, large cash pools were diverted to non-bank WMPs with an implicit government guarantee, which subsequently led to massive run and bailout by the authority. The so-called shadow banking activities via investment and trust companies (ITCs) satisfied the endogenous market demand of the post-crisis period for asset management needs as banks underwent serious bailout and reform. For instance, the Korean ITC debacle in 1999 demonstrates the limitations of government-initiated capital market development in controlling systemic risks. As always, lack of early recognition of risks due to interconnected governance will spell bigger trouble in the future. Warning signs can flash, but nothing can be done due to network-driven decision-making process that turns a blind eye to market evaluations. The following looks at the Korean ITC case in light of the aforementioned vulnerabilities of Chinese shadow banking. In short, what has happened in Korea bears some resemblance to the current Chinese situation in the sense that the authority deliberately tried to use nonbanks to ease the post-crisis adjustment burden via encouraging ITC products. Detailed account of how vulnerabilities were dealt with and how these ended up in a debacle that entailed government intervention can be found in the appendix. Simply, it underscores the importance of guarding against using nonbank tools, e.g. Chinese WMPs, to make up for the deficiencies of the existing system.

This is undoubtedly a rare incident where public money has been applied to bailing out non-bank ITCs, which has no explicit government guarantee. The heart of the matter is that the ITC's operating principle of managing investors' money and distributing the returns among investors without any guarantees has been compromised. The ITCs used implicit guarantee to increase their market share with some investors' implicit moral hazard incentives on public guarantees. The gap between the *de jure* principle applied to ITCs and the *de facto* "guarantee" promises of ITCs resulted in massive buildup of losses. There are still unresolved issues with the regulatory forbearance of ITCs' extra-ordinary practices. Excessive risk taking for higher profits has been the linchpin of ITCs in Korea. The ground for the authorities' intervention remains ambiguous, but the regulatory oversight was missing and ITCs implicitly engaged in using various guarantee schemes to step up their position in the market. It also turned out that fierce competition among ITCs prompted them to invest heavily in high-risk bonds and long-term bonds, which eventually led to massive loss. It should also be noted that the absence of "mark to market principle" allowed valuation of mixed bond funds at their face book value, forcing promised higher returns to investors, which subsequently led to fund runs and public money injection. With variable haircuts and robust dealer-broker support, this could have been prevented. At that time, the authority could not avoid being

held hostages to the situation even though they have no legal and institutional reason to step in. In one way or the other, the authority exercised discretion with the political support to use the non-banking institution outside the regulatory perimeter to prop up the dislocated retirees after the crisis. Finally, as a backdrop, the strong government initiative to ease the post-crisis panic and to engage in capital market development drive has been at play.

The Korean experiences clearly showed the possibility of non-banking risks propagate into the proprietary LOLR banking support. Even non-banking activities can enjoy public support with smart product and players that can avoid supervisory scrutiny for prompt corrective actions. First, it shows that banking regulation alone would not suffice to secure financial stability. It also underscores the importance of the banking sector as the ultimate bearer of the risks. Real economy's situation would influence CPs, whose importance cannot go unnoticed among ITC or wealth management industries. Second, the moral hazard issue needs a more careful scrutiny since it may involve a transfer of wealth from the poor to the rich when things get really bad. Large positions are artificially supported for fears of a systemic failure. And this type of moral hazard needs to be controlled *prima facie*. Third, trust companies are one of the key factors of multi-faceted shadow banking in China that serve various needs, while the Korean case can be singled out as ITC-specific asset management practices that hinge on unsafe and unchecked assets.

It also should be noted that the mechanism behind the Chinese trust companies' promise of higher return on their WMP seems different with that of the Korean case. First, one of the differences is that the Korean case involves "limited pool of clients (mostly involuntary retirees after the Asian financial crisis)" who sought higher yields on their savings with an implicit guarantee by the government. Given that there were shaky social safety nets in place, political concerns exercised discretionary decision to forgo regulatory concerns. Chinese case is different in that local governments and SOEs are deeply involved for their infrastructure investment projects. The target population is quite different between the two countries and the function of shadow banking has the dual purpose of serving investment drive as well as offering higher yields to the privileged. Second, trust companies in China mainly use public bonds to raise funds, while that of Korean case is the ITC holding on to higher yields of CPs even with a recognition that they are risky. The assets ITCs manage are mostly public bonds, while that of Korea consists of CPs issued by chaebols. While the Korean case more or less revolves around chaebols and ITCs as key players in direct financing, the Chinese case has more public and convoluted features as local governments remain key players with some sideshows with WMPs offered by trust companies. Third, the Chinese case involves elements of innovation, including the internet banking and securitization practices, while that of Korea is a classic case of moral hazard with the heavy use of less-regulated financial arena for partly political purposes. Alibaba could be a good case in point

that shows China's shadow banking has some social utility attached to it. Given that sizable linkage exists between shadow banking vehicles and banks, similar situations can evolve in China if vulnerability becomes reality. While shadow banking serves some critical functions that are not available in traditional banking, the accompanying contagion and spillover shocks in the non-banking area would spell even bigger trouble. Therefore, to better assess potential risks properly, it is important to evaluate the possible linkages that can be disrupted.

In a dramatic fashion, the Korea's past experiences show that shocks from shadow banking can easily disrupt the overall financial stability even with strong ex-post prudential regulation and supervisory guidelines. Despite stronger rhetoric, things would not improve until it gets really serious. As such, the real question for the Chinese authority is how to regulate the shadow banking before it gets out of hand with less damage to the banking sector and to the growth momentum. Overall, addressing problems at the root with a more careful and comprehensive approach is required. The suggested approach has dual aspects: tighter regulation of speculative activities and more liberalization and promotion of local and investment vehicles in the rural economies. Since the authority has fewer choices among the macro war chests, the current emphasis on regulatory reform is highly desirable as the positive role of private, market driven institutions become vital in an interconnected environment. Further, credit supply based on the public sector budget needs to be brought under the oversight of the financial authority.

## **POLICY IMPLICATIONS**

In this chapter, we explore ways to overcome the challenge of securing financial stability when one is not equipped with a full-fledged capital market support. The intended focus would be to strengthen the market discipline in the shadow banking without over-regulating as well as providing compensatory incentives for existing participants to deal with forward-looking transition. More fundamentally, the policy responses need to address the underlying causes for the growing role of shadow banking in the post-crisis episode. As discussed, what is happening in China requires comprehensive and careful evaluation of policy responses primarily because shadow banking performs financial services that are undeliverable with traditional banking. Shadow banking has exercised favorable cushioning effect on the economy in the aftermath of the global shock. Controlling systemic risks during the on-going deleveraging process remains the top policy priority and the balancing act is required lest the positive impacts are overshadowed by overkill or complacency.

In fact, we can claim that China's dichotomized financial system is the natural byproduct of an export-orient growth paradigm. The export-led growth paradigm dictates conditions that are less favorable to market development, i.e., financial repression. If that is the case, a balanced TSF seems a valid approach to the problem

and the increasing proportion of TSF among total credit implies compensatory policy efforts to enhance social stability. Essentially, the growing role of TSF within the credit supply signifies rebalancing efforts by the authority. Further, a relatively sanguine view on China is based on the fact that Chinese debt is mostly domestic. However, the beneficial effect has vanished recently and there is a need for extra rebalancing both on shadow and traditional banking. Despite the positive role they play in the post-crisis adjustment, the shadow banking issue poses de facto threat to the authority as they have little policy choice for controlling it going forward. The authority acknowledges the need to do something, but finds it hard as current market participants themselves operate in an environment in which they cannot properly assess risks.

As such, the shadow banking in the event of global financial crisis has served largely as a stop-gap measure, but regulatory and other efforts have become necessary going forward given its limited role as a quasi-capital market or securitized banking. The credit machine by local government and LGFVs will be more tightly controlled to avoid any drastic shock associated with an abrupt decline in credit supply. When the alternative growth engine cannot be identified, it is quite predictable that rebalancing easily derails the virtuous cycle. Therefore, the authority needs to separate out those that need tighter control and those that need further institutional building as well as more policy support. Especially, once the underlying causes of systemic risks are identified, it is important to disentangle various factors with caution.

It is predictable that previous high growth in China generated lots of pressure on the tightly regulated as well as the unregulated dichotomized financial system. Even though it is important to develop capital market in China, it would take time. On the other hand, premature efforts to develop capital markets can easily backfire. In fact, when pseudo capital markets are developed out of the needs of the real economy, e.g., LGFVs, problems can get much worse (Choi 2000). It is much better to get prepared ex-ante for the increased need for financial services that can only be delivered via the expanded capital market. This means gradual opening and liberalization. For this to happen, comprehensive regulatory and legal framework needs to be installed well before the required changes as well as the application of short-term stabilization measures. In this vein, current incentive schemes among market participants need to be improved to prepare for the changing environment. Specifically, securitization capacity and swap market facilities with prime broker-dealers need to be further developed in the region to mitigate the growing financial gap that remains unabated and only adds to the already huge pressures within the current IMS.

Also, even though overall structural reform is emphasized, we need to check how this reform drive on SOE and local governments are accepted. Shadow banking that leads to the increase in local government debt should be monitored

closely and some remedial measures need to be in place because those remain the weakest link in the prevailing banking system. Finally, the dominant power of the authority itself needs to be held in check if the financial markets need to flourish. Even with best policy efforts after the Daewoo debacle, the capital market is still reeling from the devastation after the shock. In short, attacking vulnerabilities is more important than controlling the macro measures, and the following provides possible choices to overcome vulnerabilities.

### **Local Financial Network and CRA**

The Chinese authority needs to build a local financial network while encouraging banks to expand their role in terms of social responsibility (CRA: Community Reinvestment Act). This measured and moderated response to shadow banking would be time-consistent and comprehensive measures for the majority of the population. Through conscientious efforts, strengthening local financing network for the underprivileged as well as encouraging social responsibility of commercial banks would be possible. Global guidelines can only be applied to pertinent entities with the right preparations to avoid any unintended spillovers. The marginalized population should be brought back into the financial arena for better financial services. Roughly cracking down on shadow banking (phase I) would be a disproportionate response to the problem. Rather a proper risk assessment of high yield WMP should be done (i.e., requiring explicit consent that potential investors can lose their value). Since market assessment would be difficult under the existing environment, comprehensive and gradual approach toward institution building need to be emphasized first before applying short-term remedies.

### **Social Concerns for Shadow Banking**

One of the most visible concerns with shadow banking is its negative ramifications on social cohesion. The possible costs of financial repression will be borne by the public, while a few well-connected people reap financial windfall. Equally, the rich are largely compensated for the financial repression, while the poor are deprived of the chance to increase their wealth since they have to pay higher interest rate for loans and earn only a small return for their deposits, with no access to WMPs offered by trust or internet companies. To ease the financial repression, interest rate liberalization is required in principle, yet it remains a long-term issue. This is a serious mismatch: Depositors suffer from financial repression and borrow only in the shadow banking sector, yet the high net worth individuals enjoy profits of WMPs with easily borrowed money from the banking sector. In this case, social cohesion would be seriously undermined.

Also, any financial service related activities need to be monitored closely lest hidden links to the banking sector should prompt incidents like what happened in Korea in 1999 and 2004. For proper actions, the nature of TSF-related support should be further investigated in terms of speculative activities or local government support. If the end user base is balanced, there is no reason to intervene prematurely. However, if the non-banking activities are mostly for the privileged, the potential systemic risks they generate should be countervailed with other compensatory measures. What needs to be done is a renewed recognition of the authority that these uncontrolled activities of trust companies have the potential of leading to major financial crisis that would paralyze the whole system. The Korean ITC case reveals that politically motivated compensatory measures to allow retirees with higher return backfired in the form of trust run via massive redemption (Choi, 2003). Therefore, it is important to come up with remedies that allow for financial diversity without aggravating systemic risks.

The partially open export-driven system dichotomized the current financial system, which calls for vigorous rebalancing efforts by the authority. The direction is obvious: more active involvement of the banking sector to be more socially responsible and sustained infrastructure building to allow for local financial institutions to help reduce financial exclusion. Markets need to be developed with the macro environment that does not entail precipitous changes in exchange rate and interest rate. Premature opening would be detrimental, but too much delay also results in a misallocation of resources, which would be more damaging when economies become more sophisticated. The bridge that binds the fragmented financial system would be financial markets, with interbank and swap market playing an increasingly important role. China seems to be doing what needs to be done (i.e., macroprudential measures), and what Korea has gone through are mainly quick ex-post operations to regain financial stability. Some of the possible lessons are 1) There is a strong rationale for intervening in Ponzi scheme before it gets out of control 2) It is important to install reform-friendly incentives to induce smoother adjustment (privatization incentives) 3) Capital market connection, which is essential in modern-day banking, can be quite risky when proper supervisory functions are missing. In the absence of alternatives, allowing temporary regulatory arbitrage for trust companies and SIVs seems a good incentive when the formal banking sector cannot do the job after the crisis. However, the authorities should not jump ahead based on indicators and discretionary rules that seem less reflective of the Chinese situation. At the same time, moral hazard and speculation associated with social finance need to be monitored and controlled. Overall, the intervention needs to be guided by a principle to seek more balance among different groups of financial institutions.

The ensuing question would be how much of the current shadow banking issue in China is related to the ITC-type operations? And how would the mostly ex-post stabilization measures of the Korean authority remain relevant to deal



with the potential nature of the Chinese case? It seems that Chinese story involves very complex and tricky issues, and the Korean experiences from 14 years ago might provide a partial insight in dealing with the ultimate form of the vagaries of modern finance.

### **The Ultimate Challenge**

The real challenge is to replace the existing, successful participants with new market entrants to sustain the reform momentum going forward. Chinese banks face risks from various dimensions: Loans to LGFVs initiated by property developers, and WMPs produced by trust companies are exposed to maturity mismatch and lack of transparency. This is more or less related to the underdeveloped state of the Chinese financial system. And it can be also characterized as an endogenous development in a unique setting. Above all, the worrisome situation is mostly related to its various links with risky assets offered by trust companies. In fact, WMPs may eventually expose banks to the increased credit risks.

Unlike in Korea, however, China's problem is more related with political issues and trust companies' WMPs. Since the potential link with the real sector and the society is much larger than that of Korea, there needs to be more comprehensive measures to protect financial stability in the transition period. It is a much more difficult task to contain risks in the Chinese situation. The key task is how we deal with the potential risks without having a firmer grip on them. The even bigger challenge is the inability to interpret the numbers that are generated in a less transparent environment. The lack of reliable statistics should not prevent the authority from taking steps in a timely manner. Both identification and containment would be difficult. As such, systematic problems cannot be easily controlled, yet moral hazard issues are always the area of regulation. Even though moral hazard itself is related to the system issue, the ultimate goal is to develop the system further without being tampered with lingering moral hazard issue. That is, if major risks related with LGFV and local governments are tightly controlled, the remaining task for the authority is to contain possible risks from the trust companies. Shadow banking can actually threaten the real banking sector when it is not properly supported via market and/or poorly regulated. However, the case of China highlights the need to remain careful in applying policy measures. To separate political considerations from market assessment, it is important that market uncertainties are properly mitigated via market development and proper supervision and regulation: The three pillars of financial stability (supervision and regulation, self-restraint with capital-adequacy, and market discipline) need to remain intact at all times. Summarizing the above discussions can be written as follows:

- 1) The importance of controlling risks in overall balance sheets: Short-term response would be to transfer some of the risk factors residing in LGFVs into a

longer-term maturity. And the longer-term solution would be capital market development. The main purpose of controlling balance sheet risks is to reduce its growing bank dependency. Even the corrective measures, if approached in a hasty manner, can worsen the current financial system problem by paralyzing credit channel and further straining the overstretched shadow banking. Demand side also needs some guidance, and directed incentives need to be installed.

2) Needs for enhanced network of local financial institutions: Instead of cramping down on the shadow banking altogether, which may turn into a bigger mess, China should engage in technical rebalancing to control systemic risks by way of strengthening the rural credit supply and mitigating the loan concentration. This will make the transition smoother. The use of the crowd-funding and internet, the mobile-banking platform needs to be actively explored.

3) Reform efforts for SOE and local governments via debt management: China needs to allow some deleveraging of its local governments while leveraging up the central government. During the transition, the authority may replace local governments' short-term bank and trust loans with long-duration public bonds.

While the macro rationale for shadow banking is evident, the authority needs to find ways to curb speculative motives of existing players in the shadow-banking arena. From an institutional perspective, the roles of local governments, LGFV, property developers, trust companies and credit guarantee companies remain the long-term issue. The point of contention is how these leading participants can undergo a transition toward more market discipline, yet maintain vitality to engage in a more transparent environment. Clearly, capital market functioning cannot be enhanced in short time. The analyses of the Chinese shadow banking show that controlling vulnerabilities needs to be given a top policy priority in favor of macro measures that can wipe out even favorable effects of shadow banking activities. In fact, a crackdown on existing entities without a viable exit strategy would entail even bigger problems. By contrast, trust companies that rely on capital pools to manage WMP with Ponzi-game scheme need a tighter scrutiny. Unchecked developments of WMPs are likely to spell trouble going forward. Therefore, this needs stronger regulatory oversight.

It remains to be seen whether the current reform drive to overcome existing vulnerabilities by the Chinese government would take hold in a tougher environment. In fact, an input-driven growth paradigm can only be replaced with productivity-driven one with massive reform efforts. Until recently, the authority relied heavily on Keynesian-style public sector infrastructure investments and shied away from difficult structural reforms. Reform efforts per se are difficult to implement. In practice, even with strong rebalancing efforts by the authority, de facto little change has been documented in market-based monetary policy framework and/or the services sector. Ironically, given the difficulty with the reform

of its financial system, it is clear that the authority opted for something more practical and tangible in the short-run. This choice has entailed a shadow banking friendly environment, which would bring about more difficult policy challenges later. For instance, despite some positive effects of channeling credits to otherwise marginalized clients, unrecognized risks of shadow banking can be a source of future trouble. As emphasized, issuance of WMPs has been a major source of funding that has fueled the rise in shadow banking credit in China. WMPs are usually of short maturity therefore the banks have the flexibility to move assets and liabilities on- and off-balance-sheet by choosing the start-and end-dates of WMPs so they will maintain a low average deposit balance to circumvent high reserve requirements. The careful, incremental changes are basically double-edged sword, however. It may lead to persistent moral hazard that would result in massive crisis or it would buy enough time to engage in necessary structural reforms. It turns out that the choice of moderation resulted in increased reliance on shadow banking. A similar sequence of events can be found in Korea, where ITC debacles were followed by credit card bubbles and household debt overhang (Choi, 2003). This incurs significant socioeconomic costs. As China relies more and more on public investment via shadow banking to sustain growth, its productivity gain is suppressed. China became too much dependent on investment to sustain its growth engine. Today's medicine can turn into tomorrow's poison. Also, it is clear that the authority finds it more difficult to rely on traditional macro policy and the revised form of shadow banking to eke out the transition toward a more market-based balanced growth paradigm. As such, without a massive reform, even the prevailing input-driven growth cannot be sustained. Some fundamental reforms are considered essential and unavoidable to preserve the growth momentum. Even more challenging is the needs for a massive reform that also involves shadow-banking and possibly some socioeconomic governance structure. Both the push and pull-factors exist in future reform efforts.

Reform efforts are likely to begin with stronger market discipline in the shadow banking activities that involve WMPs. Given the role of providing the last resort function, that part of shadow banking related to policy-motivated choices is less of a problem than WMPs offered by trust companies. In retrospect, shadow banking itself has had some beneficial effects by bridging the growing gap between increasing demand and the restricted supply of financial assets. Unlike the infrastructure investment, however, public resources should not be utilized for private speculation. In many respects, the endogenously developed profit making arrangements delivered by non-banks have a common feature of implicitly relying on the bank bailout scheme. Whether they recognize it or not, potential problems can be dealt with the ultimate line of defense, taxpayers' money. The problem is that the risks they generate cannot be detected immediately and controlled in a timely manner. In short, the rapid rise of debt in recent years suggests the lingering

structural weakness of the Chinese economy. The so-called systemic risks are there and pose potential threats to overall financial stability.

In short, the Chinese authority cannot let those murky irresponsible operations of shadow banking affect welfare without the public knowing about it. By the same token, the current narrow banking cannot serve them better either. So the authority needs to balance conflicting aspects of their policy goal into a coherent service framework so that stability as well as diversity can be best attained. More regulation that leads to balloon or spillover effect to other arena is not a solution. As such, careful rebalancing of the financial system should remain the core task for the authority. Rebalancing task in the deleveraging process that involves key players who are not private requires the utmost attention and care. As noted earlier, this is essentially a bubble story that has resemblance to the recent Korean real estate situation during the Great Moderation. In principle, stricter prudential measures are suggested to address the potential moral hazard problems with the shadow banking. The Korean incident also shows that the policy agenda is even more difficult to implement during the deleveraging process. The authority can stabilize the market with strong measures, but market dynamics would vanish altogether and the confidence buildup becomes very difficult afterwards. Above all, the authority needs to help current market participants with what needs to be controlled and how it can be done.

## SUMMARY AND CONCLUSION

The objective of this paper is to bring a balanced perspective to the discussion of Chinese shadow banking that relies on outright regulatory measures. It is feared that too much reliance on macro and macro-prudential measures would hurt fundamental dynamics that underlie financial activities that largely are cushioning the impact of post-crisis adjustments and support areas where conventional banking cannot reach. Rather the focus to contain systemic risk needs to control vulnerabilities by strengthening market functioning via implanting infrastructures for increased supply of safe assets. Given that sizable gap exists between financial demand and supply of safe assets, increase in shadow banking needs to be given comprehensive analyses and balanced regulatory oversight. In short, shadow banking can be better handled with an objective to supply diverse, safe assets par excellence, rather than the renewed focus to strengthen regulation.

Overall, the Chinese shadow banking, if not the shadow banking itself, is not merely a financial problem, but a complex socio-political-economic problem with capital market inefficiency and the governance constraints. The policy implications would be to rebalance the system so that more people can enjoy financial access as well as diverse financial services (financial inclusion, without the privileged monopolizing of low-hanging fruits of WMPs at the possible expense of the

society.) The opaque nature of shadow banking needs to be reduced in the future so that one sector cannot take advantage of the rest of the society. However, the extra services that were made available by allowing other profit opportunities should not be suppressed due to unfounded recognition of tail risk. In short, the focus of regulatory oversight should be placed on possible distortions this dualistic bipolar system would entail during the transition. Too often, when credits are supplied via different conduits, it would result in serious bi-polarization and social unrest. To redress this issue, the severe dichotomy needs to be mitigated via strengthening local financial network and expanding the traditional banking sector to allow for an organic growth of capital market in China. In an EM setting, it is important to maintain balance in addressing various symptoms that arise from lack of fully functioning capital market. Even though it remains a challenge to the authority to adopt a long time perspective in responding to short-term market instability, proposed measures should not interfere with a long-standing market development initiative. The so-called general-to-specific approach for market development needs to be kept at all times for policies to remain time-consistent. At the least, shadow banking in China clearly reflects the gap that exists between banking and non-banking services. On the supply side, check and balance in the non-banking sector is necessary with enhanced services. On the demand side, a wider array of financial products and services need to be made available to EM customers.

The real message of shadow banking is a renewed call for financial development and reform in the region that makes this set of agenda a real possibility. Remedial measures taken in the aftermath of the Korean ITC crisis are clear reminders of what needs to be done in China right now. Without a paradigm reform that can accommodate rebalancing, signs of development can be temporary and deceiving. And the IMS needs a reform to better serve an extended global financial network that critically hinges on the new EM contribution. First, it becomes increasingly difficult to assess systemic risks associated with shadow banking despite some obvious benefits of diversification. Despite repeated stabilization measures, the market instability lingered until the massive bailouts were executed, leaving indelible marks of moral hazard. Second, instead of strengthening the regulation or extending the dollar-centric hierarchical financial network, it is important to rebalance and strengthen markets to help secure the necessary conditions to supply more diverse safe assets. In fact, despite sophisticated and securitized banking practices, EM remains more vulnerable to external shocks and has made little contributions toward supplying safe assets. Third, the growing gap between the supply and demand for financially safe assets needs to be addressed by promoting EM's role in the IMS to supply various forms of guaranteed debt, e.g. covered bonds, agency bonds, and EM-CDOs.

In conclusion, shadow-banking issue in China has many implications and requires complex responses. The main thrust of this paper about shadow banking

is the emphasis on dealing with underlying causes of the shadow banking, which has deeper roots in the dollar-centric international monetary system and the financial market imperfections. Instead of addressing various shadow banking issues with macro and prudential measures, vulnerabilities need to be contained first to promote healthy financial ecosystem to allow the more diverse supply of financial assets. This would require controlling vulnerabilities with a delicate balancing act lest macro measures stifle favorable functions of shadow banking all together. An ecosystem perspective is critically important since even the most effective policy responses often result in lingering structural issues. Longer-term issues require responses by market participants. Shadow banking in China and elsewhere calls for actions that consistently promote market functioning and financial system development. Since the shadow banking that involves innovation should not be discouraged, the authority should be careful in implementing macro-based rebalancing efforts. It needs to allow CSR (corporate social responsibility) and CRA (community reinvestment act) for banks and streamline regulatory efforts for non-banks without over-killing the momentum for securitized banking platforms. Also, while existing participants played a greater role during the post-crisis period, they need to be succeeded by more active private participants, notably wealth managers, prime broker-dealers, and hedge funds. The sustained stance of the authority, which mainly assumes increased debt burden during the initial transition, would only spell trouble in the future. Accordingly, local authorities and SOEs need to be complemented and reformed with the inclusion of new private participants for the key governance rebalancing. Likewise, managing Ponzi-scheme of trust companies would not only require pertinent regulation, but extensive local financial network and newly invigorated institution-building to respond to a fast-changing market environment.

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Gongpil CHOI

**KINESKO BANKARSTVO U SENCI:  
IZAZOVI I REŠENJA**

*Apstrakt:* Rizici u kineskom bankarstvu u senci nisu pravilno ocenjeni. S obzirom na prednosti koje pružaju delovi bankarstva u senci u Kini, koji popunjavaju prazninu nastalu zbog rastuće potražnje za boljim finansijskim uslugama i proizvodima, neophodni su razumni i uravnoteženi naponi regulacione politike. Za razliku od popularnog verovanja da su potrebne strožije regulatorne mere da bi se zaustavila negativna preliivanja regulatorne arbitraže, naponi politike moraju da se usredsrede na kontrolisanje specifičnih slabosti i ka negovanju budućnosti finansijskog ekosistema. Bolji nadzorni i regulatorni naponi treba da se kombinuju sa primenom infrastruktura za razvoj finansijskih tržišta i da zadovolje rastuće potrebe za sigurnim ulaganjima. (JEL E44, E50, E61, E62, E65, E66).

*Ključne reči:* bankarstvo u senci, regulatorna arbitražu, nadzor i regulativa.

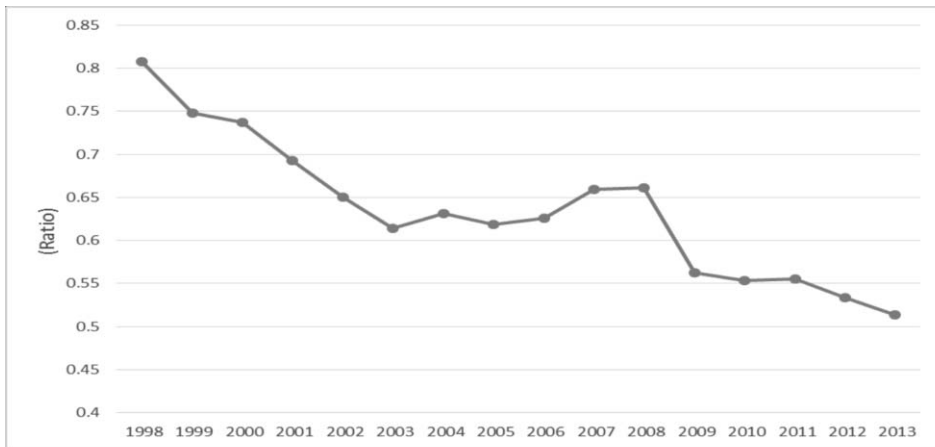
Received: 13.01.2016.

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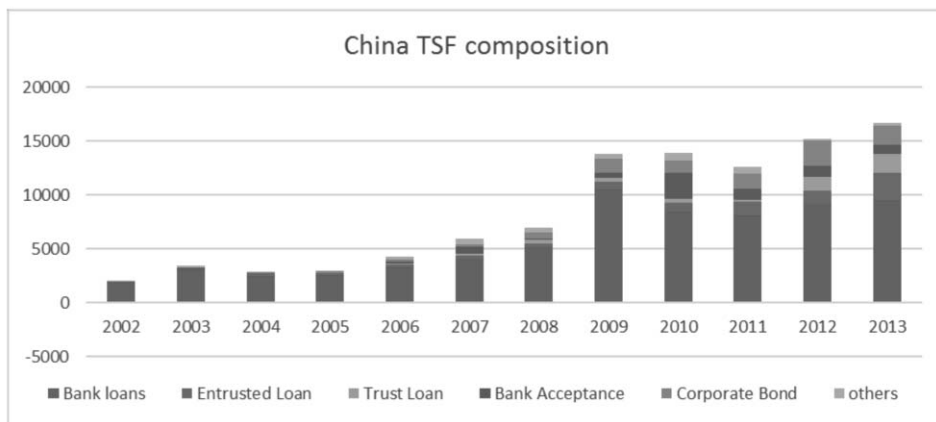
Figure 1  
Chinese M2 Velocity



Source: IMF, World Bank (WDI), CEIC

Figure 2  
TSF Composition by Type

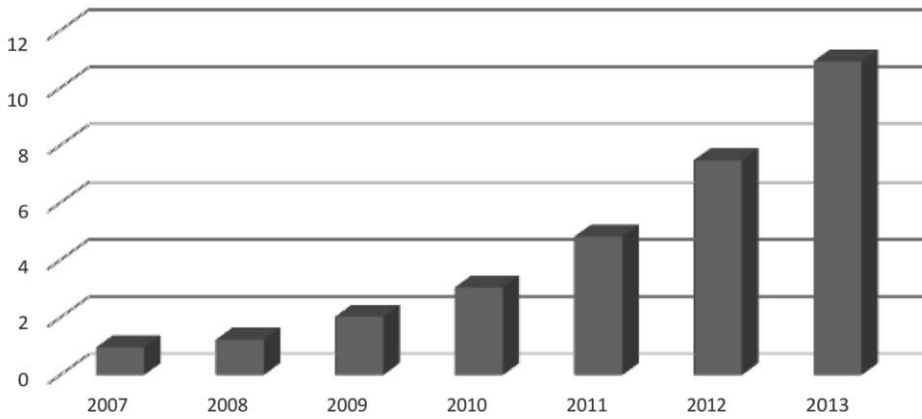
(Unit: RMB bn)



Source: The People’s Bank of China

Figure 3  
Chinese Trust Assets

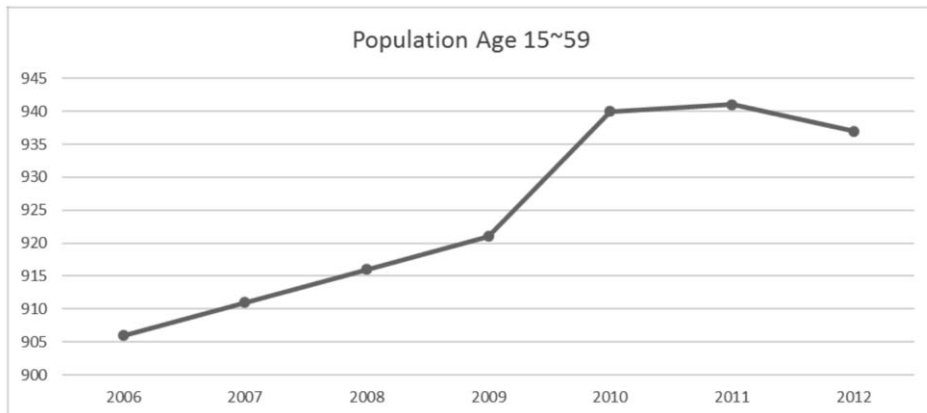
(Unit: trillion Yuan)



Source: China Trust Association

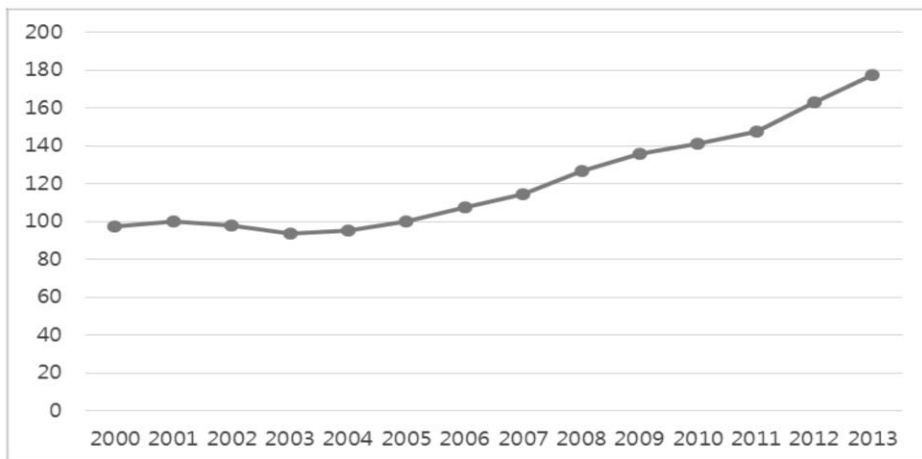
Figure 4  
Labor Supply

(Unit: Person mn)



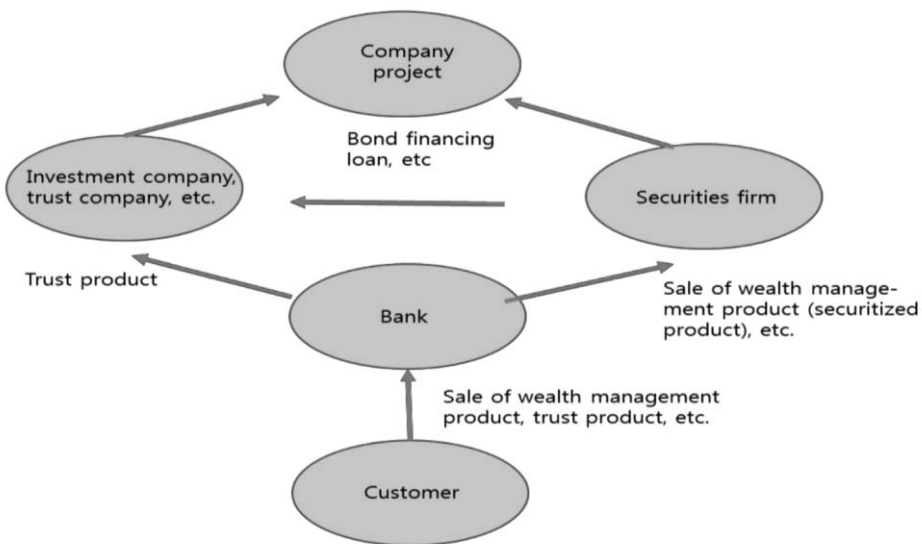
Source: National Bureau of Statistics.

Figure 5  
Trend of China's Unit Labor Cost



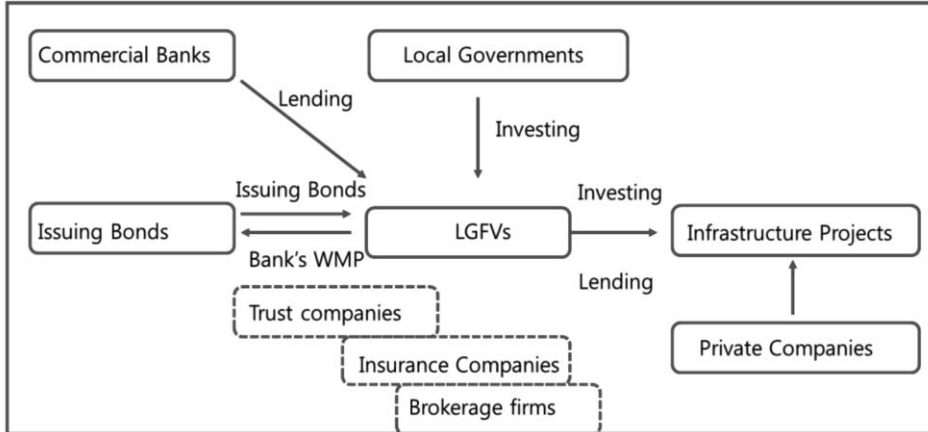
Source: OECD.

Figure 6  
Off-balance-sheet bank financing scheme



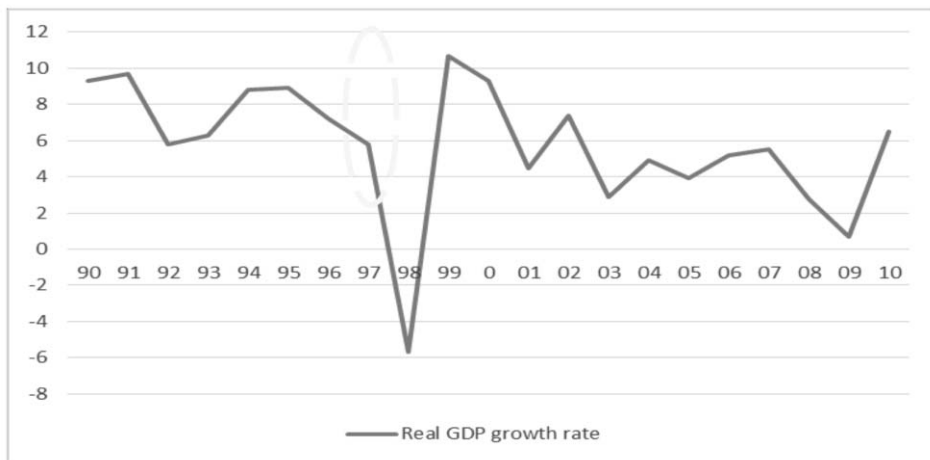
Source: Nomura Research Institute.

Figure 7  
General scheme of a LCFV (Indicates the flow of money)



Source: Kenji Ueda and Yuki Gomi (2013), *Shadow Banking in China and Expanding debt of Local Governments*.

Figure 8  
Korean ITC-run and Economic Growth (yoy,%)



Source: Bank of Korea.

Table 1  
Estimates of Shadow Banking in China

(Unit: trillion Yuan, %)

Institution	Shadow Banking	Ratio of Shadow Banking to GDP
Financial Times	20	38
Citic Securities Company Limited	23~35	44~48
China International Capital Corporaation	27	52
Gwang Pa Investment Bank	31.5	61

Note: Chinese GDP in 2012 is 52 Trillion Yuan

Source: Woori Finance Research Institute and each Press

Table 2  
Global Credit Supply

(Unit: trillion Dollar, %)

	Central Bank	Bank	Insurance and Pension	Public Financial Institutions	Shadow Banking
2008	14.7(6)	118.2(49)	35.8(1.5)	12.8(5)	59.4(25)
2009	15.1(6)	116.8(47)	40.4(1.6)	12.7(5)	63.8(26)
2010	16.6(6)	120.7(46)	43.6(17)	12.5(5)	66.9(26)
2011	20.4(7)	130.2(48)	42.9(16)	12.5(5)	66.6(24)

Note: Global data covers Euro and other 20 nations, including Argentina, Australia, Brazil, Canada, Chile, China, Hong Kong, India, Indonesia, Japan, Korea, Mexico, Russia, Saudi Arabia, Singapore, South Africa, Swiss, Turkey, U.K., and U.S.

Source: National Flow of Funds Data

Table 3  
Comparing trust financing with Subprime debt

	Trust financing in China	Subprime debt in the US
Main investors	Individuals	Financial institutions
Investor leverage	Low	High
Financial product	Wealth management products	Subprime debt /equity
Underlying assets	Projects/housing projects	Subprime mortgages
Risks to underlying assets	Policy-/market-driven	Unemployment rate/Borrower creditworthiness
Financing vehicle	Trust scheme	Special purpose vehicle
Intermediary	Trust company	Mortgage finance devotions/investment banks
Due diligence	Almost none	Limited
Rating quality	None/poor	Poor
Risk of redemption	High	High
Deleveraging to repair balance sheets	Not likely	Very likely

Source: Barclays Capital

## APPENDIX

### HOW THE SHADOW BANKING TURNED INTO A DEBACLE: THE CASE OF KOREA

Often ailing companies resort to market devices to overcome imminent financial difficulties. Unfortunately, markets in emerging economies have relatively poor track records and lack broad and unwavering confidence. If not properly regulated, activities that cannot go through the rigorous market scrutiny often lead to even bigger problem going forward. The marked balloon effect as that appears in the shadow banking activities in China is related to the Korean Daewoo case, which increased CP issuance just before it went bankrupt in 1999. Their funding strategy partly reflected their deteriorating financial positions as reflected in comparative prudential measures by investment banks and a huge increase in non-bank borrowing, especially via CPs (Table A.1.,A.2) The FSC data also show that Daewoo increased their financial debt mainly via CPs and corporate bonds issuance (80.9%), increasing the vulnerability dramatically against market shocks. In fact, a massive redemption of funds at ITCs erupted when the CPs investors held soured, triggering a series of corporate failures. Essentially, the Daewoo debacle per se is a modern shadow banking issue because the basic

elements of their operation, e.g., instrument and the player remained both outside the tightly regulated banking sector. In the aftermath of the Asian financial crisis, Korea seemed to enjoy increased financial opening and more capital market support. Corporate bonds, commercial papers, CDs became widely available. However, the essential supervisory functions get sidelined either by lack of legal preparation or by lack of incentives. Before they went bankrupt, Daewoo resorted to issuing sizable corporate bonds to pay back their bank loans. Entering 1999, Daewoo began issuing CPs instead of bonds as the bond issuance became difficult. In fact, Daewoo took advantage of the newly available capital market access after the 1997 shock, but risks have not been mitigated properly. On the demand side, Daewoo CPs provided a valuable opportunity for ITCs to offer attractive return to fund investors. However, market based operations can easily face unexpected turn of events. After the Daewoo debacle in the summer of 1999, ITCs that had huge holdings of Daewoo CPs of the promised higher yield suddenly faced massive redemption pressure, which subsequently led to “Comprehensive Stabilization Measures” by the authority in November 1999. Since the measure allowed redemption up to 80%, ITCs with liquidity problems suddenly faced solvency risks. What has been touted as a favorable market development turned out to be a systemic risk failure and no single entity could have been singled out to be responsible for the meltdown. This conflicted picture in the role and responsibility provided a backdrop to provide a massive bailout scheme when the market took the hit of Daewoo debacle. The blurred distinction along the banking and non-banking activities with the implicit support by the authority basically necessitated the public involvement in clearing the mess created by private participants. Wherever there are politically motivated supports, it would later result in public recognition of doomed failures. In fact, continued intervention has weakened the market discipline and still plagues market environment to distort private participation to this day.

In contrast to the sharp increase in ITC holdings in bond-type fund right after the crisis and the advent of equity-type mutual funds in the spring, we observed a large swing between two types of funds in 1999: Monthly average fund size directed to equity investment amounted to 12 trillion won from April to July 1999. After the debacle in July, 20 trillion won left the bond type fund, and a similar decline occurred in the equity fund. There we also observed a trend reversal in financial markets, reverting back to the previous bank-dominant system, resulting in depressed direct financing afterwards. The spread between corporate bond yield and call rate widened to a historic 5.68%p on July 17, which used to hover around 1~2%p before the debacle. Long-term financing suddenly vanished as the increasingly short-term use of funds became a dominant feature.

Almost 3 trillion won of public money was injected into Korea Trust and Investment Corp. and Daehan Trust and Investment Corp., which turned out to be falling short of stabilizing the market as Daewoo-related NPLs began to mount amid paralyzed market conditions. The EM situation usually calls for a massive bailout by the authority because EM debt problems tend to exacerbate over a longer period of time despite workout possibilities before the default.

Some of the obvious lessons from the Korean experiences include 1) Installing necessary gears for the incumbent banking sector to take advantage during the transition period. Without this, strong reform efforts can backfire and would trigger time-inconsistent policies. 2) Addressing the symptoms needs to be complemented with structural rebalancing since

problems often result from lack of necessary functions available in the system. In fact, eliminating local financial network during the reform process based on global guidelines created a vacuum by shutting down existing multi-layered network without either compensatory measures or balanced regulatory oversights. In retrospect, we cannot deny that the Korean ITC crisis was largely unavoidable with the background of fewer asset choices and largely passive private participants which necessitated the moral hazard-prone interventions by the authority. Going forward, the targeted policy efforts should be made to control balance sheet risks of the risky group via restructuring, not by indiscriminating strengthening of regulation. What are the risk factors and how the authorities can tackle them remain the key topics related with shadow banking in China. Broadly speaking, there should be a stricter regulatory oversight on moral hazard, stronger local financial network and more active role of conventional banks. This boils down to stressing the importance of a broader policy perspective to build a viable financial eco-system.

Table A.1  
Soundness of Top Chaebols in Korea

	Hyundai	Samsung	LG	Daewoo	SK
Overall soundness score	1.7	4.3	3	1.7	4.3
Operating profit/ Total interest cost					
1993	2.2	4.4	2.9	1.4	2.2
1994	2.6	6	3.3	1.5	2.3
1995	2.8	7	3.8	1.6	2.5
1996	1.9	3.7	2.7	1.6	2.7
1997	2.3	4.2	3.4	1.7	4.2
Grade	C	A	A	D	A
Short-term debt / Operating cash flow					
1993	3.8	1.6	2.7	8.7	4
1994	4.3	1.3	2.6	25.7	4.2
1995	4	1.4	2.7	45.9	2.7
1996	18	4	4.5	5.8	2.8
1997	82.9	4.2	46.7	-17.5	4.2
Grade	F	A	E	F	A
Net liabilities/Equity capital					
1993	171.9	161.7	159.5	221.4	190.2
1994	197.4	124.2	151.3	206	212.2
1995	202.4	109.4	166.3	257.9	180.1
1996	257.5	183.6	198.5	269	214.2
1997	376.1	240.2	317.3	357.1	279.4
Grade	D	B	C	C	C

Note: Overall soundness means a weighted average of grades

Source: CSFB Korea's Top-Ten Chaebols: Part 1, How to play chaebol reform, 1998. 6



Table A.2  
Trend of Daewoo's borrowing from The Domestic Financial Institutions  
(Unit: billion Won)

	1997. 12(A)	1998.8	1998.12	1999.3	1999.6(B)	B-A
Total debt	28,712	46,243	43,907	44,250	43,389	14,677
Bank	8,614	9,141	8,231	8,434	8,609	-5
Non-monetary institution	8,115	6,273	3,989	4,017	4,022	-4,093
Corporate bond	8,414	143,222	19,702	19,703	22,039	13,625
CP	3,569	16,507	11,985	12,096	8,719	5,150

Source: Financial Supervisory Commission.

## BOOKS REVIEW

### SERBIA ON THE SILK ROAD

Branko Žujović, *Srbija na putu svile* [*Serbia on the Silk Road*]. Nova srpska politička misao, Belgrade, 2015.

A book „Serbia on the Silk Road“ by the journalist and publicist Branko Žujović offers a plenty of historical, social, and above all economic data about the biggest and most ambitious undertaking of the Peoples Republic of China (PRC) in the 21<sup>st</sup> century. In its 12 sections, this smoothly read book also points out the benefits of the Chinese project for Serbia, relations between the two countries, and in respect to the Serbian emotional question of Kosovo and Metohija, the policies of Beijing regarding the secessionist province of Taiwan.

Žujović, a longstanding journalist in the Serbian section of the China Radio International (CRI) in Beijing, reminds that the President of the PRC Xi Jinping proposed in September 2013 an initiative called „Economic Belt Silk Road“ (SREB) stretching via Central Asia to Europe. The next month, President Xi proposed the Maritime Silk Road (MSR) for the 21<sup>st</sup> century, connecting ports down the Chinese coast with other Asian countries, East Africa, Middle East and the Mediterranean. In the PRC the combination of the two initiatives is called “One Belt, One Road“ (OBOR).

Žujović ascertains that the PRC is searching for global space so that it can continue dizzying economic growth and becoming what is in Beijing called well-of society. Cheap goods (“Made in China”) have been replaced by products and services of high technologies and significant value added, which are supposed to be sold all over the world.

For the time being investments from the PRC in infrastructure projects are the basic of OBOR, which is, otherwise open for every country. The PRC inaugurated a \$40 billion Silk Road Fund, and the sources from the recently established Asian Infrastructure Investment Bank (AIIB) with planned capital of \$100 billion will be at disposal. Chinese Development Bank announced that it will invest more than \$890 billion in more than 900 projects.

But Žujović warns it is a big question how the powers along the OBOR will coordinate their interests. The European Union is on the far West, Russia with Eurasian Economic Union partly on the West, on the North and in the central regions of Asia, India and Pakistan on the South, Turkey on the Southwest, and the USA is a global player...

Accordingly, despite good economic motives, it is not possible to consider building SREB out of a geopolitical frame. Žujović quotes western analysts who are inclined to emphasize that the result of the initiative for OBOR could be spreading the Chinese soft power in Eurasia.

Žujović draws attention to the fact that, up to now, cooperation with the PRC has been perceived in Serbia through infrastructural investment, and gives a long list of examples. On the other side, Chinese projects in Serbia, like the bridge Zemun-Borča, have become, to a certain extent, references for the constructing companies of the faraway country in European lands which need a lot of such projects. That is the reason why Belgrade has been mentioned as a possible seat of Chinese infrastructural investments in Central and Eastern Europe (CEEC).

Žujović many times raises the question: Where is Serbia's place, within the complicated geopolitical and economic integrations in Eurasia, in cooperation between the PRC and CEEC, the so-called format "1+16"? The author offers the responses in this book published last October by the media house „New Serbian Political Thoughts“ (NSPM).

Substantial quantities of goods from Piraeus, a port of entry for Chinese products to Europe, have been transported by rail down the Morava-Vardar direction and further north through the Danube Valley towards Hungary, the Czech Republic and other states of the CEEC. That is the most convenient continental link between the Aegean Sea and Central Europe. It is of utmost importance for Chinese economic initiatives and trade from Piraeus, one of the final destinations of the MSR. "That is a huge chance for Serbia, since it plans, in cooperation with the PRC, to modernize and upgrade the railway line Belgrade-Budapest, primarily because of the potentials of the port of Piraeus", noticed the author.

But, according to Žujović, there was no significant response in Belgrade to Chinese Prime Minister Li Keqiang's calls to the companies from CEECs to his country's market, particularly the agricultural and food products. Serbia should have an ambition to export its agricultural and other food products of good quality, especially to the PRC where they will enjoy higher prices, emphasizes Žujović.

Žujović argues that the tourism industry should not be forgotten too, because that sector is already important in cooperation between the PRC and CEECs. But, Serbia and other Balkans countries, proportionally, receive less Chinese visitors.

The author devotes particular attention to bilateral relations between the PRC and Serbia. As a big Asian country, the PRC is the only permanent member of the United Nations Security Council who never voted against the interests

of Serbia. An important bond between the two countries is also a support of the official Beijing to the territorial integrity of Serbia, which is of practical and principle nature, stresses Žujović.

Žujović also points out that the situations regarding Taiwan and Kosovo and Metohija are similar only at first glance. While a majority of the local population in Kosmet are ethnic Albanians, Taiwan is inhabited by Chinese, who mostly have patriotic orientation. Taiwan is also, in contrast to Kosmet, well established and orderly society with efficient economy. The exchange between mainland China and Taiwan was valued at \$198,31 billion in 2014. Under such circumstances, Belgrade should not count too much on Taiwan`s example in argumentation of the Serbian stand *vis-à-vis* its southern province, concludes the author of the book „Serbia on the Silk Road“.

*Borislav KORKODELOVIĆ*



## DOCUMENTS

# Vision and Actions on Jointly Building Silk Road Economic Belt and 21st-Century Maritime Silk Road<sup>1</sup>

2015/03/28

Issued by the National Development and Reform Commission,  
Ministry of Foreign Affairs, and Ministry of Commerce of the People's Republic  
of China, with State Council authorization

March 2015

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### Preface

More than two millennia ago the diligent and courageous people of Eurasia explored and opened up several routes of trade and cultural exchanges that linked the major civilizations of Asia, Europe and Africa, collectively called the Silk Road by later generations. For thousands of years, the Silk Road Spirit – “peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit” – has been passed from generation to generation, promoted the progress of human civilization, and contributed greatly to the prosperity and development of the countries along the Silk Road. Symbolizing communication and cooperation between the East and the West, the Silk Road Spirit is a historical and cultural heritage shared by all countries around the world.

In the 21st century, a new era marked by the theme of peace, development, cooperation and mutual benefit, 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.

When Chinese President Xi Jinping visited Central Asia and Southeast Asia in September and October of 2013, he raised the initiative of jointly building the Silk Road Economic Belt and the 21st-Century Maritime Silk Road (hereinafter referred to as the Belt and Road), which have attracted close attention from all over the world. At the China-ASEAN Expo in 2013, Chinese Premier Li Keqiang emphasized the

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<sup>1</sup> Source: [http://en.ndrc.gov.cn/newsrelease/201503/t20150330\\_669367.html](http://en.ndrc.gov.cn/newsrelease/201503/t20150330_669367.html)

need to build the Maritime Silk Road oriented towards ASEAN, and to create strategic propellers for hinterland development. Accelerating the building of the Belt and Road can help promote the economic prosperity of the countries along the Belt and Road and regional economic cooperation, strengthen exchanges and mutual learning between different civilizations, and promote world peace and development. It is a great undertaking that will benefit people around the world.

The Belt and Road Initiative is a systematic project, which should be jointly built through consultation to meet the interests of all, and efforts should be made to integrate the development strategies of the countries along the Belt and Road. The Chinese government has drafted and published the Vision and Actions on Jointly Building Silk Road Economic Belt and the 21st-Century Maritime Silk Road to promote the implementation of the Initiative, instill vigor and vitality into the ancient Silk Road, connect Asian, European and African countries more closely and promote mutually beneficial cooperation to a new high and in new forms.

### **I. Background**

Complex and profound changes are taking place in the world. The underlying impact of the international financial crisis keeps emerging; the world economy is recovering slowly, and global development is uneven; the international trade and investment landscape and rules for multilateral trade and investment are undergoing major adjustments; and countries still face big challenges to their development.

The initiative to jointly build the Belt and Road, embracing the trend towards a multipolar world, economic globalization, cultural diversity and greater IT application, is designed to uphold the global free trade regime and the open world economy in the spirit of open regional cooperation. It is aimed at promoting orderly and free flow of economic factors, highly efficient allocation of resources and deep integration of markets; encouraging the countries along the Belt and Road to achieve economic policy coordination and carry out broader and more in-depth regional cooperation of higher standards; and jointly creating an open, inclusive and balanced regional economic cooperation architecture that benefits all. To build jointly the Belt and Road is in the interests of the world community. Reflecting the common ideals and pursuit of human societies, it is a positive endeavor to seek new models of international cooperation and global governance, and will inject new positive energy into world peace and development.

The Belt and Road Initiative aims to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the Belt and Road, set up all-dimensional, multi-tiered and composite connectivity networks, and realize diversified, independent, balanced and sustainable development in these countries. The connectivity projects of the Initiative will help align and coordinate the development strategies of the countries along the Belt and Road, tap market potential in this region, promote investment and consumption, create demand and job opportunities, enhance people-to-people and cultural exchanges, and mutual learning among the

peoples of the relevant countries, and enable them to understand, trust and respect each other and live in harmony, peace and prosperity.

China's economy is closely connected with the world economy. China will stay committed to the basic policy of opening-up, build a new pattern of all-round opening-up, and integrate itself deeper into the world economic system. The Initiative will enable China to further expand and deepen its opening-up, and to strengthen its mutually beneficial cooperation with countries in Asia, Europe and Africa and the rest of the world. China is committed to shouldering more responsibilities and obligations within its capabilities, and making greater contributions to the peace and development of mankind.

## **II. Principles**

The Belt and Road Initiative is in line with the purposes and principles of the UN Charter. It upholds the Five Principles of Peaceful Coexistence: mutual respect for each other's sovereignty and territorial integrity, mutual non-aggression, mutual non-interference in each other's internal affairs, equality and mutual benefit, and peaceful coexistence.

The Initiative is open for cooperation. It covers, but is not limited to, the area of the ancient Silk Road. It is open to all countries, and international and regional organizations for engagement, so that the results of the concerted efforts will benefit wider areas.

The Initiative is harmonious and inclusive. It advocates tolerance among civilizations, respects the paths and modes of development chosen by different countries, and supports dialogues among different civilizations on the principles of seeking common ground while shelving differences and drawing on each other's strengths, so that all countries can coexist in peace for common prosperity.

The Initiative follows market operation. It will abide by market rules and international norms, give play to the decisive role of the market in resource allocation and the primary role of enterprises, and let the governments perform their due functions.

The Initiative seeks mutual benefit. It accommodates the interests and concerns of all parties involved, and seeks a conjunction of interests and the "biggest common denominator" for cooperation so as to give full play to the wisdom and creativity, strengths and potentials of all parties.

## **III. Framework**

The Belt and Road Initiative is a way for win-win cooperation that promotes the common development and prosperity and a road towards peace and friendship by enhancing mutual understanding and trust, and strengthening all-round exchanges. Chinese government advocates peace and cooperation, openness and inclusiveness, mutual learning and mutual benefit. It promotes practical cooperation in all fields,



and works to build a community of shared interests, destiny and responsibility featuring mutual political trust, economic integration and cultural inclusiveness.

The Belt and Road run through the continents of Asia, Europe and Africa, connecting the vibrant East Asia economic circle at one end and developed European economic circle at the other, and encompassing countries with huge potential for economic development. The Silk Road Economic Belt focuses on bringing together China, Central Asia, Russia and Europe (the Baltic); linking China to the Persian Gulf and the Mediterranean Sea through Central Asia and West Asia; and connecting China with Southeast Asia, South Asia and the Indian Ocean. The 21st-Century Maritime Silk Road is designed to go from China's coast to Europe through the South China Sea and the Indian Ocean in one route, and from China's coast through the South China Sea to the South Pacific in the other.

On land, the Initiative will focus on jointly building a new Eurasian Land Bridge and developing China-Mongolia-Russia, China-Central Asia-West Asia and China-Indochina Peninsula economic corridors by taking advantage of international transport routes, relying on core cities along the Belt and Road and using key economic industrial parks as cooperation platforms. At sea, the Initiative will focus on jointly building smooth, secure and efficient transport routes connecting major sea ports along the Belt and Road. The China-Pakistan Economic Corridor and the Bangladesh-China-India-Myanmar Economic Corridor are closely related to the Belt and Road Initiative, and therefore require closer cooperation and greater progress.

The Initiative is an ambitious economic vision of the opening-up of and cooperation among the countries along the Belt and Road. Countries should work in concert and move towards the objectives of mutual benefit and common security. To be specific, they need to improve the region's infrastructure, and put in place a secure and efficient network of land, sea and air passages, lifting their connectivity to a higher level; further enhance trade and investment facilitation, establish a network of free trade areas that meet high standards, maintain closer economic ties, and deepen political trust; enhance cultural exchanges; encourage different civilizations to learn from each other and flourish together; and promote mutual understanding, peace and friendship among people of all countries.

#### **IV. Cooperation Priorities**

Countries along the Belt and Road have their own resource advantages and their economies are mutually complementary. Therefore, there is a great potential and space for cooperation. They should promote policy coordination, facilities connectivity, unimpeded trade, financial integration and people-to-people bonds as their five major goals, and strengthen cooperation in the following key areas:

##### *Policy coordination*

Enhancing policy coordination is an important guarantee for implementing the Initiative. We should promote intergovernmental cooperation, build a multi-level

intergovernmental macro policy exchange and communication mechanism, expand shared interests, enhance mutual political trust, and reach new cooperation consensus. Countries along the Belt and Road may fully coordinate their economic development strategies and policies, work out plans and measures for regional cooperation, negotiate to solve cooperation-related issues, and jointly provide policy support for the implementation of practical cooperation and large-scale projects.

#### *Facilities connectivity*

Facilities connectivity is a priority area for implementing the Initiative. Based on respect for each other's sovereignty and security concerns, countries along the Belt and Road should improve the connectivity of their infrastructure construction plans and technical standard systems, jointly push forward the construction of international trunk passageways, and form an infrastructure network connecting all sub-regions in Asia, and between Asia, Europe and Africa step by step. At the same time, efforts should be made to promote green and low-carbon infrastructure construction and operation management, taking into full account the impact of climate change on the construction.

With regard to transport infrastructure construction, we should focus on the key passageways, junctions and projects, and give priority to linking up unconnected road sections, removing transport bottlenecks, advancing road safety facilities and traffic management facilities and equipment, and improving road network connectivity. We should build a unified coordination mechanism for whole-course transportation, increase connectivity of customs clearance, reloading and multimodal transport between countries, and gradually formulate compatible and standard transport rules, so as to realize international transport facilitation. We should push forward port infrastructure construction, build smooth land-water transportation channels, and advance port cooperation; increase sea routes and the number of voyages, and enhance information technology cooperation in maritime logistics. We should expand and build platforms and mechanisms for comprehensive civil aviation cooperation, and quicken our pace in improving aviation infrastructure.

We should promote cooperation in the connectivity of energy infrastructure, work in concert to ensure the security of oil and gas pipelines and other transport routes, build cross-border power supply networks and power-transmission routes, and cooperate in regional power grid upgrading and transformation.

We should jointly advance the construction of cross-border optical cables and other communications trunk line networks, improve international communications connectivity, and create an Information Silk Road. We should build bilateral cross-border optical cable networks at a quicker pace, plan transcontinental submarine optical cable projects, and improve spatial (satellite) information passageways to expand information exchanges and cooperation.

#### *Unimpeded trade*

Investment and trade cooperation is a major task in building the Belt and Road. We should strive to improve investment and trade facilitation, and remove

investment and trade barriers for the creation of a sound business environment within the region and in all related countries. We will discuss with countries and regions along the Belt and Road on opening free trade areas so as to unleash the potential for expanded cooperation.

Countries along the Belt and Road should enhance customs cooperation such as information exchange, mutual recognition of regulations, and mutual assistance in law enforcement; improve bilateral and multilateral cooperation in the fields of inspection and quarantine, certification and accreditation, standard measurement, and statistical information; and work to ensure that the WTO Trade Facilitation Agreement takes effect and is implemented. We should improve the customs clearance facilities of border ports, establish a “single-window” in border ports, reduce customs clearance costs, and improve customs clearance capability. We should increase cooperation in supply chain safety and convenience, improve the coordination of cross-border supervision procedures, promote online checking of inspection and quarantine certificates, and facilitate mutual recognition of Authorized Economic Operators. We should lower non-tariff barriers, jointly improve the transparency of technical trade measures, and enhance trade liberalization and facilitation.

We should expand trading areas, improve trade structure, explore new growth areas of trade, and promote trade balance. We should make innovations in our forms of trade, and develop cross-border e-commerce and other modern business models. A service trade support system should be set up to consolidate and expand conventional trade, and efforts to develop modern service trade should be strengthened. We should integrate investment and trade, and promote trade through investment.

We should speed up investment facilitation, eliminate investment barriers, and push forward negotiations on bilateral investment protection agreements and double taxation avoidance agreements to protect the lawful rights and interests of investors.

We should expand mutual investment areas, deepen cooperation in agriculture, forestry, animal husbandry and fisheries, agricultural machinery manufacturing and farm produce processing, and promote cooperation in marine-products farming, deep-sea fishing, aquatic product processing, seawater desalination, marine biopharmacy, ocean engineering technology, environmental protection industries, marine tourism and other fields. We should increase cooperation in the exploration and development of coal, oil, gas, metal minerals and other conventional energy sources; advance cooperation in hydropower, nuclear power, wind power, solar power and other clean, renewable energy sources; and promote cooperation in the processing and conversion of energy and resources at or near places where they are exploited, so as to create an integrated industrial chain of energy and resource cooperation. We should enhance cooperation in deep-processing technology, equipment and engineering services in the fields of energy and resources.

We should push forward cooperation in emerging industries. In accordance with the principles of mutual complementarity and mutual benefit, we should promote in-depth cooperation with other countries along the Belt and Road in new-generation information technology, biotechnology, new energy technology, new

materials and other emerging industries, and establish entrepreneurial and investment cooperation mechanisms.

We should improve the division of labor and distribution of industrial chains by encouraging the entire industrial chain and related industries to develop in concert; establish R&D, production and marketing systems; and improve industrial supporting capacity and the overall competitiveness of regional industries. We should increase the openness of our service industry to each other to accelerate the development of regional service industries. We should explore a new mode of investment cooperation, working together to build all forms of industrial parks such as overseas economic and trade cooperation zones and cross-border economic cooperation zones, and promote industrial cluster development. We should promote ecological progress in conducting investment and trade, increase cooperation in conserving the eco-environment, protecting biodiversity, and tackling climate change, and join hands to make the Silk Road an environment-friendly one.

We welcome companies from all countries to invest in China, and encourage Chinese enterprises to participate in the infrastructure construction in other countries along the Belt and Road, and make industrial investments there. We support localized operation and management of Chinese companies to boost the local economy, increase local employment, improve local livelihood, and take social responsibilities in protecting local biodiversity and eco-environment.

#### *Financial integration*

Financial integration is an important underpinning for implementing the Belt and Road Initiative. We should deepen financial cooperation, and make more efforts in building a currency stability system, investment and financing system and credit information system in Asia. We should expand the scope and scale of bilateral currency swap and settlement with other countries along the Belt and Road, open and develop the bond market in Asia, make joint efforts to establish the Asian Infrastructure Investment Bank and BRICS New Development Bank, conduct negotiation among related parties in establishing the Shanghai Cooperation Organization (SCO) financing institution, and set up and put into operation the Silk Road Fund as early as possible. We should strengthen practical cooperation of China-ASEAN Interbank Association and SCO Interbank Association, and carry out multilateral financial cooperation in the form of syndicated loans and bank credit. We will support the efforts of governments of the countries along the Belt and Road and their companies and financial institutions with good credit-rating to issue Renminbi bonds in China. Qualified Chinese financial institutions and companies are encouraged to issue bonds in both Renminbi and foreign currencies outside China, and use the funds thus collected in countries along the Belt and Road.

We should strengthen financial regulation cooperation, encourage the signing of MOUs on cooperation in bilateral financial regulation, and establish an efficient regulation coordination mechanism in the region. We should improve the system of risk response and crisis management, build a regional financial risk early-warning

system, and create an exchange and cooperation mechanism of addressing cross-border risks and crisis. We should increase cross-border exchange and cooperation between credit investigation regulators, credit investigation institutions and credit rating institutions. We should give full play to the role of the Silk Road Fund and that of sovereign wealth funds of countries along the Belt and Road, and encourage commercial equity investment funds and private funds to participate in the construction of key projects of the Initiative.

*People-to-people bond*

People-to-people bond provides the public support for implementing the Initiative. We should carry forward the spirit of friendly cooperation of the Silk Road by promoting extensive cultural and academic exchanges, personnel exchanges and cooperation, media cooperation, youth and women's exchanges and volunteer services, so as to win public support for deepening bilateral and multilateral cooperation.

We should send more students to each other's countries, and promote cooperation in jointly running schools. China provides 10,000 government scholarships to the countries along the Belt and Road every year. We should hold culture years, arts festivals, film festivals, TV weeks and book fairs in each other's countries; cooperate in the production and translation of fine films, radio and TV programs; and jointly apply for and protect World Cultural Heritage sites. We should also increase personnel exchange and cooperation between countries along the Belt and Road.

We should enhance cooperation in and expand the scale of tourism; hold tourism promotion weeks and publicity months in each other's countries; jointly create competitive international tourist routes and products with Silk Road features; and make it more convenient to apply for tourist visa in countries along the Belt and Road. We should push forward cooperation on the 21st-Century Maritime Silk Road cruise tourism program. We should carry out sports exchanges and support countries along the Belt and Road in their bid for hosting major international sports events.

We should strengthen cooperation with neighboring countries on epidemic information sharing, the exchange of prevention and treatment technologies and the training of medical professionals, and improve our capability to jointly address public health emergencies. We will provide medical assistance and emergency medical aid to relevant countries, and carry out practical cooperation in maternal and child health, disability rehabilitation, and major infectious diseases including AIDS, tuberculosis and malaria. We will also expand cooperation on traditional medicine.

We should increase our cooperation in science and technology, establish joint labs (or research centers), international technology transfer centers and maritime cooperation centers, promote sci-tech personnel exchanges, cooperate in tackling key sci-tech problems, and work together to improve sci-tech innovation capability.

We should integrate existing resources to expand and advance practical cooperation between countries along the Belt and Road on youth employment,

entrepreneurship training, vocational skill development, social security management, public administration and management and in other areas of common interest.

We should give full play to the bridging role of communication between political parties and parliaments, and promote friendly exchanges between legislative bodies, major political parties and political organizations of countries along the Belt and Road. We should carry out exchanges and cooperation among cities, encourage major cities in these countries to become sister cities, focus on promoting practical cooperation, particularly cultural and people-to-people exchanges, and create more lively examples of cooperation. We welcome the think tanks in the countries along the Belt and Road to jointly conduct research and hold forums.

We should increase exchanges and cooperation between non-governmental organizations of countries along the Belt and Road, organize public interest activities concerning education, health care, poverty reduction, biodiversity and ecological protection for the benefit of the general public, and improve the production and living conditions of poverty-stricken areas along the Belt and Road. We should enhance international exchanges and cooperation in culture and media, and leverage the positive role of the Internet and new media tools to foster harmonious and friendly cultural environment and public opinion.

## **V. Cooperation Mechanisms**

The world economic integration is accelerating and regional cooperation is on the upswing. China will take full advantage of the existing bilateral and multilateral cooperation mechanisms to push forward the building of the Belt and Road and to promote the development of regional cooperation.

We should strengthen bilateral cooperation, and promote comprehensive development of bilateral relations through multi-level and multi-channel communication and consultation. We should encourage the signing of cooperation MOUs or plans, and develop a number of bilateral cooperation pilot projects. We should establish and improve bilateral joint working mechanisms, and draw up implementation plans and roadmaps for advancing the Belt and Road Initiative. In addition, we should give full play to the existing bilateral mechanisms such as a joint committee, mixed committee, coordinating committee, steering committee and management committee to coordinate and promote the implementation of cooperation projects.

We should enhance the role of multilateral cooperation mechanisms, make full use of existing mechanisms such as the Shanghai Cooperation Organization (SCO), ASEAN Plus China (10+1), Asia-Pacific Economic Cooperation (APEC), Asia-Europe Meeting (ASEM), Asia Cooperation Dialogue (ACD), Conference on Interaction and Confidence-Building Measures in Asia (CICA), China-Arab States Cooperation Forum (CASCF), China-Gulf Cooperation Council Strategic Dialogue, Greater Mekong Sub-region (GMS) Economic Cooperation, and Central Asia Regional Economic Cooperation (CAREC) to strengthen communication with

relevant countries, and attract more countries and regions to participate in the Belt and Road Initiative.

We should continue to encourage the constructive role of the international forums and exhibitions at regional and sub-regional levels hosted by countries along the Belt and Road, as well as such platforms as Boao Forum for Asia, China-ASEAN Expo, China-Eurasia Expo, Euro-Asia Economic Forum, China International Fair for Investment and Trade, China-South Asia Expo, China-Arab States Expo, Western China International Fair, China-Russia Expo, and Qianhai Cooperation Forum. We should support the local authorities and general public of the countries along the Belt and Road to explore the historical and cultural heritage of the Belt and Road, jointly hold investment, trade and cultural exchange activities, and ensure the success of the Silk Road (Dunhuang) International Culture Expo, Silk Road International Film Festival and Silk Road International Book Fair. We propose to set up an international summit forum on the Belt and Road Initiative.

## **VI. China's Regions in Pursuing Opening-Up**

In advancing the Belt and Road Initiative, China will fully leverage the comparative advantages of its various regions, adopt a proactive strategy of further opening-up, strengthen interaction and cooperation among the eastern, western and central regions, and comprehensively improve the openness of the Chinese economy.

Northwestern and northeastern regions. We should make good use of Xinjiang's geographic advantages and its role as a window of westward opening-up to deepen communication and cooperation with Central, South and West Asian countries, make it a key transportation, trade, logistics, culture, science and education center, and a core area of the Silk Road Economic Belt. We should give full scope to the economic and cultural strengths of Shaanxi and Gansu provinces and the ethnic and cultural advantages of the Ningxia Hui Autonomous Region and Qinghai Province, build Xi'an into a new focus of reform and opening-up in China's interior, speed up the development and opening-up of cities such as Lanzhou and Xining, and advance the building of the Ningxia Inland Opening-up Pilot Economic Zone with the goal of creating strategic channels, trade and logistics hubs and key bases for industrial and cultural exchanges opening to Central, South and West Asian countries. We should give full play to Inner Mongolia's proximity to Mongolia and Russia, improve the railway links connecting Heilongjiang Province with Russia and the regional railway network, strengthen cooperation between China's Heilongjiang, Jilin and Liaoning provinces and Russia's Far East region on sea-land multi-modal transport, and advance the construction of an Eurasian high-speed transport corridor linking Beijing and Moscow with the goal of building key windows opening to the north.

Southwestern region. We should give full play to the unique advantage of Guangxi Zhuang Autonomous Region as a neighbor of ASEAN countries, speed up the opening-up and development of the Beibu Gulf Economic Zone and the Pearl River-Xijiang Economic Zone, build an international corridor opening to the ASEAN region, create new strategic anchors for the opening-up and development

of the southwest and mid-south regions of China, and form an important gateway connecting the Silk Road Economic Belt and the 21st-Century Maritime Silk Road. We should make good use of the geographic advantage of Yunnan Province, advance the construction of an international transport corridor connecting China with neighboring countries, develop a new highlight of economic cooperation in the Greater Mekong Sub-region, and make the region a pivot of China's opening-up to South and Southeast Asia. We should promote the border trade and tourism and culture cooperation between the Tibet Autonomous Region and neighboring countries such as Nepal.

Coastal regions, and Hong Kong, Macao and Taiwan. We should leverage the strengths of the Yangtze River Delta, Pearl River Delta, west coast of the Taiwan Straits, Bohai Rim, and other areas with economic zones boasting a high level of openness, robust economic strengths and strong catalytic role, speed up the development of the China (Shanghai) Pilot Free Trade Zone, and support Fujian Province in becoming a core area of the 21st-Century Maritime Silk Road. We should give full scope to the role of Qianhai (Shenzhen), Nansha (Guangzhou), Hengqin (Zhuhai) and Pingtan (Fujian) in opening-up and cooperation, deepen their cooperation with Hong Kong, Macao and Taiwan, and help to build the Guangdong-Hong Kong-Macao Big Bay Area. We should promote the development of the Zhejiang Marine Economy Development Demonstration Zone, Fujian Marine Economic Pilot Zone and Zhoushan Archipelago New Area, and further open Hainan Province as an international tourism island. We should strengthen the port construction of coastal cities such as Shanghai, Tianjin, Ningbo-Zhoushan, Guangzhou, Shenzhen, Zhanjiang, Shantou, Qingdao, Yantai, Dalian, Fuzhou, Xiamen, Quanzhou, Haikou and Sanya, and strengthen the functions of international hub airports such as Shanghai and Guangzhou. We should use opening-up to motivate these areas to carry out deeper reform, create new systems and mechanisms of open economy, step up scientific and technological innovation, develop new advantages for participating in and leading international cooperation and competition, and become the pacesetter and the main force in the Belt and Road Initiative, particularly the building of the 21st-Century Maritime Silk Road. We should leverage the unique role of overseas Chinese and the Hong Kong and Macao Special Administrative Regions, and encourage them to participate in and contribute to the Belt and Road Initiative. We should also make proper arrangements for the Taiwan region to be part of this effort.

Inland regions. We should make use of the advantages of inland regions, including a vast landmass, rich human resources and a strong industrial foundation, focus on such key regions as the city clusters along the middle reaches of the Yangtze River, around Chengdu and Chongqing, in central Henan Province, around Hohhot, Baotou, Erdos and Yulin, and around Harbin and Changchun to propel regional interaction and cooperation and industrial concentration. We should build Chongqing into an important pivot for developing and opening up the western region, and make Chengdu, Zhengzhou, Wuhan, Changsha, Nanchang and Hefei leading areas of opening-up in the inland regions. We should accelerate cooperation between regions



on the upper and middle reaches of the Yangtze River and their counterparts along Russia's Volga River. We should set up coordination mechanisms in terms of railway transport and port customs clearance for the China-Europe corridor, cultivate the brand of "China-Europe freight trains," and construct a cross-border transport corridor connecting the eastern, central and western regions. We should support inland cities such as Zhengzhou and Xi'an in building airports and international land ports, strengthen customs clearance cooperation between inland ports and ports in the coastal and border regions, and launch pilot e-commerce services for cross-border trade. We should optimize the layout of special customs oversight areas, develop new models of processing trade, and deepen industrial cooperation with countries along the Belt and Road.

## VII. China in Action

For more than a year, the Chinese government has been actively promoting the building of the Belt and Road, enhancing communication and consultation and advancing practical cooperation with countries along the Belt and Road, and introduced a series of policies and measures for early outcomes.

High-level guidance and facilitation. President Xi Jinping and Premier Li Keqiang have visited over 20 countries, attended the Dialogue on Strengthening Connectivity Partnership and the sixth ministerial conference of the China-Arab States Cooperation Forum, and met with leaders of relevant countries to discuss bilateral relations and regional development issues. They have used these opportunities to explain the rich contents and positive implications of the Belt and Road Initiative, and their efforts have helped bring about a broad consensus on the Belt and Road Initiative.

Signing cooperation framework. China has signed MOUs of cooperation for the joint development of the Belt and Road with some countries, and on regional cooperation and border cooperation and mid- and long-term development plans for economic and trade cooperation with some neighboring countries. It has proposed outlines of regional cooperation plans with some adjacent countries.

Promoting project cooperation. China has enhanced communication and consultation with countries along the Belt and Road, and promoted a number of key cooperation projects in the fields of infrastructure connectivity, industrial investment, resource development, economic and trade cooperation, financial cooperation, cultural exchanges, ecological protection and maritime cooperation where the conditions are right.

Improving policies and measures. The Chinese government will integrate its domestic resources to provide stronger policy support for the Initiative. It will facilitate the establishment of the Asian Infrastructure Investment Bank. China has proposed the Silk Road Fund, and the investment function of the China-Eurasia Economic Cooperation Fund will be reinforced. We will encourage bank card clearing institutions to conduct cross-border clearing operations, and payment institutions to conduct cross-border payment business. We will actively promote

investment and trade facilitation, and accelerate the reform of integrated regional customs clearance.

Boosting the role of cooperation platforms. A number of international summits, forums, seminars and expos on the theme of the Belt and Road Initiative have been held, which have played an important role in increasing mutual understanding, reaching consensus and deepening cooperation.

### **VIII. Embracing a Brighter Future Together**

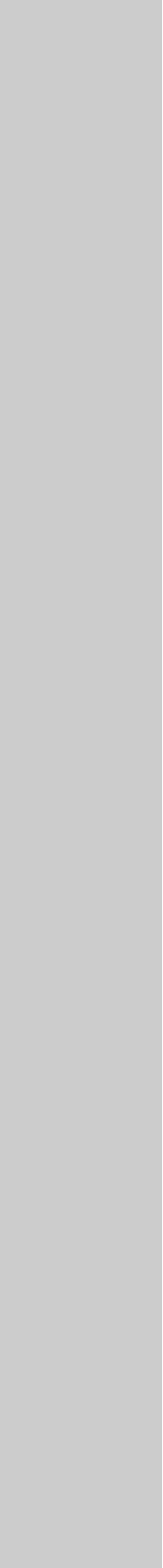
Though proposed by China, the Belt and Road Initiative is a common aspiration of all countries along their routes. China is ready to conduct equal-footed consultation with all countries along the Belt and Road to seize the opportunity provided by the Initiative, promote opening-up, communication and integration among countries in a larger scope, with higher standards and at deeper levels, while giving consideration to the interests and aspirations of all parties. The development of the Belt and Road is open and inclusive, and we welcome the active participation of all countries and international and regional organizations in this Initiative.

The development of the Belt and Road should mainly be conducted through policy communication and objectives coordination. It is a pluralistic and open process of cooperation which can be highly flexible, and does not seek conformity. China will join other countries along the Belt and Road to substantiate and improve the content and the mode of the Belt and Road cooperation, work out relevant timetables and roadmaps, and align national development programs and regional cooperation plans.

China will work with countries along the Belt and Road to carry out joint research, forums and fairs, personnel training, exchanges and visits under the framework of existing bilateral, multilateral, regional and sub-regional cooperation mechanisms, so that they will gain a better understanding and recognition of the contents, objectives and tasks of the Belt and Road Initiative.

China will work with countries along the Belt and Road to steadily advance demonstration projects, jointly identify programs that accommodate bilateral and multilateral interests, and accelerate the launching of programs that are agreed upon by the parties and ready for implementation, so as to ensure early harvest.

The Belt and Road cooperation features mutual respect and trust, mutual benefit and win-win cooperation, and mutual learning between civilizations. As long as all countries along the Belt and Road make concerted efforts to pursue our common goal, there will be brighter prospects for the Silk Road Economic Belt and the 21st-Century Maritime Silk Road, and the people of countries along the Belt and Road can all benefit from this Initiative.



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2-6 authors:

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Fatić, M., Đukanović, D., & Gajić, D. (2012). Security of Balkans and Serbia in the Context. *Review of International Affairs*, 44(3), 70–83.

More than 6 authors:

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United Nations. (2006, November 9). *Delivering as one*. Report of the Secretary-General's High-Level Panel on UN System-wide Coherence in the Areas of Development, Humanitarian Assistance and the Environment, New York.

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Zakon o spoljnim poslovima, *Službeni glasnik RS*. Br. 116 (2007).

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