

Chapter 3

The Chinese Concept of 21st Century Maritime Silk Route and It's Strategic Objectives in the Indian Ocean Region

“Whoever is lord of Malacca shall have his hands on the throat of Venice”

-Tome Pires¹⁵

The Economic History of China

The economic history of China covers thousands of years and the region has undergone alternating cycles of prosperity and decline. China had, for most of the last two millennia, the world's largest and most advanced economies¹⁶. China was the leading economy in the beginning of the first millennium and continue to dominate till 19th century (Fig 3.1 refers). However due to opium wars and industrilaisation of Europe and USA, it's economy declined in 1860s. After nearly a century, China's economy started looking up due to various measures implemented successfully. Thus China, is trying to regain it's last glory and position in world's economy. The OBOR is one such attempt where China is aiming to further enhance it's economic capability apart from military superiority.

¹⁵ **Tomé Pires** (1465?–1524 or 1540) was a Portuguese apothecary from Lisbon who spent 1512 to 1515 in Malacca immediately after the Portuguese conquest, at a time when Europeans were only first arriving in South East Asia. After his arduous experiences in India and the East Indies, he headed the first official embassy from a European nation in China (Portugal, to the Chinese Zhengde Emperor, during the Ming dynasty), where he died.

¹⁶ https://en.wikipedia.org/wiki/Economic_history_of_China_before_1912

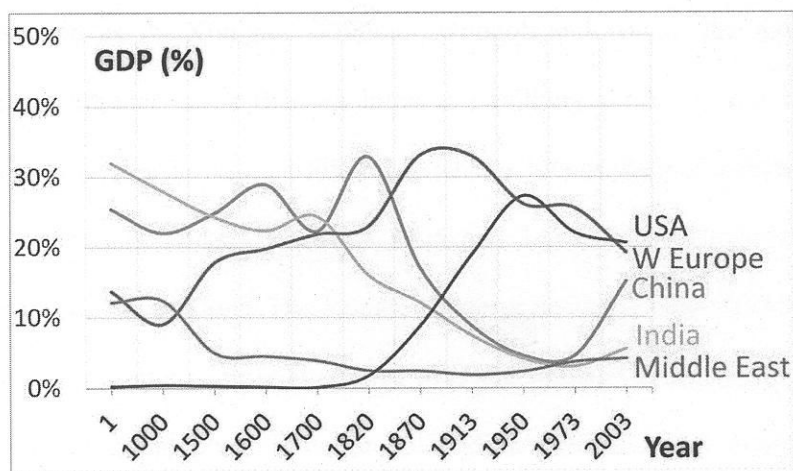


Fig 3.1 : World GDP in past 2000 years

(Source: <https://www.google.co.in/search?q>)

The Maritime History of China

Like India, China has a rich maritime history. Apart from the Land silk route which was used for trade and culture, sea was also exploited for similar purposes. The naval history of China dates back thousands of years, with archives existing since the late Spring and Autumn Period (722 BC–481 BC) about the ancient navy of China and the various ship types used in war.¹⁷ It was during the Song Dynasty (960–1279 AD) that the Chinese established a permanent, standing navy in 1132 AD. At its height by the late 12th century there were 20 squadrons of some 52,000 marines, with the admiral's headquarters based at Dinghai, while the main base remained closer to modern Shanghai in those days. The establishment of the permanent navy during the Song period came out of the need to defend against the Jurchens, who had overrun the northern half of China, and to escort merchant fleets entering the South East Pacific and Indian Ocean on long trade missions abroad to the Hindu, Islamic, and East African spheres of the world. However, considering China was a country which was longtime menaced by land-based

¹⁷ https://en.wikipedia.org/wiki/Naval_history_of_China (sourced on 25 January 2016)

nomadic tribes such as the Xiongnu, Göktürks, Mongols and so on, the navy was always seen as an adjunct rather than an important military force. China was the leading maritime power in the years 1405-1433, when Chinese shipbuilders began to build massive oceangoing junks. Between 1405 and 1433, the Ming government sponsored seven naval expeditions. The Yongle Emperor designed them to establish a Chinese presence and impose imperial control over the Indian Ocean trade, impress foreign people in the Indian Ocean basin, and extend the empire's tributary system. It has also been inferred from passages in the History of Ming that the initial voyages were launched as part of the emperor's attempt to capture his escaped predecessor, which would have made the first voyage the "largest-scale manhunt on water in the history of China". Zheng He¹⁸ was placed as the admiral in control of the huge fleet and armed forces that undertook these expeditions. Wang Jinghong was appointed his second in command. Preparations were thorough and wide-ranging, including the use of such numerous linguists that a foreign language institute was established at Nanjing. Zheng He's first voyage departed 11 July 1405, from Suzhou and consisted of a fleet of 317 ships holding almost 28,000 crewmen.

Zheng He's fleets visited Brunei, Java, Thailand and Southeast Asia, India, the Horn of Africa, and Arabia, dispensing and receiving goods along the way (see Fig 3.2). Zheng He presented gifts of gold, silver, porcelain, and silk; in return, China received such novelties as ostriches, zebras, camels, and ivory from the Swahili. After the First and Second Opium Wars, which shook up the generals of the Qing dynasty, the government attached greater importance to the navy. In modern times, the current Mainland Chinese and Taiwanese governments continue to

¹⁸ https://en.wikipedia.org/wiki/Zheng_He & Robert D Kaplan, (2010) Monsoon: The Indian Ocean & Future of American Power, Random House Publication, Newyork, eISBN : 978-0-679-60405-1

maintain standing navies with the People's Liberation Army Navy and the Republic of China Navy, respectively.

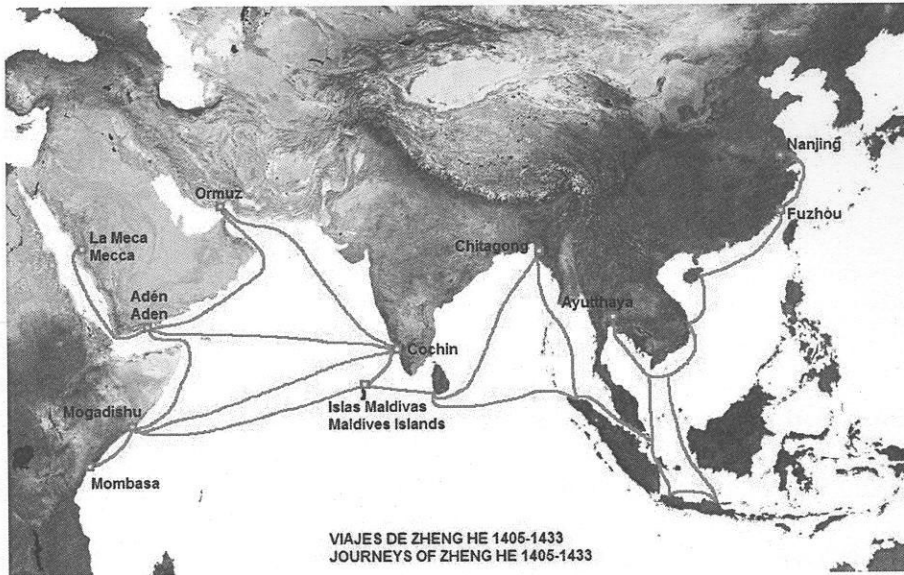


Fig 3.2 : Map showing Zheng He's expedition in 15th century

(Source : https://en.wikipedia.org/wiki/Zheng_He)

As of today, The Chinese People's Liberation Army Navy (PLAN) is the largest navy¹⁹ in Asia in terms of ships, with some 88 principal surface combatants, more than 60 submarines, 55 medium and large amphibious ships, one aircraft carrier, and roughly 85 missile-equipped small combatants. The Chinese Navy is currently replacing its older ships with fewer but more capable ships, but its operational focus remains largely limited to the western Pacific, in particular the Yellow, East China, and South China Seas. However, the role of the PLAN is evolving, as the navy is increasingly deployed beyond these nearby seas to respond to non-traditional security threats and as a diplomatic tool.

¹⁹ Cordsemen & Colly, Chinese Strategy & Military Modernisation in 2015 : A Comparative Analysis : Centre for Strategic & International Studies, Washington (Burke Chair in Strategy) pp 227

Currently, the PLAN has a total strength of 235,000 officers and men, and commands three fleets, namely, the Beihai Fleet, the Donghai Fleet and the Nanhai Fleet. Each fleet has fleet aviation headquarters, support bases, flotillas and maritime garrison commands, as well as aviation divisions and marine brigades. In September 2012, China's first aircraft carrier Liaoning was commissioned into the PLAN. China's development of an aircraft carrier has a profound impact on building a strong PLAN and safeguarding maritime security.²⁰

The One Belt One Road Project

The One Belt, One Road (abbreviated **OBOR**) or the **Belt and Road Initiative** is a development strategy and framework, proposed by People's Republic of China that focuses on connectivity and cooperation among countries primarily in Eurasia, which consists of two main components, the land-based "Silk Road Economic Belt" (SREB) and oceangoing "Maritime Silk Road" (MSR). The strategy underlines China's push to take a bigger role in global affairs, and its need to export China's production capacity in areas of overproduction such as steel manufacturing. It was unveiled by Chinese paramount leader Xi Jinping in September and October 2013 in announcements revealing the SREB and MSR, respectively. Also, it was promoted by Premier Li Keqiang during the State visit in Asia and Europe²¹.

²⁰ Cordsemen & Colly, *Chinese Strategy & Military Modernisation in 2015 : A Comparative Analysis* : Centre for Strategic & International Studies, Washington (Burke Chair in Strategy) pp 157

²¹ https://en.wikipedia.org/wiki/One_Belt,_One_Road

Silk Road Economic Belt

When Chinese leader Xi Jinping visited Central Asia and Southeast Asia in September and October 2013, he raised the initiative of jointly building the Silk Road Economic Belt and the 21st-Century Maritime Silk Road . Essentially, the 'belt' includes countries situated on the original Silk Road through Central Asia, West Asia, the Middle East, and Europe. The initiative calls for the integration of the region into a cohesive economic area through building infrastructure, increasing cultural exchanges, and broadening trade. Apart from this zone, which is largely analogous to the historical Silk Road, another area that is said to be included in the extension of this 'belt' is South Asia and Southeast Asia. Many of the countries that are part of this belt are also members of the China-led Asian Infrastructure Investment Bank (AIIB). North, central and south belts are proposed. North belt goes through Central Asia, Russia to Europe. Central belt goes through Central Asia, West Asia to the Persian Gulf and the Mediterranean. South belt starts from China to Southeast Asia, South Asia, the Indian Ocean.

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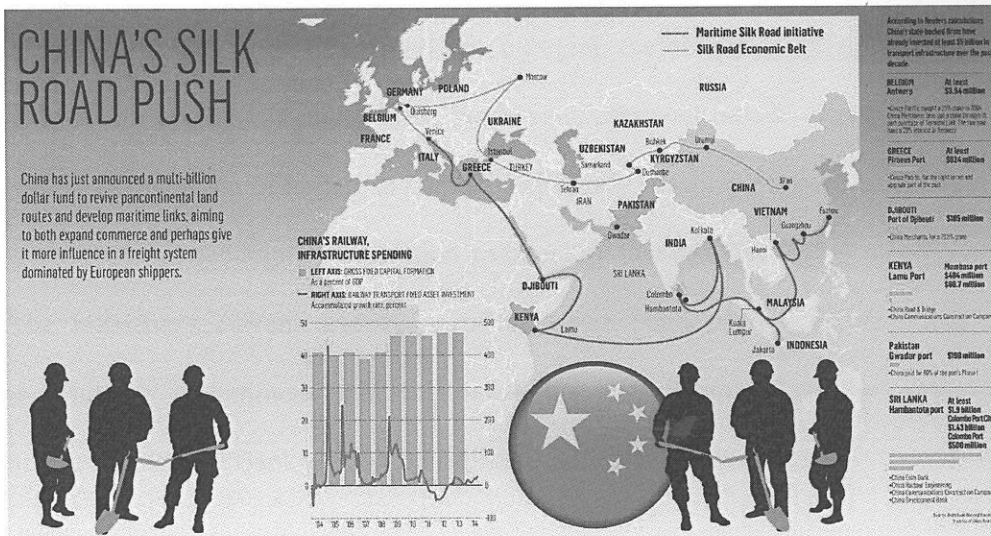


Fig 3.3 : One Belt One Road (SREB & MSR)

(Source : <https://www.google.co.in/search?q=One+Belt+One+Road&esp>)

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The Maritime Silk Route Concept

The concepts of the Silk Road Economic Belt and the Maritime Silk Road were first introduced by Chinese President Xi Jinping during his visits to Kazakhstan and Indonesia in 2013. The Central Government has since then further elaborated on the idea of building the Silk Road Economic Belt and the 21st Century Maritime Silk Road. The concept is often shorthanded as the “One Belt One Road” Initiative, or more simply as the Belt and Road. On 28 March 2015, during the Boao Forum for Asia, China’s National Development and Reform Commission, in conjunction with China’s Foreign Ministry and Commerce Ministry, issued an action plan for the Belt and Road, bringing the concept one important step closer to realization.

Titled the “Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road” (copy placed at Appendix C), the official document lays out the basic goals of the “One Belt One Road” Initiative: “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.”

The Initiative’s current priority is infrastructure connectivity. Towards that end, the Chinese government has facilitated the establishment of the Asian Infrastructure Investment Bank and set up a US\$40 billion Silk Road Fund.

Geographic Coverage

According to the action plan, the Belt will have three routes and the Road will have two routes²² (Fig 3.4 below refers).

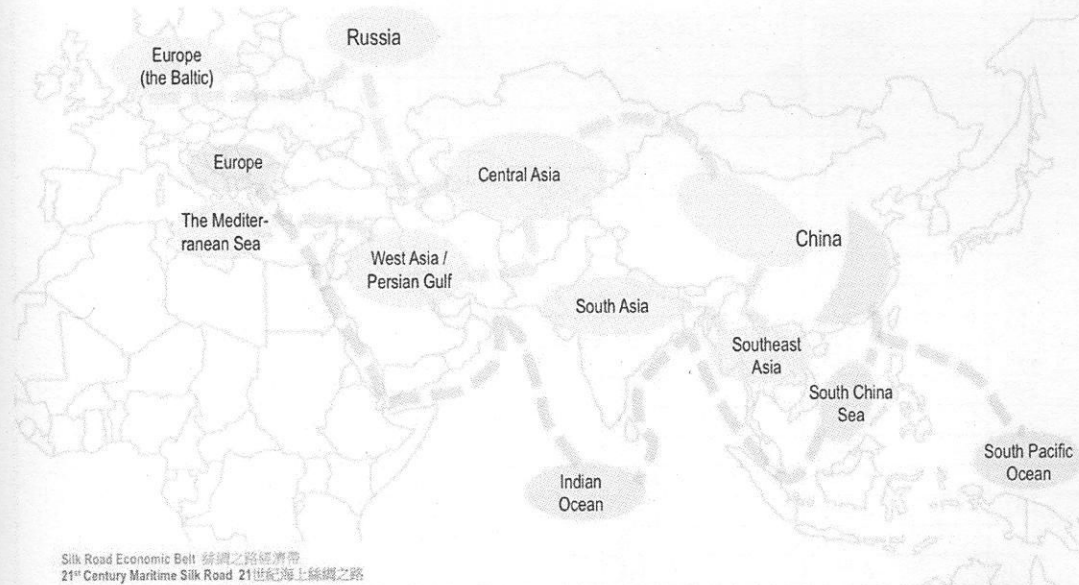


Fig 3.4: Geographic Coverage of the Silk Road Economic Belt and the 21st Century Maritime Silk Road

Source: Compiled by the Fung Business Intelligence Centre based on the FRAMEWORK chapter of the "Vision and Actions on Jointly Building Silk Road Economic Belt and 21st Century Maritime Silk Road"

The Silk Road Economic Belt

- China—Central Asia—Russia—Europe (the Baltic)
- China—Central Asia—West Asia—Persian Gulf—Mediterranean Sea
- China—Southeast Asia—South Asia—Indian Ocean

The 21st Century Maritime Silk Road

- Coastal China—South China Sea—Indian Ocean—Europe
- Coastal China—South China Sea—South Pacific

On the same day that the official action plan of the Initiative was announced, China's President Xi also revealed in his speech that around 60 countries along the routes have shown interest in taking part in the development of the Belt and Road.

²² Helen Chin & Co, *The Silk Road Economic Belt & the 21st Century Maritime Silk Road*, Fung Business Intelligence Centre Hong Kong (www.fbicgroup.com), pp3

The full list of the countries and the relevant economic indicators is shown in table

below:-

	<u>Country</u>	<u>Land Area in Sq Km (2014)</u>	<u>Population mn (2013)</u>	<u>GDP US D Bn (2013)</u>	<u>Household Consumption USD mn (2013)</u>
North & east Asia	China	9388.2	1357380.0	9240.3	3446.8
	Russia	16376.9	143.5	2096.8	1089.1
	Mangolia	1533.6	2.8	11.5	6.2
Central Asia	Kazakhstan	2699.7	17.0	231.9	117.5
	Kyrgyzstan	191.8	5.7	7.2	6.8
	Tajikistan	140.0	8.2	8.5	9.5
	Turkmenistan	469.9	5.2	41.9	5.3
	Uzbekistan	425.4	30.2	56.8	30.4
	Afghanistan	652.9	30.6	20.3	16.6
West Asia	Armenia	28.5	3.0	10.4	9.2
	Azerbaijan	82.7	9.4	73.6	30.8
	Bahrain	0.8	1.3	32.9	11.6
	Cyprus	9.2	1.1	21.9	NA
	Georgia	69.5	4.5	16.1	11.5
	Iran	1628.6	77.4	368.9	0.0
	Iraq	434.3	33.4	229.3	0.0
	Israel	21.6	8.1	290.6	164.3
	Jordan	88.8	6.5	33.7	27.3
	Kuwait	17.8	3.4	175.8	42.5
	Lebanon	10.2	4.5	44.4	31.5
	Oman	309.5	3.6	73.7	22.8
	Qatar	11.6	2.2	203.2	24.1
	Saudi Arabia	2149.7	28.8	748.4	222.2
	Syria	183.6	22.8	NA	NA
	Turkey	769.6	74.9	822.1	582.7
	UAE	83.6	9.3	402.3	200.4
	Yemen	528.0	24.4	36.0	NA
	South East Asia	Brunei	5.3	0.4	16.1
Cambodia		176.5	15.1	15.2	12.6
Indonesia		1811.6	249.9	868.3	484.8
Laos		230.8	6.8	11.2	7.3
Malaysia		328.6	29.7	313.2	160.0
Myanmar		653.3	53.3	NA	NA
Philippines		296.2	98.4	272.1	199.4
Singapore		0.7	5.4	297.9	110.5
Thailand		510.9	67.0	387.3	210.8
Vietnam		310.1	89.7	171.4	111.5
East Timor	14.9	1.2	1.3	0.9	
South Asia	Bangladesh	130.2	156.6	150.0	109.3
	Bhutan	38.1	0.8	1.8	1.0
	India	2973.2	1252.1	1876.8	1071.9
	Maldives	0.3	0.3	2.3	NA
	Nepal	143.4	27.8	19.3	15.1
	Pakistan	770.9	182.1	232.3	188.6
	Sri Lanka	62.7	20.5	67.2	44.9

	<u>Country</u>	<u>Land Area in Sq Km (2014)</u>	<u>Population mn (2013)</u>	<u>GDP US D Bn (2013)</u>	<u>Household Consumption USD mn (2013)</u>
Eastern Europe	Estonia	42.4	1.3	24.9	12.8
	Latvia	62.2	2.0	31.0	17.5
	Lithuania	62.7	3.0	45.9	27.2
	Ukraine	579.3	45.5	177.4	129.0
	Belarus	202.9	9.5	71.7	36.8
	Moldova	32.9	3.6	8.0	7.4
	Poland	306.2	38.5	525.9	320.2
Southern & Western Europe	Greece	128.9	11.0	242.2	172.5
	Italy	294.1	59.8	2149.5	1300.3
	Germany	348.5	80.6	3730.3	2086.6
	Netherlands	33.7	16.8	853.5	384.5
East Africa	Kenya	569.1	44.4	55.2	44.2
	Egypt	995.5	82.1	272.0	220.8
Total		50443.7	4574.6	28195.6	13601.2
Share of OBOR countries in world Total		38.9%	64.2%	37.3%	31.4%

Table 3.1: List of Countries Included in Computing the Percentage Shares Shown in Fig 3.2 - Economic Significance of One Belt One Road Countries
(Source: The World Bank, compiled by the Fung Business Intelligence Centre, HongKong)

It is claimed by China that, Together, the countries along the Belt and Road will create an “economic cooperation area” that stretches from the Western Pacific to the Baltic Sea. According to a research undertaken by Fung Business Intelligence Centre, Hong Kong, these 58 countries jointly account for 64.2%, 37.3% and 31.4% of the world’s population, GDP and household consumption respectively today (Fig 3.2 below refers). Many of these countries are home to the emerging middle class and hold the key to economic growth in the future.

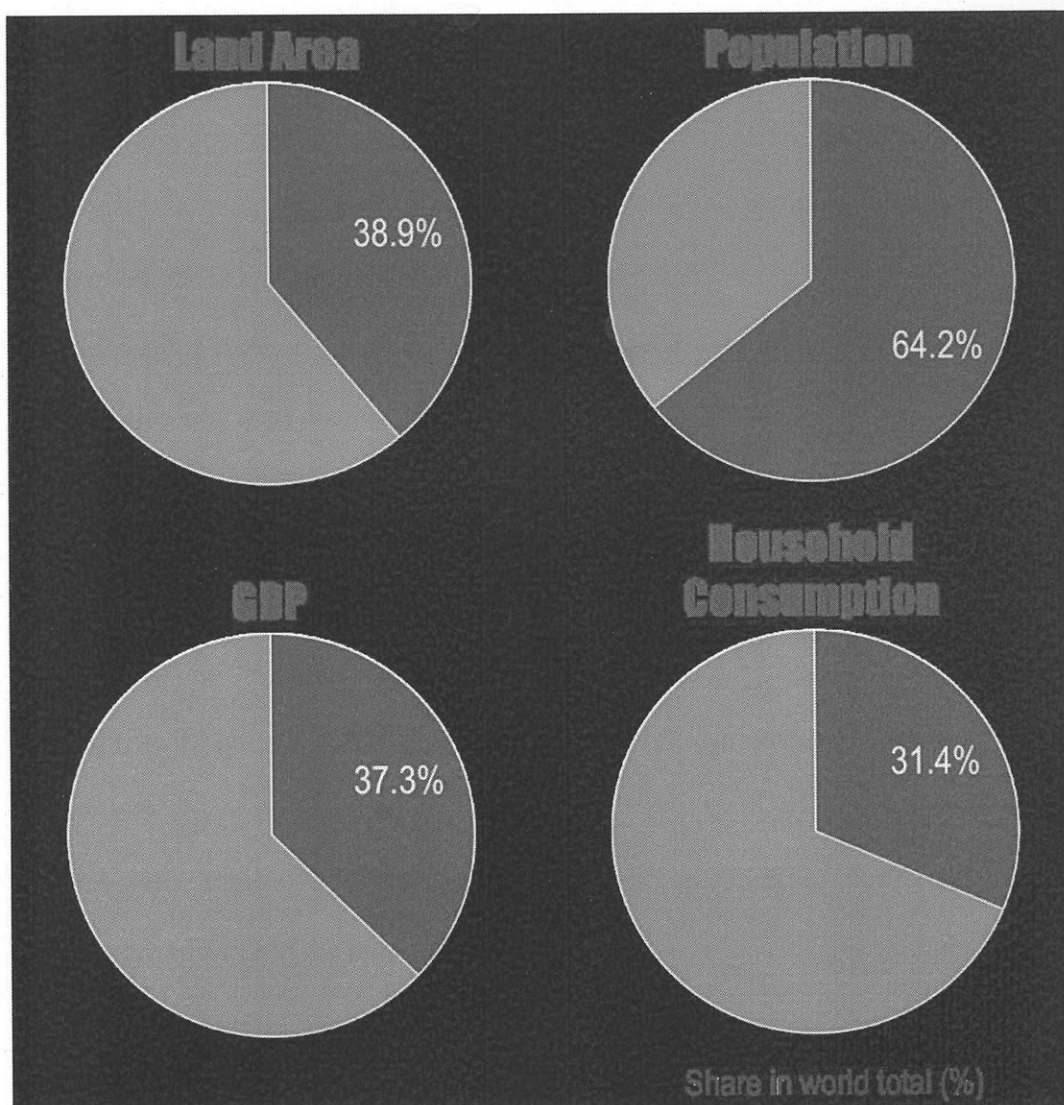


Fig 3.5: Economic Significance of One Belt One Road Countries
 (Source: *The World Bank, compiled by the Fung Business Intelligence Centre, Hongkong*)

The Vision

The vision of the One Belt One Road Initiative is to realize the “Five Links”, which refer to linkages in policies, infrastructure, trade, finance and people. The “Five Links” refer to linkages in policies, infrastructure, trade, finance and people²³.

Policy Coordination

²³Helen Chin & Co, *The Silk Road Economic Belt & the 21st Century Maritime Silk Road*, *Fung Business Intelligence Centre Hong Kong* (www.fbicgroup.com), pp 6

- Policy coordination among the countries along the Belt and Road is crucial for the success of the Initiative. According to the Initiative's vision, the countries will coordinate their economic development strategies and policies, and work out together plans and measures for regional cooperation.
- Countries along the Belt and Road will set up a multi-level inter-governmental macro policy exchange and communication mechanism.

Capacity Building

- Countries along the Belt and Road will improve the connectivity of their infrastructure and harmonize standards.
- Countries will push forward constructions of port infrastructure, remove bottlenecks in land-water transportation channels, promote cooperation of ports, and increase sea routes and the number of voyages.
- Countries will expand platforms for comprehensive civil aviation cooperation and improve aviation infrastructure.
- Cooperation in the connectivity of energy infrastructure will also be promoted.
- Countries will jointly advance the construction of communications networks, such as cross-border optical cable networks and satellite information networks.
- Countries will strengthen cooperation in science and technology by establishing joint laboratories and promoting
- China will advance cooperation between countries along the Belt and Road on areas such as youth employment, entrepreneurship training and vocational skills development

- Countries along the Belt and Road will also boost student exchange programmes.

Liberalization and Facilitation of Trade and Investment

- Countries along the Belt and Road will enhance customs cooperation in areas such as information exchange, mutual recognition of regulations and mutual assistance in law enforcement. A “Single-window system” will be established in border ports. Moreover, the countries will promote online checking of inspection and quarantine certificates and facilitate mutual recognition of Authorized Economic Operators (AEOs).
- Countries will lower non-tariff barriers and improve the transparency of technical trade measures.
- Countries will take actions to advance investment facilitation and to eliminate investment barriers. Negotiations on bilateral investment protection agreements and double taxation avoidance agreements will also be pushed forward.
- Countries will expand mutual investment areas. In particular, cooperation in non-fossil energy sectors such as hydropower, nuclear power, wind power and solar power will be strengthened.
- Countries will also promote cooperation in emerging industries such as new-generation information technology, biotechnology, new energy technology and new materials.

- Countries will cooperate in building various forms of industrial parks such as overseas economic and trade cooperation zones and cross-border economic cooperation zones.

Financial Cooperation

- Countries along the Belt and Road will strengthen financial cooperation and increase their efforts to build currency stability systems, investment & financing systems and credit information systems in Asia.
- Countries will push forward the establishment of the Asian Infrastructure Investment Bank, the BRICS New Development Bank, the Shanghai Cooperation Organization (SCO) financing institution and the Silk Road Fund.
- Countries will create or further develop their bond markets. China will support the governments in the countries along the Belt and Road as well as companies and financial institutions with good credit-ratings to issue yuan bonds in China. Meanwhile, qualified Chinese financial institutions and companies will be encouraged to issue bonds in yuan or in other currencies outside China.
- Countries will expand the scope and scale of bilateral currency swaps and settlements.
- Commercial equity investment funds and private funds will be encouraged to participate in the construction of key projects of the Initiative.

New Silk Road Fund (NSRF)

China has also established a new Silk Road Fund to explicitly support the project. The fund's initial \$10 billion financing is from China's foreign exchange reserves—which contributed the majority of the initial funds—the China

Development Bank, China Investment Corporation, and the Export-Import Bank of China²⁴. The Chinese government will tap its foreign currency reserves for about 65 percent of the Silk Road Fund. China Investment Corporation and the Export-Import Bank of China will chip in 15 percent each, and China Development Bank Capital Co. will invest 5 percent. The upcoming second and third phases will involve domestic and foreign investors. While based in Beijing and currently supported by a majority of Chinese investors, the Silk Road Fund is not state-owned and will eventually hopefully be dominated by currencies other than the Chinese yuan. The fund operates much as a private equity venture, but with a smaller group of investors committed for longer terms. It is comparable to institutions such as the World Bank's International Finance Corporation in mission and scale, but it is financed by a small number of investors rather than by public funds. The private equity venture-type structure of the fund should help avoid riskier politically-driven deals that are not always in the best economic interests. The structure will hopefully depoliticize the fund, allowing its managers to seek lower-risk investments.

China's Silk Road Fund announced its 1st project for investment in the Belt and Road initiative during Chinese President Xi Jinping's state visit to Pakistan, marking a milestone of the all weather strategic partnership of cooperation between the two countries. The investment into the US\$1.65 billion Karot hydropower project in Pakistan, along with other hydropower projects in the region, will help the South Asian country upgrade power supply and improve its economic performance.

²⁴ Ajay Chhibber (Sep 2015), China's One Belt One Road Strategy: The New Financial Institutions and India's Options, Working Paper No. 2015-155, pp 19, National Institute of Public Finance and Policy, New Delhi, available on <http://www.nipfp.org.in>

The project is a priority within the broader China-Pakistan Economic Corridor (CPEC) initiative, a flagship program of China's Belt and Road initiative. The CPEC is a planned network of roads, railways and energy projects linking southwest Pakistan's deep-water Gwadar Port with northwest China's Xinjiang Uygur Autonomous Region. With the CPEC at the center, China and Pakistan could achieve a win-win result and common development, and bring benefit to their people. For China, it would shorten the route for its energy imports. For Pakistan, a "1+4" cooperation structure with the CPEC at the center and the Gwadar Port, transport infrastructure, energy and industrial cooperation being the four key areas, will boom the country's economy and improve people's livelihood.

Owing to the corridor's geographical position where the Belt and Road meet, the CPEC is expected to combine South Asia, Central Asia, Middle East and China together, and benefit directly about 3 billion people in the region. Based on this, it could function as a bridge in advancing the Belt and Road initiative after being well developed and successfully operated. The CPEC project has risks as the infrastructure passes through areas with huge disputes.

A gold sector fund involving countries along the ancient Silk Road has been set up in northwest China's Xi'an City. The fund, led by Shanghai Gold Exchange (SGE), is expected to raise an estimated 100 billion yuan (16.1 billion U.S. Dollars) in three phases. China is the world's largest gold producer, and also a major importer and consumer of gold. Among the 65 countries along the routes of the Silk Road Economic Belt and the 21st-Century Maritime Silk Road, there are numerous Asian countries identified as important reserve bases and consumers of gold. About 60 countries have invested in the fund, which will in turn facilitate gold purchase for the

central banks of member states to increase their holdings of the precious metal, according to the SGE.

The Silk Road Fund is also looking to invest in companies that will boost transportation globally. It recently signed an equity investment agreement with ChemChina to hold a 25% stake in CNRC International Holding (HK) Limited ("CNRC HK"). CNRC HK was established to acquire, through its affiliates, the Pirelli ordinary shares owned by Camfin and thereafter to launch the 21 Mandatory Tender Offer for Pirelli ordinary shares and the Voluntary Tender Offer for Pirelli savings shares. The signing of the agreements indicates that ChemChina, Silk Road Fund, Pirelli management and other partners will join forces in the long term industrial investment in Pirelli as they are all committed to working together to build a market leader in the global tire industry

China's Strategic Objectives in the Indian Ocean Region

China's strategic objectives in the Indian Ocean region undoubtedly reflect its broader foreign policy outlook. In turn, this outlook is influenced by its core interests, Beijing's perception of what might be threatening those core interests and how it will seek to remove or reduce those threats. In the context of its foreign policy, as it relates to the Indian Ocean region, and especially with regard to India and the United States, China's core interests can be summarised in the following manner²⁵:

²⁵ Workshop Report (2011), China's Strategic Objectives in Indian Ocean, Future Directions International, Independent Strategic Analysis of Australia's Global Interests

Paramount National Objective

Maintaining the supremacy of the Chinese Communist Party (CCP)

Core Domestic Objectives

- Ensuring continued popular support for the CCP government via the continued security and prosperity of the Chinese people
- Maintaining China's internal stability
- Maintaining China's territorial integrity
- Developing China's economic base and thus maintaining the implicit trade-off between greater economic freedom and restricted political freedoms
- Preparing for China's future domestic challenges including: food, water and energy security; an ageing population; coping with environmental pressures; and a sustainable and balanced economic growth that ensures high employment, distribution of wealth and low inflation.

Primary Foreign Policy Objectives

- Ensuring the legitimacy of the Chinese Communist Party as the only government of greater China and thus the acceptance of the “One China” policy
- Ensuring that China achieves international status as a major power, concentrating on its economic influence and development
- Reducing foreign support for internal dissident groups or individuals
- Ensuring availability of, and access to, resources and markets
- Ensuring China’s territorial integrity and the security of its borders

Indian Ocean Objectives

- Preventing the development of dissident groups in neighbouring Indian Ocean littoral states that might challenge China’s internal security
- Ensuring that China’s national image is supported by a network of diplomatic relations with which to secure trade relations and influence
- Ensuring that China’s objectives are not jeopardised by India or the United States
- Ensuring unimpeded access to markets, energy supplies, raw materials and technology
- Ensuring secure maritime and land transport corridors

China’s Indian Ocean Region Interests

China’s Growing Energy Import Demand

Since its opening up in the late 1970s, China has undergone very high energy consumption growth due to its explosive economic expansion and industrialization, although the economy has slowed recently. China’s total energy consumption in 2013

consisted mainly of coal (68%), followed by oil (18%), hydropower (7%) and natural gas (5%), and the consumption of renewables (2%) and nuclear power (under 1%) remained small²⁶. The country's oil demand began to outstrip its domestic supply in the 1990s, and it became an importer of oil products from 1993 and an importer of crude oil from 1996. China consumed an estimated 10.7 million barrels per day (bbl/d) of oil in 2013, up 380 thousand bbl/d, or almost 4%, from 2012. The country's growth in oil consumption accounted for one-third of the world's oil consumption growth in 2013. China overtook the United States as the world's largest net importer of crude oil and other liquids in September 2013 and imported a record 7 million bbl/d of oil in December 2014.

China has the world's third largest recoverable coal reserves. As the largest producer and consumer in the world, China accounted for 50.3% of the world's coal consumption in 2013. Coal consumption grew more than two fold between 2000 and 2012, and China became a net coal importer from 2009 onwards due to rising demand and the high cost of transporting coal from the producing regions located inland to the coastal areas where demand is concentrated. In 2012, China consumed 4 billion (short) tons of coal, and as coal imports became more cost competitive, total imports rose 30% from 2011 levels, reaching 323 million short tons in 2012. The imports in 2012 came mainly from Australia (38%), Indonesia (34%), South Africa (13%), Russia (7%), United States (4%), Colombia (3%) and Canada (1%).

China's demand for natural gas has rocketed since it first imported liquefied natural gas (LNG) in 2006 and it quickly became the world's third largest LNG importer in 2012. In a bid to reduce the reliance on coal, which is highly polluting, the

²⁶ Christopher Len (2015) China's 21st Century Maritime Silk Road Initiative, Energy Security and SLOC Access, pp 3-4, Maritime Affairs: Journal of the National Maritime Foundation of India, 11:1, 1-18, DOI: 10.1080/09733159.2015.1025535

government has looked to natural gas, being the cleanest burning fossil fuel, as an alternative. Natural gas accounted for about 4.9% of China's 2012 total energy consumption with consumption rising 17% annually, on average, from 2003 through 2013. The Chinese government is expecting consumption, which stood at 108 billion cubic metres (bcm) in 2010, to grow to 8% of total energy consumption (230 bcm) by the end of 2015 and reach 10% (400 bcm) by 2020. While there are plans to boost domestic production in the deep waters of the South China Sea, including areas under dispute with some of its Southeast Asian neighbours, as well as develop unconventional gas resources on land, these are unlikely to meet total demand. The total import volume will continue to grow as a result of growing consumption and expanding infrastructure capacity in terms of import pipelines and LNG receiving terminals. The 12th Five Year Plan (2011–2015) for natural gas development estimates that the total import volume in China will be 93.5 bcm in 2015.

Increased Dependence on Seaborne Energy Trade

The Indian Ocean and South China Sea are major transit routes carrying oil and gas from the Middle East and Africa to the major East Asian economies, including China. About 80% of China's oil imports pass through these SLOCs before reaching China. In 2013, China's largest LNG suppliers were from the Middle East (44%), Southeast Asia (28%) and Australia (20%). In 2012, 72% of China's coal imports traversed across the South China Sea to reach the mainland. The BP Energy Outlook has projected that China will become world's largest net energy importer as production, as a share of consumption, will drop from 85% today to 80% by 2035. As a result, China's oil import dependence will rise from 57% in 2012 to 76% in 2035, while gas dependence will rise from 25% to 41%. Given such projections, it is likely

that the country's already large oil and gas shipments traversing the Indian Ocean and the South China Sea will increase in the decades ahead²⁷.

The global energy transport system is vulnerable to disruption at key maritime choke points and such incidents could seriously impact the level and volatility of energy prices and also result in physical supply shortages. From the 2000s, the Chinese policy intellectuals began to discuss the importance of SLOC security for China's seaborne trade, identifying this reliance as a strategic vulnerability. They began to refer to the Strait of Malacca as the "Malacca Dilemma" due to it being a chokepoint in China's seaborne energy trade. The other key chokepoints of concern are the Straits of Hormuz and Bab-el-Mandeb. The government's inability to protect its interests and assets along these critical SLOCs became a serious concern given its traditional emphasis on self-reliance. China's President Hu Jintao, according to one report has bemoaned China's sea lane vulnerability, referring to it as his country's 'Malacca Dilemma', a dependence on narrow and vulnerable strait of Malacca for oil imports from which China must escape somehow. It is an old fear, for Ming China's world was disrupted in 1511, when the Portuguese conquered the Malacca²⁸. China's anxiety can be traced to the embedded memory of the Sino-Soviet split when the abrupt withdrawal of the Soviet advisors from China's oil sector damaged the large-scale project under development and created serious energy shortages and this has come to shape the way the Chinese regard their dependence on overseas imports. The government today understands that it would not be possible for China to attain energy self-sufficiency through domestic production, given its large and growing domestic demand. Beijing's sense of vulnerability provided a powerful imperative to diversify

²⁷ Christopher Len (2015) China's 21st Century Maritime Silk Road Initiative, Energy Security and SLOC Access, pp4, Maritime Affairs: Journal of the National Maritime Foundation of India, 11:1, 1-18, DOI: 10.1080/09733159.2015.1025535

²⁸ Robert D Kaplan, (2010) Monsoon: The Indian Ocean & Future of American Power, Random House Publication, Newyork, eISBN : 978-0-679-60405-1

its energy import sources and to develop China's naval capabilities to protect its rights and interests overseas and to ensure unimpeded access along the strategic SLOCs.

The Chinese Strategy

In November 2012, the strategy to develop China into a maritime power was included in a Communist Party of China (CPC) report for the first time. This report to the 18th National Congress of the CPC specifically called for China to develop the capability to safeguard the country's maritime rights and interests. In April 2013, China published a white paper entitled, *The Diversified Employment of China's Armed Forces*, which referred to the People's Liberation Army Navy (PLAN) as China's mainstay for maritime security operations "involving overseas energy and resources, strategic sea lines of communication (SLOCs), and Chinese nationals and legal persons overseas" and would include "vessel protection at sea, evacuation of Chinese nationals overseas and emergency rescue".

Such missions are not new for the PLAN, which has been a developing blue-water capability. Since December 2008, the PLAN has sent 19 Escort Task Groups in succession to the Gulf of Aden for anti-piracy operations and offered protection to nearly 6000 ships. The Chinese navy completed its 800th escort mission in the Gulf of Aden in late December 2014. The PLAN has also been involved in the evacuation of Chinese nationals overseas. During the Libyan civil war in 2011, a PLAN frigate helped evacuate 35,000 Chinese citizens including staff from the three major Chinese NOCs China National Petroleum Corporation, China National Offshore Oil Corporation and Sinopec. This was the PLAN's first operational deployment to Africa and the Mediterranean, and the largest non-combatant evacuation operation to date. These two cases demonstrated China's long-range naval capabilities to address non-

traditional security challenges and also reinforced the Chinese belief in the need to maintain a sustained naval presence in the Indian Ocean.

President Xi has continued the call to develop China into a maritime power. In a study session held with members of the Political Bureau of the CPC Central Committee in July 2013, Xi noted that in the 21st century, the ocean has an increasingly important role to play in economic development and opening to the outside world, and added that China will steadily build its maritime power through peaceful and mutually beneficial cooperation. Therefore, during his first visit to Southeast Asia in October 2013, Xi proposed the MSR while addressing the Indonesian Parliament. In his speech, he expressed willingness to enhance mutual political and strategic trust with ASEAN countries, strengthen maritime cooperation with ASEAN countries by making use of the China–ASEAN Maritime Cooperation Fund and to work towards greater connectivity between China and ASEAN²⁹.

China and IOR Countries

The following briefly summarises aspects of Chinese involvement in the Indian Ocean by country/sub-region³⁰.

²⁹ Christopher Len (2015) China's 21st Century Maritime Silk Road Initiative, Energy Security and SLOC Access, pp6, Maritime Affairs: Journal of the National Maritime Foundation of India, 11:1, 1-18, DOI: 10.1080/09733159.2015.1025535

³⁰ Workshop Report (2011), China's Strategic Objectives in Indian Ocean, Future Directions International, Independent Strategic Analysis of Australia's Global Interests

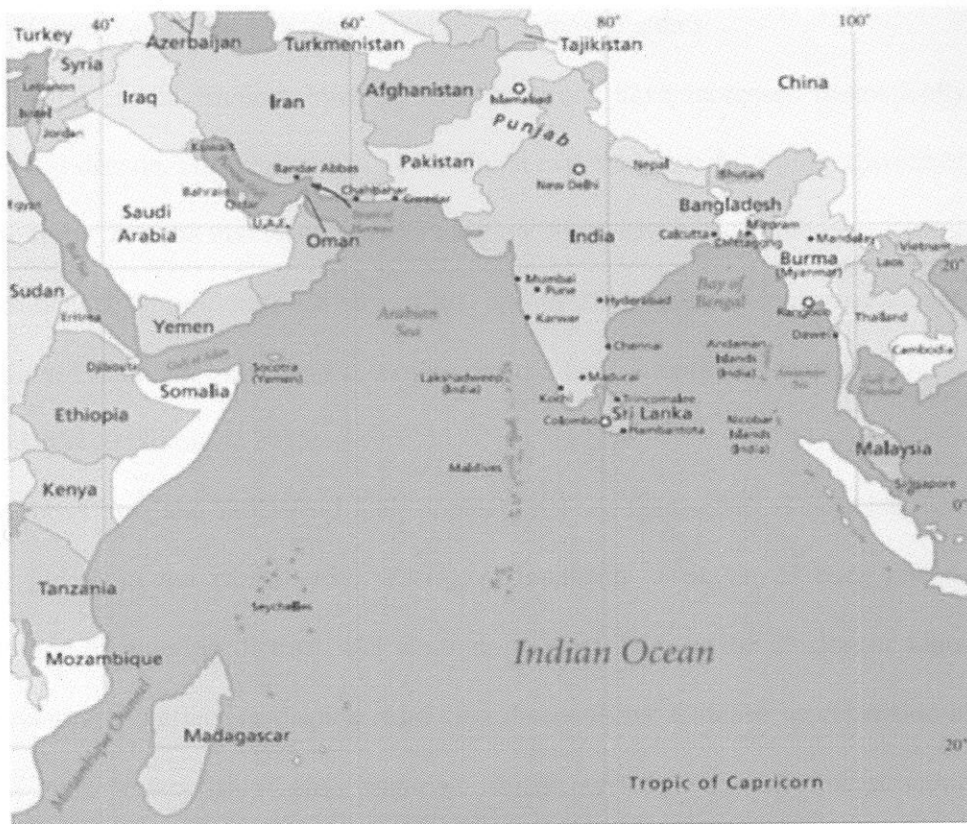


Fig 3.6 : Indian Ocean littoral, (Source: Berlin, 2006: 61).

India

China appears content to allow India to play a greater role in the Indian Ocean region but not to the extent that it interferes with or jeopardises China's own objectives. Despite the difficulties, it is in China's best interests to have a good relationship with India. India's rise took China somewhat by surprise, but the deepening of US-India relations has made China take a greater interest in India, although China recognises that India would not wish to be a junior partner to US.

There are a number of tensions in Sino-Indian relations. These include Chinese support for Pakistan; disputes over the 3,500 kilometer border; the implications of climate change; competition for water, food and energy resources,

China's reluctance to back India's attempt to obtain a permanent seat on the UN Security Council and even as a future rival for superpower status.

Despite some friction, bilateral trade relations have increased dramatically over the last decade. For example, in 2000, China exported over \$1.5 billion worth of goods to India; in 2008 that figure was \$32 billion. Similarly, in the same period India exported over \$760 million to China in 2001, and by 2008, this had increased to over \$20 billion. China and India have recently declared their intention to further increase trade to US\$100 billion by 2015.

Both China and India (and their populations) see themselves as retaking their rightful places in the world order. Rising nationalism, suspicion of each other's motives and a lingering distrust will continue to contribute to the tension in Sino-Indian relations. Ineffective dispute resolution mechanisms, Chinese apprehension at the US-India relationship and negative Indian perceptions of infrastructure developments in the border regions are also contributing factors.

While the media, militaries and commentariat in both countries may talk up the prospects of competition and conflict, the leadership of both countries recognise the importance of economic ties and the need for a peaceful rise for both countries. Economic links such as the above will contribute to attitudes of coexistence.

Pakistan

Pakistan is vitally important to China's strategic calculations, not only in counterbalancing India, but in using Pakistan's strategic position as an energy corridor to China's western borders. China is keen to develop access to the Middle East and West Asia in this way. Bilateral trade between the two countries has now increased to US\$7 billion in 2010 and there further plans to increase this to US\$15 billion in 2011. There are now more than 60 Chinese companies operating in Pakistan on 122 projects

employing an estimated 11,000 Chinese businesspeople, engineers, technicians and workers.

For Islamabad, the China relationship provides Pakistan with a counterbalance to the US and leverage against India. Over the next ten years, China's relationship with Pakistan is likely to continue along its current trajectory, serving the same purposes. A note of caution is warranted, however. China and Pakistan are not natural allies, having as they do widely differing cultures and languages. Beijing will also be very mindful of the possibility of Islamist extremists using Pakistan as a gateway to Muslim-majority provinces such as Xinjiang (although Central Asia is perhaps a more likely conduit were that to happen).

Iran

The focus of China's relations with Iran chiefly encompasses energy and development of infrastructure. The continuity of energy supplies is at the forefront of Chinese policy in this sub-region. China sees Iran as a critical ally in its quest to access the energy reserves of the Middle East and Central Asia. China has moved aggressively to position itself as a key player in the Iranian energy market because Iran has the second-largest reserves of natural gas in the world. Since 1998, trade between Iran and China has grown markedly from US\$1.2 billion to over US\$10 billion. More than 100 Chinese state companies are operating in Iran. Iran is now the largest importer of Chinese military hardware.

The need for uninterrupted energy supplies complements China's support for nuclear non-proliferation, as a nuclear-armed Iran could destabilise the region and jeopardise Chinese energy imports. While China may be willing for Iran to threaten to develop a military nuclear capability, it would be less than keen to see it come to fruition.

China may be willing to act as a mediator if any future regional conflict were to threaten the security of its energy supplies. China has, however, looked to exploit United Nations sanctions against Iran by offering itself as an alternative market.

Although Iran is an important ally for China and has attained Observer status at the Shanghai Co-operation Organisation, its bid to attain full SCO membership has remained inconclusive as there are indications both China and Russia are wary of unnecessarily aggravating relations with the United States.

Middle East and Egypt

The Middle East has been a key focus of China's increasing energy demands, with around half of China's oil imports coming from this sub-region. Agreements covering energy supplies and investments are common. For Middle Eastern nations, China's growth has offered an alternative to Western markets. Providing advice and assistance to Chinese Muslims for the *hajj* pilgrimage to Mecca offers Beijing a valuable soft power opportunity.

Reciprocal visits by high-ranking military have taken place with countries such as Bahrain and Egypt. China will be keen to see stability maintained around the Strait of Hormuz so that energy flows are not disrupted and the Bab el-Mandeb and Suez Canal so that Chinese exports can pass unhindered to European markets.

China's anti-piracy patrols in the Gulf of Aden, in which its forces liaise with their counterparts from the US and other countries, have given it an opportunity to demonstrate its credentials as a responsible international citizen.

Australia

China will continue to ensure that it has access to Australia's mineral and energy resources, delivered at favourable prices. It will seek to invest in the agricultural and pastoral sectors and take advantage of educational opportunities.

China will also seek to ensure that Australia continues its "One China" policy. Should rivalry between Washington and Beijing increase, China will attempt to weaken the US-Australia alliance by offering an assured market for Australian exports.

China's policies towards Australia are unlikely to change significantly over the next ten years. The acquisition of agricultural land for food production could, however, become increasingly important aspect of the relationship and may require deft management if it is to be of maximum mutual benefit.

Indonesia

China has been active in infrastructure projects in Indonesia, constructing bridges and coal-fired power plants. Although Indonesia views an expanding Chinese military with some caution, high-level visits have taken place. Indonesia's growing role as a regional leader offers China scope for increased influence among the ASEAN members and Indonesia may be called upon to act as a moderator among the states involved the South China Sea territorial disputes.

For Jakarta, engagement with ASEAN, the United States and Australia offers a means of counterbalancing China. Like Australia, Indonesia may find itself caught between its economic links with China and its security interests which require a continuing US presence in South-East Asia.

Eastern and Southern Africa

China has ambitious plans for Africa. Despite some dissatisfaction at the local level, African leaders will continue to embrace Chinese involvement as their countries or, in some cases, they themselves, can stand to benefit significantly from them. A

key message that China uses is that of a shared underdog or oppressed status with Africa. Beijing is likely to continue to capitalise on the anti-colonial sentiment that can still be prevalent in Africa. Other than four exceptions,¹ support for the “One China” policy is now uniform across the continent.

Burkina Faso, Gambia, São Tomé and Príncipe, Swaziland.

Across Africa, more than 1,600 Chinese businesses are currently investing in the mining, processing, commercial, agricultural, construction and manufacturing sectors. China will provide US\$10 billion of preferential loans to African countries and support Chinese financial institutions in granting special loans to small and medium-sized African businesses. Beijing will phase in zero-tariff treatments to 95 per cent of the products from the least developed African countries. China also aims to further enhance agricultural co-operation with Africa, to provide medical equipment, school construction and training for school principals, teachers and medical personnel.

Sudan is China’s third-largest African trade partner and a vitally important source of oil. Nearly 70 per cent of Sudan’s oil production goes to China. Following the South Sudan independence vote of January 2011, it is reasonable to expect that China will be heavily involved in the new country’s future oil industry.

China has demonstrated an interest in mining operations in Djibouti and there are concerns that its rising influence could threaten Western interests in the strategically located country, which is currently an important base for French, US and Japanese forces operating in the Horn of Africa and the Red and Arabian Seas. In the event that Chinese vessels were offered basing facilities in Djibouti, it is open to

conjecture as to whether it would be a source of Sino-Western contention or co-operation.

Chinese investment in Zambia exceeded \$1 billion in 2010, creating more than 15,000 local jobs. A recently signed Investment Promotion and Protection Agreement with Hong Kong-based Zhonghui Mining Group has pledged \$5 billion for the mining of Zambia's substantial copper reserves, while China has earmarked US\$250 million for a new copper smelter.

China's involvement in Mozambique is centered on agricultural products. Unlike many other African countries, its trade is not focused on the resources sector but is dominated by agricultural goods, fisheries, forest products and investment in the services sector. In turn, Mozambique imports cheap manufactured goods and machinery from China.

South Africa

The August 2010 Beijing Declaration set the scene for future co-operation between South Africa and China. Beijing has agreed to assist in the development of railways, power generation and transmission (including nuclear), construction, mining, insurance, agriculture and telecommunications. China will also play a role in other construction projects involving airports and housing. Beijing is already South Africa's largest trading partner. An alignment of the two countries' economic and security interests will be a significant feature of future co-operation. South Africa is a large importer of military hardware and also has a substantial defence industry. China will be keen to utilise and capitalise on this expertise through reverse-engineering or joint ventures.

Indian Ocean Islands

Excluding the French *départments* of La Réunion and Mayotte, the Indian Ocean islands of Madagascar, Comoros, Mauritius and Seychelles are important to China due to their location astride the sea lanes that pass through the Mozambique Channel and the south-western Indian Ocean. Other attractions for China are fishery resources and, particularly in the case of Madagascar – large areas of which are believed to have huge untapped reserves of oil and natural gas – the energy and mining sectors. China could also be seeking to counter Indian influence in the area. In addition to its cultural links, India has reportedly constructed listening stations in Madagascar and the Seychelles.

Soft power activities have been a key component of China's approach in this sub-region. Projects such as the funding and construction of key government buildings, a water-supply project, an anti-malarial treatment campaign and the expansion of the Mauritius international airport have secured considerable goodwill for it to build upon in the future.

Sri Lanka

For Sri Lanka, Chinese involvement serves as a counterweight to its giant neighbour, enabling it to adroitly balance the two. From the perspective of checking India's expanding Indian Ocean influence, China's interest in Sri Lanka derives from the island's strategic position astride the major east-west shipping arterial. Its mega-development projects such as the Hambantota port are designed to harness Sri Lanka's position as a convenient stop-over point for oil and gas tankers.

Indeed, the rise of China as the largest investor and donor in Sri Lanka is most notable in terms of projects such as the Hambantota Port Development Project (valued

at US\$1 billion); the Colombo-Katunayake Expressway (US\$248.2 million), the National Performing Arts Theatre (US\$21.2 million) and many other smaller projects. From 2006 to 2008, Chinese investment in Sri Lanka grew fivefold, replacing Japan as Sri Lanka's largest donor. Sri Lanka's growing relations with China have been further strengthened by its acceptance as a dialogue partner in the Shanghai Co-operation Organisation.

Bangladesh

Bangladesh is reportedly China's third-largest trading partner in South Asia. Bangladesh relies heavily upon China to meet its defence requirements and is also seeking China's support to counterbalance India and Burma (the two countries share a porous border along the Chittagong Hill Tracts). Bangladesh also needs to keep good relations with China due to the major river systems that emanate from the Chinese side of the Himalayas and which pass through Bangladesh.

Indian analysts believe that growing Bangladesh-China relations make the Siliguri corridor, which connects mainland India to its north-eastern provinces, more strategically vulnerable and therefore a possible point of contention between India and China. Military co-operation between China and Bangladesh is increasing, as is the purchase of Chinese military hardware by Bangladesh. This is only likely to continue in the future as Bangladesh seeks to balance a rising India.

Myanmar

China views Myanmar as an energy source and, perhaps even more importantly, as a means of bypassing the Strait of Malacca chokepoint. Port facilities and pipelines into south-western China enable Beijing to escape its "Malacca Dilemma" and aid in the development of those provinces.

China is increasingly facing competition from India in Burma, but Beijing's wealth and long-standing warm relations with the Burmese authorities should see it maintain its advantage over New Delhi. Burma has the potential to serve as a conduit for China into South-East Asia, possibly to the extent of establishing a sub-regional trading bloc incorporating Thailand, Cambodia, Laos and Vietnam.

East Timor

China's strategic interests in East Timor relate to the securing of energy supplies and influence. Despite its small size, East Timor is an attractive proposition for China, given its unrealised agricultural potential and sizeable oil and natural gas deposits. East Timor is a member of the Community of Portuguese Language (CPLP) countries, several of which are energy-rich. Since the mid-2000s, Beijing has been actively engaging with the CPLP countries in order to diversify its energy and food sources, export markets and trading opportunities. In light of the Portuguese and Brazilian involvement in East Timor, and its business and linguistic links with Macao, East Timor offers China an additional avenue into the CPLP.

Beijing has increased its involvement in East Timor via development aid, military links, high profile construction projects and soft power initiatives such as the donation of farm machinery. Increased Chinese influence and Timorese acceptance of the "One China" policy could also serve to reduce the future influence of Australia and the US. China's growing presence in East Timor may raise concerns in Jakarta if it extended to the opening of a Chinese naval base in what it, like Canberra, sees as its own backyard. Being well-endowed with natural resources of its own, East Timor's resources will be of greater interest to China than they are to Indonesia.

Other South-East Asia States

Strategically located along the eastern side of the Strait of Malacca, China's relationship with Malaysia, Singapore and Thailand centres on trade and maritime security. China is acutely conscious of the vulnerability of its energy imports as they pass through the Malacca chokepoint. In the future, China may be willing to deploy naval forces to protect its interests in the waterway as it has in the Gulf of Aden. China has expressed interest in constructing a canal across the Isthmus of Kra and into the Gulf of Thailand.

Although economic relations with China are of great importance to the three countries, they use their relationships with the US to hedge against China. Malaysia, in particular, strives to maintain a non-aligned foreign policy but a stable trading environment is of paramount importance to all three. For Singapore, the US is viewed as an essential security guarantor, while China has ever-increasing importance as a cultural and economic partner. For Thailand, Chinese activities on the upper reaches of the Mekong River will likely continue to be an irritant to relations and reinforce support for the US as a hedge.

China's territorial disputes in the South China Sea are a source of continuing unease among South-East Asian countries, including fellow claimant Malaysia.

China's interests and activities across the Indian Ocean region are many and varied. While the formation of Chinese foreign policy is opaque and is increasingly challenged and informed by a greater number of interest groups, several core themes can be identified.

The overarching aim – China’s paramount national objective – is to ensure the continued supremacy of the Chinese Communist Party. Below that, the objective is to ensure that China’s internal stability and sovereignty are not compromised.

A further objective is to support the economic growth upon which the legitimacy of the Chinese Communist Party government is largely predicated. The security of sea lanes for energy imports and the export of manufactured goods is therefore of great importance. It will continue to be so as the Communist Party grapples with substantial domestic challenges over the coming decades.

³¹Chinese foreign policy in the Indian Ocean region also supports the wider objectives of countering India’s growing influence and the United States’ ability to act as guarantor of regional security, in as much as China perceives them as potential threats to its own interests.

³¹ Rory Medcalf and C Raja Mohan (2014), Sea change of China power, *The Australian*, February 11, 2014, (Rory Medcalf is director of the international security program at the Lowy Institute. C. Raja Mohan is non-resident fellow at the Lowy Institute and heads the strategic studies programme at Observer Research Foundation, Delhi. They are co-chairs of the Australia-India Roundtable)