The Dilemma of China's Belt and Road Project and Domestic Economy Strategy After the 20th National Congress of the Chinese Communist Party

Wei-Hao Huang

Assistant Professor, Institute of Political Science,
National Sun Yat-sen University

Abstract

China proposed the Belt and Road Initiative (BRI) under conditions of a thriving domestic economy and a friendly international environment. The BRI serves to redirect domestic money surplus, upgrade dated industries, and rebuild the prestige of China as a great power. However, today's environment of global finance is different from when China first unveiled the BRI. This article reviews the future development of the BRI from the following dimensions: (1) the shadow of China's domestic economy, (2) a weak renminbi against the U.S. dollar, and (3) rising tensions in Sino-U.S. relations. These factors will significantly increase the cost of implementing BRI in China and reduce the benefits. After the 20th National Congress of the Chinese Communist Party (CCP), the above conditions continued to burden the BRI. As Xi and its new leadership persist in the BRI, it will be a more challenging dilemma for China and his BRI to resolve in the 2020s than a decade ago.

Keywords: China's Economic Policy, Belt-Road Initiative, Foreign-Exchange Reserves, USD Exchange Rate, Internationalization of RMB

Chinese leader Xi Jinping introduced the Belt and Road Initiative in 2013 to establish a new cross-Eurasia cooperation model led by China. More than 130 countries responded to the call by attending the Belt and Road Forum for International Cooperation held in Beijing in 2017. They signed the Memorandum of Understanding (MoU) with China regarding economic cooperation. According to a World Bank

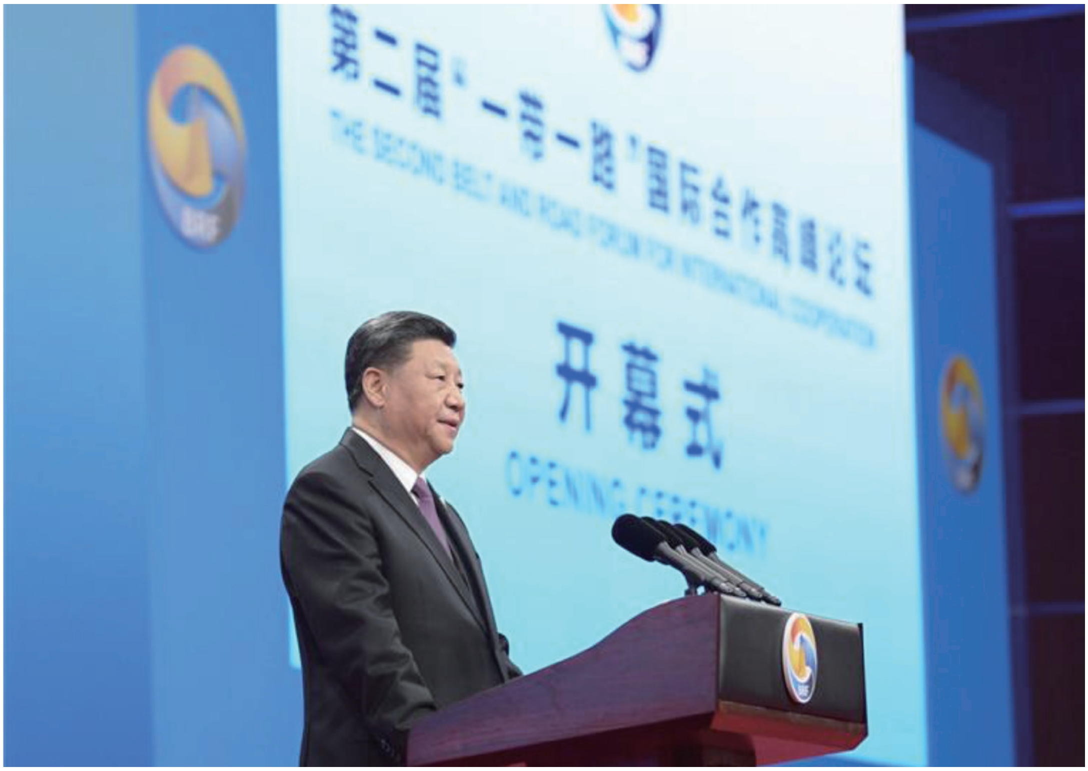

Figure 1. Xi Jinping Delivers the Keynote Speech during the Opening Ceremony of the Second BRF

Sources: The Second Belt and Road Forum for International Cooperation--Belt and Road Forum, "Xi Jinping Attends the Opening Ceremony of the Second Belt and Road Forum for International Cooperation (BRF) and Delivers a Keynote Speech," April 27, 2019, *The Second Belt and Road Forum for International Cooperation--Belt and Road Forum*, <http://www.beltandroadforum.org/english/n100/2019/0429/c22-1391.html>.

report, the BRI covers 35% of global foreign direct investment and 40% of global exports. While excluding China, the project includes around 55% population and 27% of the global GDP in 2021. For China, it was risky for the times; it was the promise of times. However, a report by the AidData project also notes that "two-thirds of BRI-themed financing was in the form of loans approaching market rates or other debt instruments."[1] In other words, the BRI is not just development assistance from China

1. Horigoshi, A., Custer, S., Burgess, B., Marshall, K., Choo, V., Andrzejewski, K., & E. Dumont, *Delivering the Belt and Road: Decoding the supply of and demand for Chines overseas*

but an investment from which China expects to profit. Do today's circumstances still support the BRI? This article describes the domestic and international contexts contributing to the BRI. If these conditions no longer exist today, especially after the 20th National Congress, what will be the possible future of the BRI in the next decade?

I. The BRI in the 2010s

1. China's Domestic Economy in the Transition

With an average growth rate of around 9% since the 1980s, China has become the world's second-largest economy since 2010. Furthermore, GDP per capita in China also increased from USD 200 to more than USD 8,000 in the 2010s. Despite these achievements, the oversupply of money, or "hot money," and the bottleneck of industrial development in China became a worry for Beijing in the 2010s. Thus, the BRI became the tool to handle the side effects of the "China miracle" on its domestic market.[2] In other words, the BRI serves as a mechanism to redirect hot money away from China's domestic market to avoid the risk of inflation and delay the "bubble" in its economy.

Moreover, the BRI helped reanimate the dying locomotive of China's economy, since economic reforms exported those sectors and labor globally. Huang notes that "rapid economic growth lifts cost of production, which, in turn, erodes the competitiveness of many industries,"[3] including the heavy and construction sectors. Those used to be the engine of China's economic success. By exporting obsolete industries through the BRI, rising high-tech and software-oriented service sectors receive more domestic opportunities for development. This way, the transition can not

development projects (Williamsburg: AidData at William & Mary, 2022), pp. 26-27. See more discussions and data on China's BRI from the AidData project at William & Mary at <https://www.aiddata.org/>.

2. Yiping Huang, "Understanding China's Belt & Road initiative: motivation, framework and assessment," *China Economic Review*, Vol. 40, September 2016, pp. 314-321.
3. Yiping Huang, "Understanding China's Belt & Road initiative: motivation, framework and assessment," p. 316.

only upgrade China's industry but also avoid the middle-income trap challenge found in other precedents in East Asia.

2. China and the Global Financial Environment

China's market remained vigorous, and its economy continued to grow in contrast to those in the West that were affected by the European debt crisis in 2010 and the Global Financial Crisis of 2007–2008. The global environment at the time provided an opportunity for China to promote its development model, known as the "Beijing consensus," and play the role of a rising but responsible great power. By disaggregating the functions of U.S. hegemony, China was financially contributing to the economic function of the U.S.-led hegemony order after the 2008 financial crisis. Therefore, the BRI, partially combined with the establishment of the Asian Infrastructure Investment Bank (AIIB), became the instrument for China to expand its global influence and achieve Xi's "Major Country Diplomacy."

Politically, China was a "*status quo*" player to the U.S. and its liberal hegemony global order. This was when the U.S. sought China's support to constrain North Korea and its nuclear issue before President Obama announced the pivot to East Asia strategy in 2012. It was also before the E.U. considered China a "systemic rival" in 2019. The E.U. and China signed the "EU-China 2020 Strategic Agenda for Cooperation" in 2013 to buster further cooperation on various issues, including economic and climate change. Thus, the domestic and international context in the 2010s was the best time for China to promote the BRI and for the world to embrace investment from China.

II. The BRI in the 2020s

The global environment is different from 2013 and even different than before the Covid, due to: (1) China's domestic economic performance and emerging problems; (2) the end of the U.S. quantitative easing (QE) policy and the rise of the U.S. dollar; and (3) the proposition of the U.S. Indo-Pacific Strategy and rising tensions in Sino-U.S. relations. The following section discusses shifts in each condition and elaborates on how these will affect China's global BRI.

Figure 2. The Fed Ends U.S. Quantitative Easing

Sources: Depositphotos.

1. The Slowdown and Hidden Crisis in China's Domestic Economy

China's economy grows slower today than a decade ago: annual GDP growth was about 9-10% then, but has dropped to an average of 5% since 2019.[4] According to estimates by the BBC, China's economy is probably in trouble in terms of industrial productivity, stability of the financial market, and the Covid policy.[5] The zero-Covid policy continues in China and has contributed to a pessimistic economic outlook. The shadow of the U.S.-China tariff war also severely affects not only traditional industries, which used to be the sources of economic growth since the economic

4. According to World Bank data, China's GDP growth was 6% in 2019, 2.2 in 2020, 8.1 in 2021, and 5.5% expected in 2022.
5. Suranjana Tewari, "Five reasons why China's economy is in trouble," *BBC News*, October 5, 2022, <https://www.bbc.com/news/world-asia-china-62830775>.

reform, but also emerging high-tech and software industries. The former is primarily export-oriented, labor-intensive, and traditional and is expected to be forced to upgrade through the BRI; on the other hand, the economic perspective of the rising industry, such as Tencent and ByteDance, does so not look optimistic. As a result, it is reasonable to expect a pessimistic and gloomy performance of China's economy. Consequently, whether China still has the incentive to export its "surplus" overseas through the BRI is in question.

In addition to the productivity of both dated and rising manufacturing industries, shadows hang over China's financial markets. Beginning with the property sector crisis sparked by the Evergrande Group in 2020, confidence among home buyers, banks, and developers has hit rock bottom. The BBC notes that there is "weak real estate activity and negative sentiment in the housing."[6] Furthermore, the real estate crisis indirectly impacts the upstream and downstream industrial chains and financial markets. The crisis affects the public's confidence in the financial system and worsens real estate's contribution to China's economic growth.

The problems in China's financial markets did not end there. In April 2022, four banks in the countryside of Henan Province refused to let thousands of customers withdraw cash. Villagers began to protest local banks in Henan for their financial corruption. Local governments in Henan responded to the protest by police force and even abused the health code system against the protesters. The story of bank runs and protests did not end in Henan. The public began to worry about their savings after noticing similar instances of financial corruption in local banks. This scandal undermines the credibility of Chinese authorities in the financial market and further leads to public distrust and growing volatility in the Chinese financial system. With the crisis in real estate since 2020, the public will be more reluctant to save their surplus in the domestic financing system and further limit the perspective of currency that China's government might apply to support additional investment, especially overseas.

6. Suranjana Tewari, "Five reasons why China's economy is in trouble," p. 5.

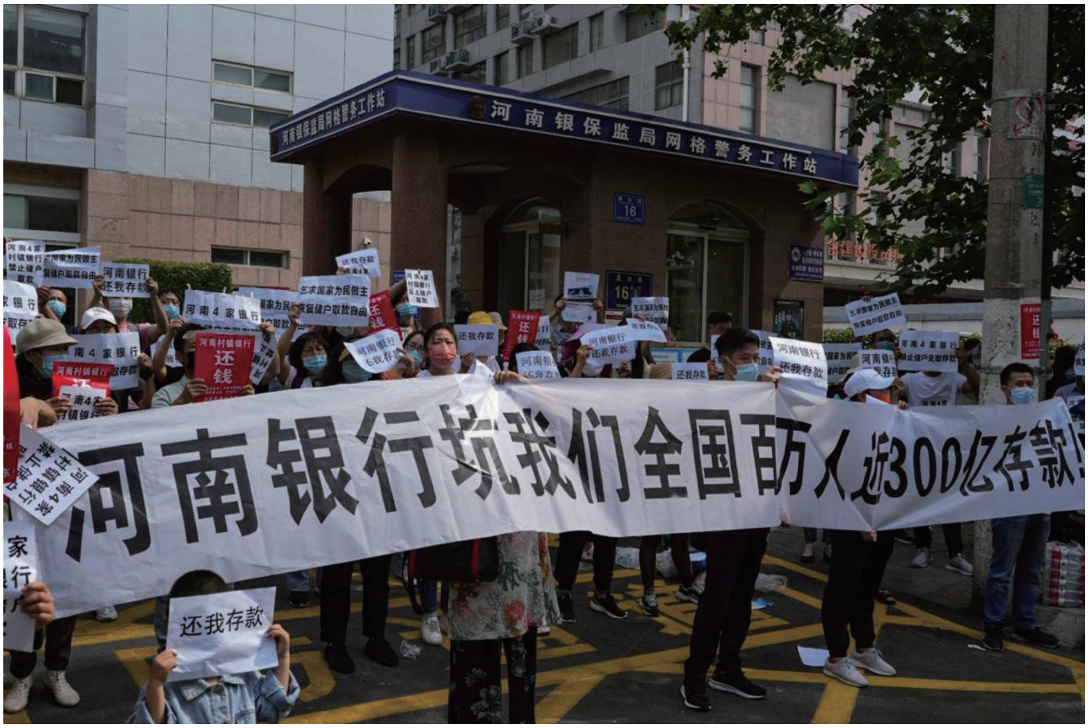

Figure 3. Henan Rural Bank Customers Curbed by COVID-19 App as They Protest Frozen Accounts

Sources: Wang Yun & Fong Tak Ho, "Henan rural bank customers curbed by COVID-19 app as they protest frozen accounts," *Radio Free Asia*, June 15, 2022, <https://www.rfa.org/english/news/china/covid-tracking-06152022151956.html>.

The last and more severe damage to China's economy is its zero-Covid policy. It has had negative effects across all sectors in China: (1) the performance of manufacturing sectors, like the Foxconn factory in Zhengzhou; (2) revenue of service industries, such as two blockades of Shanghai Disneyland; and (3) "regular" consumption of the 1.4 billion Chinese population. If the zero-Covid policy continues, neither production nor consumption of China's domestic economic activity will resuscitate to support economic growth. However, we can foresee that the Chinese government will implement and continue the zero policy in the future from the unprecedented promotion of Li Qiang and Cai Qi into the 20th Politburo Standing Committee (PSC) of the CCP. Both members of the new PSC in 2022 are well-known for their strict implementation of Xi's "zero community transmission policy" and the "dynamic zero-Covid" policy.

The performance of China's domestic economy will not be as prosperous as when the BRI was proposed. The domestic circumstances supporting China's BRI no longer exist in the 2020s, especially after the 20th National Congress of CCP. Both traditional and emerging industries used to be more productive. The public has doubts about the stability of the financial market. Most of all, the zero-Covid policy that has debilitated production and consumption will continue to intensify. As a result, can China's domestic market provide the incentive or the energy to support and expand the scope of the BRI?

2. Weak RMB against the U.S. Dollar and Little Progress in Internationalization of the RMB

In addition to supporting the BRI through the excellent performance of the domestic economy, abundant China's foreign reserves accumulated since the era of economic reform. Nevertheless, these foreign reserves are under threat, due to the appreciating U.S. dollar and the depreciating RMB since 2021.

The story began with the rapid inflation and the end of the QE monetary policy in the U.S. In November 2021, the U.S. Federal Reserve announced to end of its QE policy since the 2008-2009 Global Financial Crisis. Since then, the Federal Reserve raised the benchmark interest rate six times yearly from 1% to 4%. The current interest rate is not historically high, but the speed is the fastest in the past 40 years. Moreover, the Federal Reserve's schedule is to continue raising interest rates before the domestic inflation falls back to its 2% target, around 8.2%, in late 2022.

When global financial markets expect U.S. interest rates to continue to rise, funds from all over the world quickly flow back into the U.S. market. With the influx of funds, the dollar's exchange rate soared. The RMB-USD exchange rate has not been an exception. The exchange has reached a new high since 2008: one U.S. dollar to more than 7 RMB in the third quarter of 2022. The rate used to be around 1 to 6 in past decades. Not surprisingly, China's foreign exchange reserves in September fell by $25.9 billion from the end of August.

In contrast, China's foreign exchange reserves totaled $3.968 trillion at its peak in 2014. The combination of factors such as exchange rate conversion and changes in asset prices is the reason for the continuous reduction of China's foreign exchange reserves. In other words, it is another strike at China's economic capability to support the BRI project in addition to the dismal performance of the domestic economy. China may need help to splurge like the BRI in the past.

Beijing anticipated that the exchange rate of the U.S. dollar would significantly impact its BRI. RMB internationalization is an integral part of China's strategy to implement the BRI. China has encouraged BRI countries to embrace the RMB as an alternative to other international currencies. By 2020, 22 BRI countries had signed the Bilateral Local Currency Swap Agreement, and eight of those had also signed the RMB Clearing Agreement with China. With these agreements on the RMB exchange, beneficiaries will see China as a great power or even an emerging hegemony. More

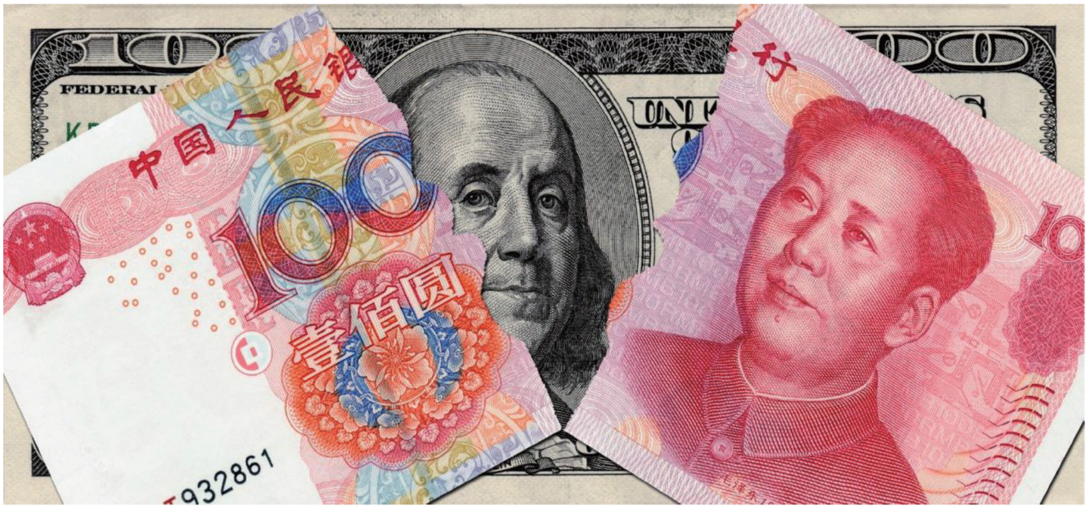

Figure 4. China Faces Tough Choices in Currency Defense as the Yuan Weakens

Sources: Depositphotos.

importantly, China can shed its economic activity from Federal Reserve policy and the exchange rate of the U.S. dollar.

Regardless of the BRI's combination and the RMB's internationalization, there needs to be more progress in the global use of the RMB. The share of the RMB as global foreign currency reserves remains low. By the second quarter of 2022, the RMB only accounted for 2.88% of total global reserves. In contrast, it is 58.8% for the U.S. dollar, 20.6% for the Euro, 5.6% for the Japanese yen, and 4.8% for the British pound. A recent report by the People's Bank of China pointed out that the amount of cross-border receipts and payments in RMB has multiplied, reaching approximately RMB 28.39 trillion.

However, nearly half of the data flows between China and Hong Kong, and the remaining transaction objects are Singapore, the United Kingdom, Macau, and Taiwan. These counterparts are different from the investment targets of the BRI project, and none of those have signed RMB agreements with China. They are not even China's most extensive trade partnerships, such as Japan, the U.S., and Germany. As a result, China still needs to promote the RMB as an international exchange currency even combined with the BRI strategy.

The last point concerns China's consideration of the BRI as a financial loan rather than developmental assistance aid. If China's recognition of the BRI is the former, it will expect recipient countries to pay back the debt and the accrued interest, especially when those numbers are relatively more prominent than non-BRI loans. Ideally, the money China expects to receive can assist in upgrading its domestic industries or further expand the scope and projects of the BRI.

However, these BRI recipient countries are likely to be unable to repay the BRI debt, let alone the derived interest. In 2022, Wang Yi announced debt relief on its BRI investment in Ethiopia and 16 other African countries. Sri Lanka and the Solomon Islands are essential countries for BRI investment, but debt crises plague both. The former has gone bankrupt, while the IMF believes the latter is about to become the next Sri Lanka and fall into China's "debt trap." Under the global recession resulting from the epidemic and the Ukrainian-Russian war, the inability of BRI borrowers to repay China's debt will likely continue and could even worsen. In such an environment, can China continue to bank on the economic benefits of BRI?

International financial markets in the early 2020s are different for China than when the BRI was proposed in the 2010s. The Federal Reserve's decisions and the appreciation of the U.S. dollar have weakened the renminbi, eroding China's foreign exchange reserves. On the other hand, China still needs help to shake off the impact of the dollar exchange rate on its BRI strategy. Internationalization of the renminbi is an essential first step to resolve the problem. Lastly, as expected, China needs to recover huge investing funds through BRI borrowing. This is another shadow that is being cast on the future of China's BRI from the perspective of the global financial market.

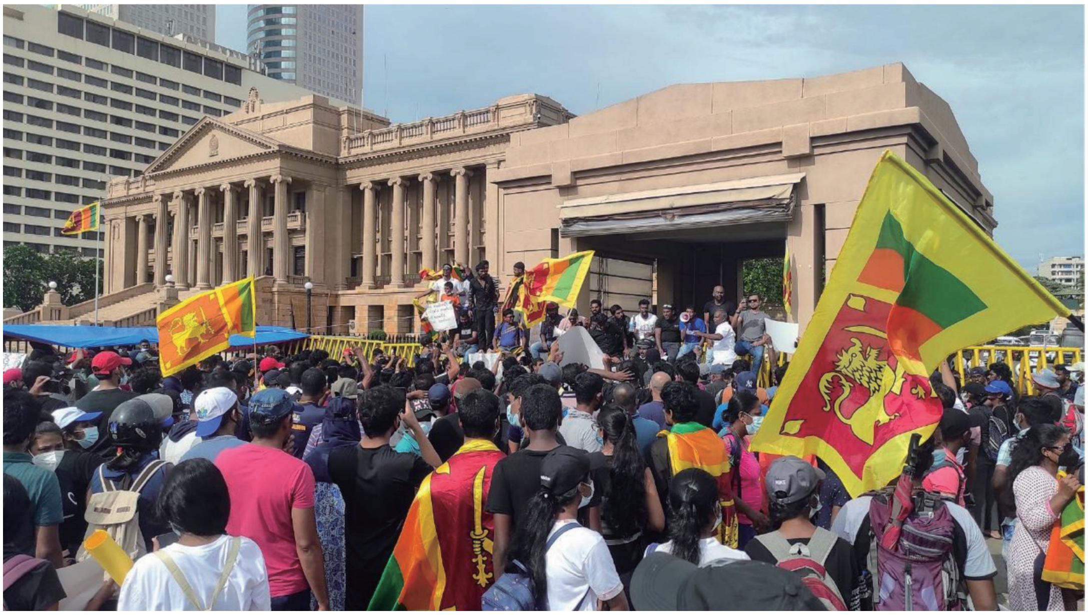

Figure 5. Chinese Debt Trap Diplomacy Behind Sri Lanka's Bankruptcy

Sources: AntanO, "Anti-government protest in Sri Lanka on April 13, 2022 in front of the Presidential Secretariat," April 13, 2022, *Wikipedia*, <en.wikipedia.org/wiki/2022_Sri_Lankan_political_crisis#/media/File:Anti-government_protest_in_Sri_Lanka_2022.jpg>.

3. Rising Tensions in Sino-U.S. Relations

By the 2010s, China was a status quo player in the U.S. and Western global order. The U.S. still sought China's cooperation on various issues, including the war on terrorism and nuclear proliferation in Iran and North Korea. It was an era when China had not yet militarized small islands in the South China Sea. It was also a time when China had yet to brutalize Hong Kong and Taiwan. Today's U.S.-China relationship is very different from when China proposed the BRI in terms of (1) the shift of China's grand strategy, (2) the continuation of the trade war, and (3) the proposal of the U.S. Indo-Pacific strategy.

Overall, both the U.S. and the E.U. regard China as a strategic challenger rather than a peaceful rising *status quo* player. China has shifted its grand strategy from "peaceful rise" to "major-country diplomacy" during the Xi administration. The latter, also known as "wolf warrior diplomacy," includes aggressively blaming other countries on social media and engaging in violence against protesters overseas. Xi's foreign strategy reveals his political ambitions to "make China great again" and a new ideology of confrontation with the West. The shift in China's foreign policy sparked a backlash against China and prompted the U.S. government to re-examine its blueprint for China's policy. With Covid, U.S.-China relations continue to deteriorate at the political level.

Moreover, the Sino-U.S. trade war is not over, and the Biden administration's tariffs on China remain unchanged. The trade war left over from the Trump administration is one of many conflicts between the two countries. The Biden administration has even imposed more comprehensive sanctions on China and Huawei by extending the ban to major foreign chip suppliers in Taiwan and South Korea. Disputes over semiconductors and tariffs are not expected to directly affect the BRI's progress. However, intensifying disputes between the U.S. and China on economic issues are unexpected because of their complex international trade and division of labor. Conflicts at such a level mean the overall deterioration of the relationship between the two countries. This way, the U.S. will raise more objections and new competitive strategies directly against BRI worldwide.

The purpose of the U.S. Indo-Pacific Economic Framework (IPEF) is a typical instance. At the Quadrilateral Security Dialogue (QUAD) Leaders’ Summit in 2021, Biden announced the U.S. grand strategy to the Asia Pacific with its regional allies. It is a U.S.-led economic framework committing to an Indo-Pacific that is free, open, connected, prosperous, secure, and resilient. The partners in the framework include G7 countries, U.S. allies, ASEAN countries, and (indirectly) Taiwan. Moreover, China’s coercion and aggression in the region is the goal stated in the proposal. For instance, a theme of the IPEF is “opposing efforts to alter territorial boundaries or undermine the rights of sovereign nations at sea.”[7] Of course, the statement refers to China’s aggressive behavior in the Taiwan Strait and the South China Sea.

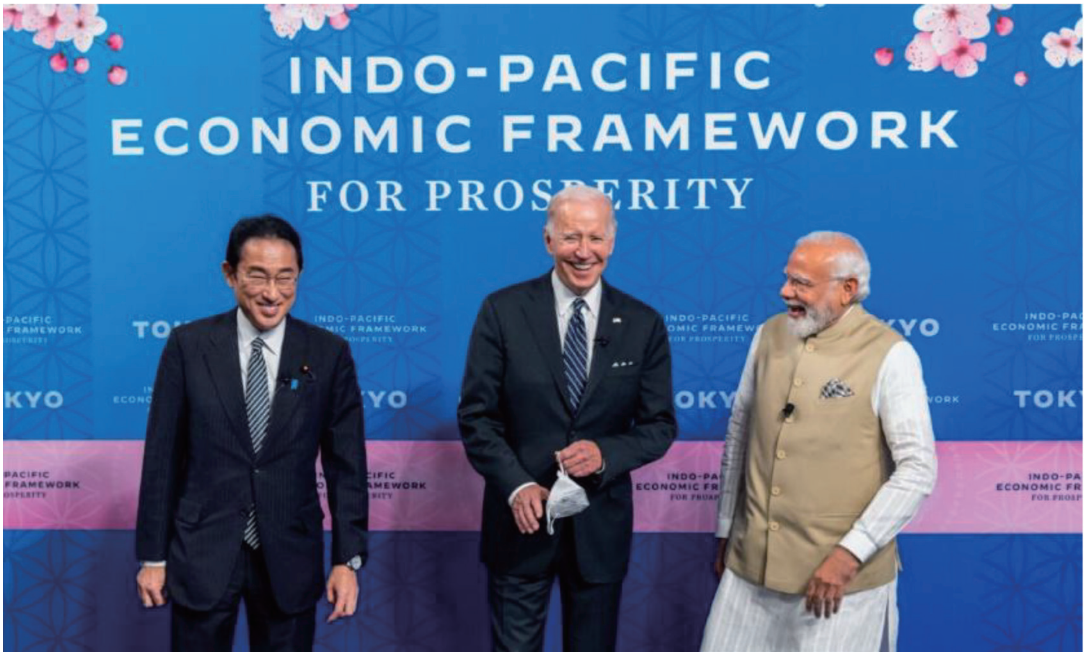

Figure 6. President Biden and a Dozen Indo-Pacific Partners Launch the Indo-Pacific Economic Framework for Prosperity

Sources: U.S. Mission India, “Statement on Indo-Pacific Economic Framework for Prosperity,” May 23, 2022, *U.S. Embassy & Consulates in India*, <https://in.usembassy.gov/statement-on-indo-pacific-economic-framework-for-prosperity/>.

7. The White House, *Indo-Pacific Strategy of the United States*, February 2022, p. 12, *The White House,* <https://www.whitehouse.gov/wp-content/uploads/2022/02/U.S.-Indo-Pacific-Strategy.pdf>.

The framework differs from previous regional trade agreements such as the Asia-Pacific Economic Cooperation (APEC) or the Comprehensive and Progressive Agreement for Trans-Pacific Partnership (CPTPP). The U.S. intends to construct a comprehensive framework incorporating economic agreements, security cooperation, and developmental assistance and strengthen commitments to its regional allies. The U.S. says the IPEF will work with G7 countries and their allies in the region to provide "high-standards infrastructure that will enable them to grow and prosper while creating good jobs on both sides of the Pacific."[8] Although the above statement does not directly refer to what it is aimed against, it would not be surprising if the object referred to was the BRI.

With additional options in the Asia-Pacific region to build infrastructure, the host countries will have more considerable bargaining power against China and its BRI. On the one hand, this will increase the probability for China to yield debt relief from its old BRI partners since the competition for a foreign funding increases. On the other hand, it will increase the cost for China to sell BRI projects to its new and potential partnerships for the same rationale.

However, western development assistance usually attaches further requirements in addition to the aid to the host countries. These requirements, known as conditionalities, are an exchange between other policy reforms and external resources for the local recipients. For example, aid from the U.S. requires host countries to establish a local democratic regime, direct them to enhance transparency and accountability, or restrengthen their civil-military cooperation with the U.S. Conditionality is standard in Western aid even though recipient countries often do not like these additional requirements. This rule applies to the IPEF as well: the U.S. expects its partners in the framework to have good governance and accountability.[9] Thus, it will be a difficult choice for countries in the Asia Pacific region: easy but more expensive loans from the BRI and China, or development assistance with further conditions to political reform from the U.S.

---

8. The White House, *Indo-Pacific Strategy of the United States*, pp. 11-12.
9. The White House, *Indo-Pacific Strategy of the United States*, p. 17.

In conclusion, the global political circumstances in the 2020s will be even more unfavorable to China for the implementation and expansion of the BRI. Compared with when China launched the BRI, Western governments and people today feel Xi and China's aggression, ideology, and challenge to the *status quo* thanks to China's wolf warrior diplomacy. The intensifying Sino-U.S. dispute has not ended because of Biden: the trade and chip wars have continued unabated. And the United States also launched the IPEF to check and balance against the development of BRI and China's political influence. Due to deteriorating relations between great powers, countries in the Asia-Pacific region may need to take sides politically and economically. At the same time, they also gain more bargaining power with China and its BRI due to the fact that they now have alternatives.

III. The BRI after the 20th National Congress of the CCP

On October 22, 2022, China unveiled its new leadership after the meeting of the 20th National Congress. Xi Jinping secured a third term as the top leader of the CCP. He is the first Chinese leader to serve three consecutive terms since Mao Zedong. The collection of members in the Political Bureau of the Central Committee no longer operates as generations of Chinese leadership since the era of economic reform. Instead, Xi's cronies dominate the new leadership of China. New Zhijiang Army politicians such as Li Qiang and Cai Qi have replaced former leader Hu Jintao's Tuanpai in the Politburo Standing Committee.

Under such a personnel arrangement, the Chinese government will thoroughly implement Xi's will in domestic politics and foreign strategy. The Chinese government has implemented its zero-Covid policy more strictly since the 20th National Congress, resulting in some village-level protests. Xi even started rebuilding the people's communes and strengthening the central government's control over the local economy. In terms of foreign strategy, China will continue to be brutal on Hong Kong and Taiwan. Lastly, Biden and Xi met for the first time at the G20 summit in Bali, Indonesia, in November 2022. However, the Sino-U.S. ideological and economic rivalry is unlikely to return to the state of the 2010s. To sum up, the direction of China's domestic and diplomatic strategy after the 20th National Congress will continue from those during the pandemic era.

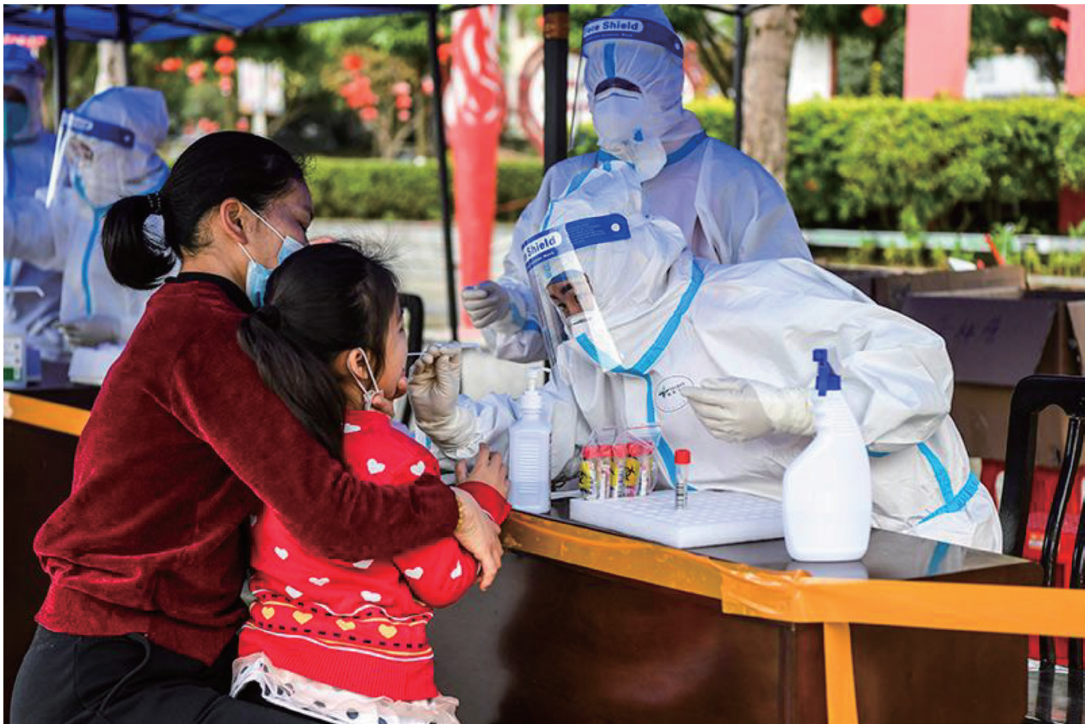

Figure 7. China's Zero-Covid Policy Could Have a Great Serious Impact

Sources: The State Council of the People's Republic of China, "People first, life first - Fighting the epidemic of the century shows the advantages of rule of China," February 20, 2022, *The State Council of the People's Republic of China*, <http://big5.www.gov.cn/gate/big5/www.gov.cn/xinwen/2022-02/20/content_5674698.htm>.

In the 2020s, both the internal and external environment will be more unfavorable for the development and expansion of the BRI. Internally, the BRI is losing energy because of the zero-Covid policy and public distrust in the domestic financial and real estate markets.

Externally, the first factor that affects the BRI is U.S. monetary policy and USD exchange. It still determines the value of China's foreign reserves and the independence of the RMB. The RMB's internationalization is a solution to the problem, but its progress during the past decade has been far slower than expected. Based on the economic sanctions imposed by Western countries on Russia during the Ukrainian War, China will strengthen the process of promoting RMB internationalization. Expanding the network and scope of the BRI is one of China's essential strategies to accelerate the internationalization of the RMB. In this way, China will continue promoting and implementing BRI internationally. Facing the demands of BRI countries for debt relief, this investment may not guarantee China the expected return on its investment.

The second external factor that influences the BRI is the U.S. unveiling of the IPEF. With additional regional investments, there will be more options for recipient countries. As recipient countries will have more bargaining power on the BRI, China must promise more economic incentives to attract them. It will increase China's costs and reduce profits from the BRI.

China's BRI faces a dilemma after the 20th National Congress: Xi and his new leadership still persist in wanting to expand the BRI. But China has lost its ability to splurge on the BRI due to the domestic economy's sluggish performance and the RMB's devaluation. The current decade will be a more challenging time for China and its BRI than the previous one.