Institute for Economic and Enterprise Research

New Silk Road deal between Italy and China and its significance for EU

– Summary in English –

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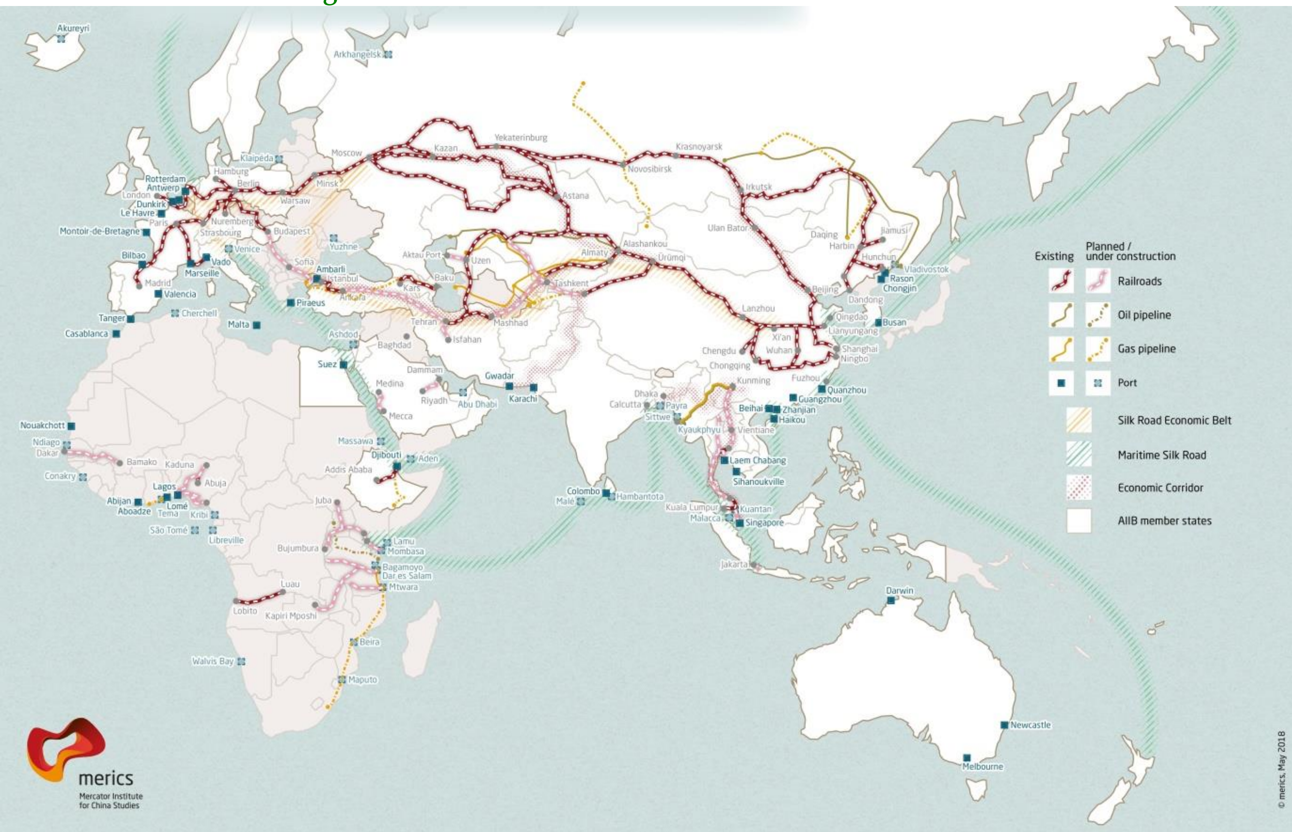
The Belt and Road Initiative (BRI) of China is an approach adopted by the Chinese government, launched in 2013, to connect Asia with Africa and Europe via land and maritime networks. It is also known as One Belt One Road (OBOR) and Silk Road Economic Belt and 21st century Maritime Silk Road. This project aims to revive the old trading routes connecting China with Europe and Africa and extend these routes via networks of upgraded or new railways, ports, pipelines, power grids and highways which will promote regional integration and will stimulate trade and economic growth. This belt and Road include 71 countries from south-east Asia to Eastern Europe and Africa which account for the half of the world's population and quarter of global GDP.

Figure 1: Land and Sea routes of Belt and Road Initiative



Source: Mercator Institute for China Studies

BRI is seen by some analysts1 as China's strategy to open new markets for its consumer goods and excess industrial capacity and to increase its influence and control over crucial infrastructure such as ports and telecoms. Similarly, European Union (EU) and the United States have been critical of the BRI. EU2 says that this initiative (in disguise of infrastructure development) benefits Chinese companies and Chinese interests, and undermines the principles of free trade by the dearth of transparency in procurement. Brushing off the warnings of European allies and the US, Italian government signed MoU

[1] Godement, F & Vasselier, A. China at the Gates a New Power Audit of EU-China Relations. 2017. https://bit.ly/2YKcZbJ
[2] Rod Sweet. EU criticises China's "Silk Road", and proposes its own alternative. Global Construction Review. 2018. https://bit.ly/2EzzBo3

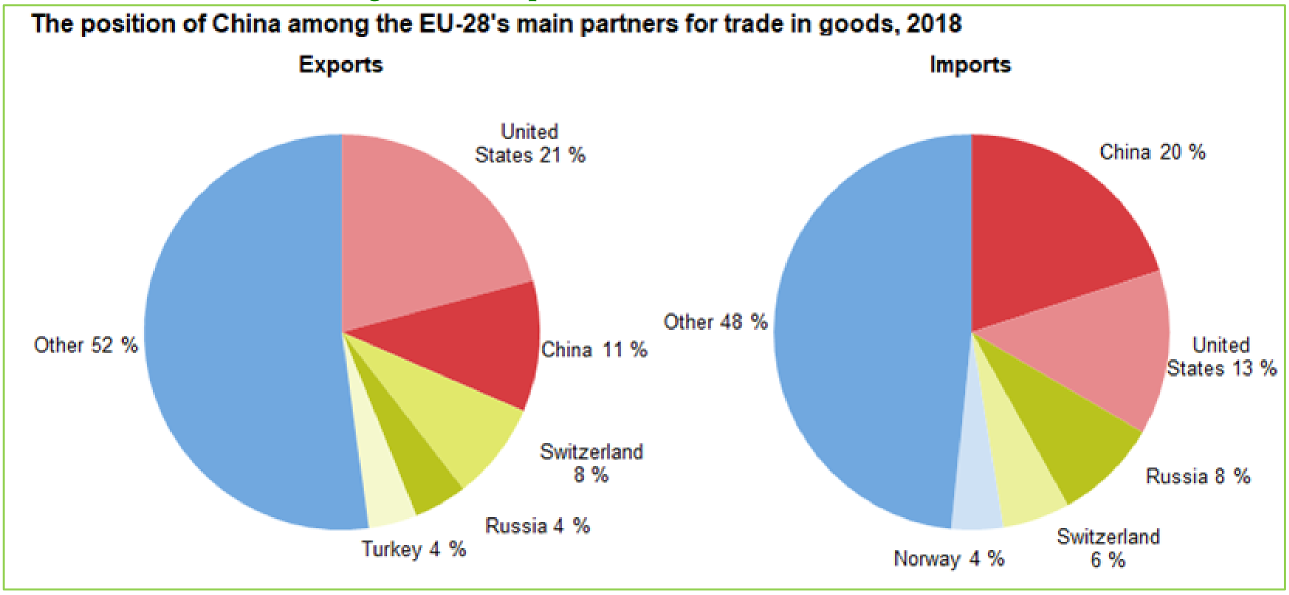
with China on March 23, 2019. Italy, became the first G7 country to sign up to China's Belt and Road Initiative. The MoU seeks to promote cooperation in the banking sector, between a Chinese construction company and Italian ports, between media outlets, in the sphere of technology and science and the export of Italian oranges to China. Some analysts[3] find this deal as Italian government's strategy to lift the country from the cycle of recessions and boost their economy.

Effect of deal on Italy and EU

Regardless of the warnings from the EU and the USA, many European countries have joined China's BRI project. As per the analysts, the main reason for them joining this project was the economic crises. As per the report[4] of European Trade Union Institute, the debt of the EU has exceeded 80% of gross domestic product in 2018. The debt of countries like Greece, Italy and Portugal has exceeded 100%[5]. Neither of them has enough fiscal means to deal with this situation.

Figure 2 shows the position of China among the largest trade partners of the European Union in 2018. China was the second largest partner for EU exports of goods and the largest partner for EU imports of goods.

Figure 2: Main partners of EU-28 for trade in 2018



Source: Eurostat

According to the world bank[6], the contribution of BRI countries to global exports has increased but major share was only from China due to lack of adequate infrastructure and effective policies in many of the countries. The BRI corridor can contribute to fill these gaps and connect those countries with the rest of the world which have been unable to fully integrate with the world economy. Moreover, improvement in networks through BRI can cut transit time and save money. The trade

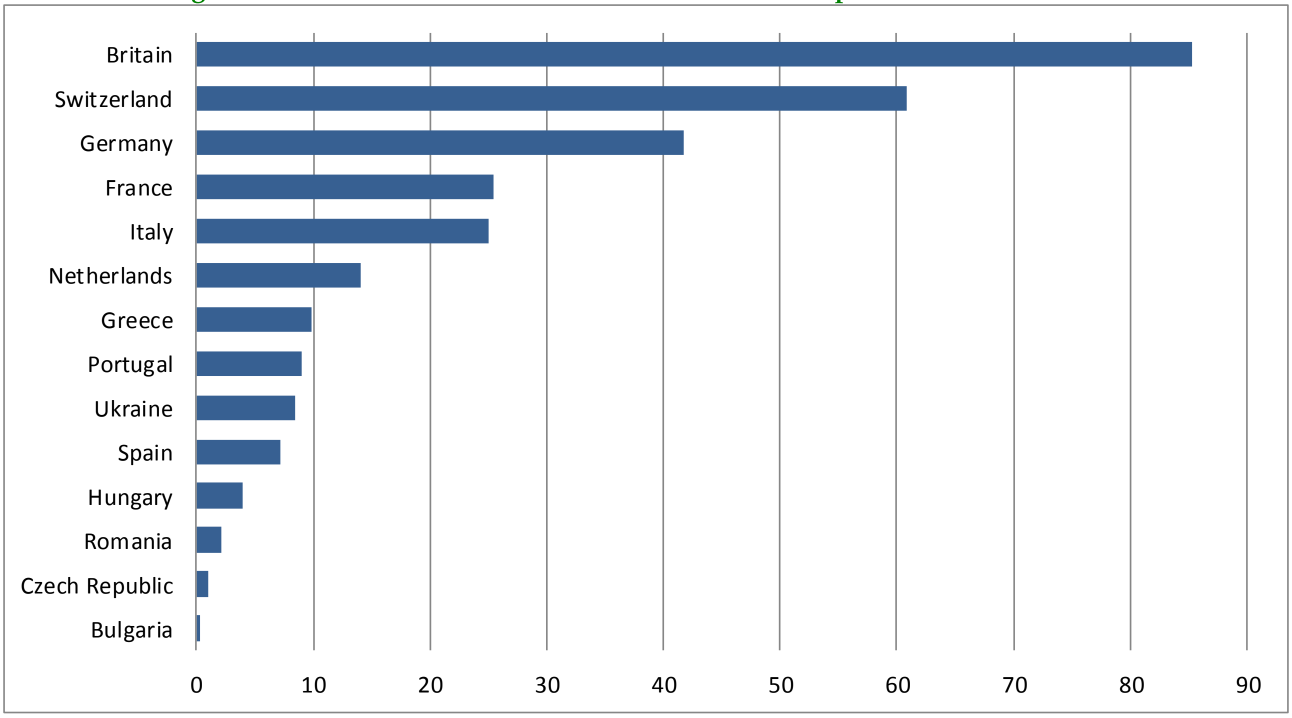
[3] Cristiani, D. Italy Joins the Belt and Road Initiative: Context, Interests, and Drivers. (Online). 2019, April 24. https://bit.ly/2wcOBDt
[4] ETUC and ETUI. Benchmarking working Europe, Brussels, ETUI. 2019. https://bit.ly/2HuFG6N
[5] Shipman, A. Eurozone is recovery resistant but it could also be recession-proof. [online] The Conversation. 2019. https://bit.ly/2VSZ7iC
[6] RUTA, M. Three Opportunities and Three Risks of the Belt and Road Initiative. 2018, May 14. https://bit.ly/2M1OIfT

between Asia and Europe was done by the two ways – slow (but cheap) sea route and fast (but expensive) air route. The BRI trains are faster than the marine transport and cheaper than the air transport will be very beneficial for the cross-border trade not only for long-lasting goods but also for the products of food industry.

Recent agreement of Italy with China put it in the spotlight for being the first large economy who has signed up to China's Belt and Road Initiative. Italy is Eurozone's third largest economy but has less Chinese investment and a small trading partner of China than its EU peers. Italy's political and economic situation led Italy to go against the other G7 countries and the EU as they were sceptical of the BRI.

Figure 3 shows that Italy lags behind its peers in terms of Chinese investment. So far Italy has received around $24 billion (as per the data of American Enterprise Institute) since 2005 which is very low compared to its neighbouring country, Germany. This partnership with China could attract additional Chinese capital inflows which can help the sinking Italian economy.

Figure 3: Chinese investment and Construction in Europe from 2005-2018 ($bn)



Source: American Enterprise Institute

Italy wasn't well connected with China earlier but now with this bilateral tie, Italy can get boost in its exports to China. Moreover, Italy, that has historically excelled in its fashion and luxury goods, aims to enhance its made in Italy brand and China, on the other hand, has been recognised as an important market for luxury goods and fashion industries.

Potential challenges of the deal

The Silk Road has the potential to stimulate economic growth but it brings many challenges. As per the reports available, Belt and Road projects often involve the use of Chinese firms and labor for construction rather than the local firms. The features and terms of BRI are not made public to stakeholders in recipient countries and so far, 89% of BRI projects have been implemented by Chinese companies. Only few skills are transferred to local workers and sometimes profit-sharing is also inequitable. This project is keeping control over infrastructure projects through long-term leases, equity arrangements, or multi-decade operating contracts. The concerns over a lack of transparency and a subsequent inability to hold political leaders accountable have grown in many countries like Malaysia, Sri Lanka, Nepal, Bangladesh, Kenya, Uganda, Ecuador, etc. Furthermore, many completed projects haven't generated the desired results and has increased the countries risk of debt default or repayment difficulties. The struggle of Sri Lanka, the Maldives and Malaysia to repay loans is notable examples of China's policy of debt-trap diplomacy.

The report of Centre for a New American Society on Grading China's Belt and Road[7] has identified several challenges associated with China's Belt and Road project like erosion of national sovereignty, transparency issues, unsustainable financial burdens, negative environmental impacts, corruption, etc. This report has evaluated 10 Chinese projects under BRI across the globe and not a single project found to be free from all the identified challenges. Thus, the findings of the report provide a glimpse of potential challenges which Europe can face due to BRI in the future.

Moreover, the intentions of China's infrastructural development are suspicious as it can be China's debt-trap diplomacy and strategy to capture the international market and strengthen China's military influence in the world. According to the compilation by Bloomberg[8], total Chinese investments in Europe, including both mergers and acquisitions (M&A) and Greenfield investments, amount to $318 billion. Also, it has taken over approximately 360 European companies. The EU's report[9] 'The State of Investment in Europe and the World' has also mentioned that despite the increase of Chinese investment in EU, the Chinese Greenfield investment remains less than 5%. Additionally, the level of control by China's partners of BRI is also not very clear. Thus, it is fair to say that the BRI presents opportunities for Europe, but it is primarily helping China in expanding its influence in the Eurasian region and beyond

Conclusion

Amidst different interpretations of the deal between China and Italy, the real objectives of the BRI are still not well understood. It is also not clear how much power the partner countries

[7] Daniel Kliman. Et al. *Grading China's Belt and Road.* Centre for a New American Society. 2009. https://bit.ly/2VSB7vP
[8] https://www.bloomberg.com/graphics/2018-china-business-in-europe/
[9] European Union. Greenfield Investment Monitor. In Focus: China's Expansion in the EU. 2017. https://bit.ly/2EkNYwk

(China's partners in BRI) hold in the deal. It would be very early to say that the membership in the BRI will be opening the areas of cooperation between different countries across the Eurasia and will boost the international trade. Considering the history of China's debt-trap diplomacy in African and Asian countries, one cannot deny that in future China can hold its control over infrastructure and markets and BRI becomes a debt trap for weaker countries of Europe.

Furthermore, Europe is an important key in the China's Belt and Road Initiative and China certainly knows how crucial European market is for China's overall growth. The way economic and geopolitical situation of Italy derived it to sign BRI deal with China; likewise, China is targeting the economically weak European countries that are highly indebted to increase its reach in Europe. It can't be denied that the deal with Italy has been a success for China as it has provided them a base in Mediterranean region and this deal will be very significant for European and Mediterranean geopolitical equations.