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# China and the power of financial instruments – way of the usage

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## *Abstract*

An almost certain major challenge for the West and NATO in the 21st century will be the People's Republic of China, which has successfully used its increased economic power to shape geopolitics to its advantage. It is necessary to pay attention to Beijing's direct and long-term ambitions, as well as the methods they use, in order to better understand the future challenges that will arise from this. China uses economic warfare as a strategic weapon. The vulnerability of the countries in Southeast Asia is increasing due to the fact that China not only remains ASEAN's largest trading partner as a bloc, but is also individually the largest trading partner with most countries. At the same time, arguably the most visible manifestation of China's aggressive economic diplomacy is through the so-called One Belt, One Road (BRI) initiative, where financially vulnerable countries are trapped in debt.

**Key words:** NATO, EU, Russia, China, terrorism, radicalization, hybrid threats, Balkans.

## *Introduction*

In the 21st century, there will be many more challenges for the democratic world. Apart from Russia, China will be the other country that will “challenge” democracies with its policies. NATO and the EU will face increasing and comprehensive challenges, both external and internal, that will require identification, innovation and adaptability. Therefore, it will be necessary to overcome divisions and optimize levels of cooperation, both within the Alliance and with the EU. This article presents and analyzes not only one part of this current threat that needs to be taken into account, but the relations between Moscow and Beijing, China's investments in NATO and EU member states are also analyzed; Chinese state-owned companies that use Western funds to finance military technology; China's influence in South Asia; as well as the situation on the Korean Peninsula.

All this requires an increase in the Alliance's expertise, and by continuing to maintain its deterrent as well as remain an attraction for democracies around the world, NATO and the EU will be able to legitimize not only their strength but their very existence.

## *Material and methods*

The materials for this article are publicly available in the Internet space. In such a manner, the subject of the research and the sources for its construction are the same, which is a good fundament for the recognizable position for the expecting results.

The main research method is to review and analyze some publicly available expert points on the security and impact policies of Chinese financial instruments. Their brief presentation in the article aims to achieve its main goal, namely much better information, when countries in transition need investment and turn to the Chinese government for support.

## *Results and Discussion*

The following method of presenting explicit Internet resources is important for the following reasons

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– a review and analysis of information on ongoing policies to predict the response to the challenges facing Europe and NATO, as well as the possibility of future opposition partnership with the Chinese side.

### China and the Power of Financial Instruments – Way of Usage

The People's Republic of China will almost certainly be a major challenge for the West and NATO in the 21st century. It is also very likely that these challenges will not be conventional, nor “hybrid” of the Russian type; The Chinese threat facing NATO and the West is the financial war, which, although not specifically mentioned, is at the heart of the 2003 concept of “three wars” by the Chinese Communist Party (Stefan, H., May, 2013). It is worth noting that Beijing's understandings and views are fully justified in their view, given China's unprecedented rise. Three decades of strong economic growth have provided the country with an opportunity to establish itself as a leading force at a regional and global level. As a result, China has successfully used its growing economic power to shape geopolitics. In order to better understand the future challenges that will arise from this, it is appropriate to pay attention to Beijing's direct and long-term ambitions, as well as the methods they use.

Reunification with Taiwan remains China's top ambition, with President Xi Jinping saying on January 2<sup>nd</sup>, 2019, that China's dream of national reunification is shared by Taiwan (Keoni, E., March 2, 2021). Two years earlier, on October 18<sup>th</sup>, 2017, during the 19<sup>th</sup> Congress of the Chinese Communist Party (CCP), Xi Jinping specified, announcing that the national unification of the country will be a fact until 2049 (Full text of Xi Jinping's October 18, 2017). Although Beijing does not officially rule out the use of solid strength, China objectively has a satisfactory set of economic and financial measures that can force Taiwan to join the country (Robert, D. B. & Jenifer, M. H., 2016). According to Robert Blackwell and Jennifer Harris, these tools and policies are implemented in two forms: **(1) multilateral**, in which China uses geoeconomics to isolate Taiwan internationally. As Taiwan is part of China, it is not possible for third countries to maintain diplomatic relations with both countries at the same time. In this approach, China is using aggressive economic policies and sanctions to limit international support for Taiwan. In 2018 alone, El Salvador and Burkina Faso renounced their diplomatic relations with Taiwan (Christ, H., August 21, 2018); **(2) through bilateral agreements and commitments** through which Beijing seeks to directly engage Taiwan and infiltrate Taiwanese society (Robert, D. B. & Jenifer, M. H., 2016). China is exerting economic pressure that is affecting the lives of ordinary Taiwanese citizens. In 1995, when Taiwanese President Lee Teng Hui delivered a speech affirming the country's status, China responded with a threat of war and conducted military exercises. At the same time, the Taiwanese stock market collapsed by approximately 30% of its total value. In 2000, Taiwan lifted a ban that prevented the country from trading directly with China or receiving investment. As a result, Beijing has become the country's largest trading partner, with nearly half (about 45%) of Taiwan's exports destined for China (World's Richest Countries). This growing dependence on Taiwan has helped China strengthen its position on the country's political processes. Beijing clearly and actively supports the Kuomintang, which seeks unification. A clear indication of this support was the huge jump in TAIEX in 2008, when Ma Ying-jeou was elected president of Taiwan. Immediately after Ma took office, he signed a currency swap agreement in August 2012, which gave Beijing a key role in Taiwan's economy (Col. Shubhankar, B., April 3, 2019).

Beyond Taiwan, China is using economic warfare as a strategic weapon in the Senkaku Islands sovereignty dispute with Japan (Brahma, C., July 28, 2017). In 2010, the captain of a Chinese fishing vessel was arrested after colliding with Japanese coast guard ships. In response to the arrest, China imposed sanctions on exports of rare minerals and metals to Japan. These minerals are a key component of electrical equipment that Japan exports to the United States and European countries. The ban forced Japan not only to release the captain, but also forced industrial giants such as Hitachi and Toyota to relocate their plants to China (Robert, D. B. & Jenifer, M. H., 2016). The ban on exports of precious metals and minerals to Japan must be seen as an economic war through which China successfully used the crisis to achieve three strategic goals: **First**, to secure the release of the captain

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of the fishing trawler, which had a psychological dimension in the country's domestic policy; **Second**, to send a strong message to Tokyo regarding Beijing's dominant position in the region; and **third**, to consolidate its market share in the global supply chain (Robert, D. B. & Jenifer, M. H., 2016).

In addition to increasing its influence in Southeast Asia, China's geoeconomic strategy aims to achieve three interrelated goals. First, to test the resilience of American alliances in the region; secondly, to punish and impose sanctions on countries that act contrary to China's territorial and maritime claims, and thirdly, to maintain and deepen cooperation with countries such as Cambodia, Laos and Myanmar. Any opposition to Chinese claims in the South China Sea, the Scarborough Islands and James Scholes, or other similar disputes, is likely to provoke an immediate Chinese response in the form of economic measures (Robert, D. B. & Jenifer, M. H., 2016). In 2012, when the Philippine Coast Guard tried to arrest Chinese fishing vessels near the disputed Scarborough Shallow, China blocked the import of 15 containers of bananas from the Philippines, followed by a ban on other fruits and vegetables that severely affected Filipino farmers. While Manila was trying to deal with the financial aspect, Beijing took the opportunity to strengthen its position in the shallows (Brahma, C., July 28, 2017). At the same time, the vulnerability of the countries in Southeast Asia is increasing due to the fact that China not only remains ASEAN's largest trading partner as a bloc, but is also individually the largest trading partner with most countries.

There are a number of examples that demonstrate China's determination and willingness to take action against countries that it believes are acting against its interests. A special example in this regard is the situation with the Dalai Lama. A 2010 study published in the *Journal of International Economics*, which examined the exports of 159 countries to China, concluded that countries whose leaders met with the Dalai Lama experienced a decline in trade with China, with exports falling from 8.1% to 16.9% (Andreas F. & Nils-Hendrik K., September, 2013). After the Dalai Lama visited Mongolia in 2016, China blocked an important trade route between the two nations and imposed additional tariffs (<https://in.reuters.com/article/us-china-mongolia-dalailama-idINKBN158197>).

When the United States deployed missiles in South Korea in 2016-17, China responded with economic sanctions against South Korea. According to the 2017 US-China Economic and Security Commission Report, Chinese regulators have banned the import of a wide range of Korean products, including cosmetics, air purifiers and video games. At the end of the first quarter of 2017, consumer exports fell by 5.6%, Hyundai and Kia had a 52% decline in sales in China, and Chinese tourists fell by 66%, dealing a serious blow to the industry (Ethan, M. & Nargiza, S., July 26, 2017). In 2009, despite UN objections, Cambodia repatriated Uighurs back to China on charges of participating in a protest in Xinjiang. According to unofficial data, Cambodia has succumbed to pressure and the threat of sanctions from China. In January 2019, the Prime Minister of Cambodia, Hun Sen, announced that Beijing would invest nearly \$ 600 million by 2021 (Cambodian leader, January 22, 2019).

At the same time, undoubtedly the most visible manifestation of China's aggressive economic diplomacy is through the so-called One Belt, One Road (BRI) initiative, where financially vulnerable countries are trapped in debt. At the 19<sup>th</sup> Congress of the Communist Party, President Xi Jinping formally adopted "One Belt, One Road" as a way to achieve "shared growth through discussion and cooperation". The project is seen as the great "Chinese dream" and an ambitious attempt to challenge the dominant position of the United States. While these aspects are true, the more important fact is that China needs new markets to support an export-based economy. The country's economic growth slowed significantly at the beginning of the second decade of the 21st century. China's 2013 White Defense Paper outlined a new role for the People's Liberation Army in protecting Chinese assets outside its territory. The Chinese government predicted that expanding trade to new frontiers was essential to the country's survival (Xinhua, April 16, 2013). Therefore, the "One Belt, One Road" initiative is primarily a result of China's economic and diplomatic need to maintain its prospects for growth and development, merely seeking to promote itself as "shared growth through discussion and cooperation".

"One Belt, One Road" is a winning project for both the Chinese government and Chinese infrastructure conglomerates. On the one hand, through the construction of large infrastructure

facilities in poor countries, Beijing is able to invest the “surplus” of foreign currency (mainly the US dollar), which would otherwise suffer only losses due to inflation, and on the other hand offers large loans to financially vulnerable countries, thus placing them in a long-term dependence, which inevitably grows into a diplomatic one. At the same time, contracts for these projects are awarded to Chinese companies that employ Chinese labor. In addition to generating employment, China has also managed to increase its strategic influence and conquer new markets. At the same time, Beijing, knowing full well that these countries will not be able to repay the loan, is still investing in these countries. In fact, the terms of the loan are made in such a way that at first glance the offer seems too attractive to refuse, but soon even the payment of interest on these loans becomes unviable (Priyanka, K. & Trang, T., January 24, 2019). According to an analysis by the Center for Global Development from March 3, 2018, the contracts are non-transparent and usually do not follow international norms (John, M. H. Scott & Gailyn, P., 2018).

There have been cases where countries have been lured into building infrastructure projects they didn't even need. The construction of the port of Hambantota in Sri Lanka is one such case in which the Chinese propose to build a port that has no economic viability. The offer was such that the Sri Lankan government fell into the trap. Following the completion of the port, the Sri Lankan government is paying 90 per cent of its revenue from servicing the debt it has taken to build the port of Hambantota. In order to pay the accrued interest and service the debt, the Sri Lankan government had to lease the port of Hambantota to the Chinese for 99 years (BBC. Anbarasan, E. September 17, 2020).

Another tangible example of the consequences of “One Belt, One Road” is Montenegro, where the country accepted a Chinese proposal to build a highway connecting the Adriatic port of Bar with Serbia. After the first phase of construction, Montenegro has a debt of about \$ 1 billion, and the project requires approximately another \$ 1.2 billion. For Montenegro, a country with a population of just 620,000, even paying interest on the loan is unaffordable. According to a World Bank report, there is a minimum need for 25,000 vehicles using the highway to justify construction, but current estimates suggest that traffic on the busiest section will almost certainly not exceed 6,000 vehicles (Noah, B. & Aleksandar, V., July 16, 2018). In 2019, Montenegro's debt-to-GDP ratio exceeded 80%, leading to tax increases and a temporary freeze on public sector wages. The feasibility studies of the project conducted by the French company Louis Berger concluded that the project will have no return and will only accumulate losses. Another study, funded by the Export-Import Bank of China, found the project viable, although the findings were never made public. Of interest in this case is the fact that the first phase of the project was built by China Road and Bridge Corporation (CRBC) with loans from the China Export-Import Bank, which illustrates the whole process and business practices followed by China (Noah, B. & Aleksandar, V., July 16, 2018) – Chinese banks provide funds to Chinese companies for non-viable projects in other countries, where the local government ultimately bears all costs and all the risk.

However, returning to Asia, it is necessary to pay attention to the strategic importance of the Indian Ocean region for China, as it accounts for nearly 80% of the country's trade. Therefore, Beijing is using all ways and means to increase its influence in the region. In the last few years, China has acquired, built and designed its influence from strategically located ports in South Asia, Kuntan in Malaysia, Kyauk Pu deepwater port in Myanmar, Hambantota in Sri Lanka and Guadar in Pakistan are some of China's de facto ports (Georgiev, V., 2018). At the same time, like a number of other countries, the Maldives is on the verge of falling into China's debt trap. According to official figures, the country already owes more than \$ 3 billion to Beijing (Panos, M., November 28, 2018). As a result, it is very likely that the Maldives will follow the path of Sri Lanka and provide a new strategic port to China in order to repay the debt or at least part of it (Maldives Times, March 24, 2018).

Of course, Beijing's actions, especially at the regional level, are not limited to opposing and limiting US influence, but also to India, which is objectively the main competitor in the regional aspect, with its demographic, economic and military potential. Therefore, both countries pursue strategic goals to limit the influence of the other, which directly intensifies the struggle for influence

in South and Central Asia. As Beijing cannot compete directly with New Delhi, China seeks to establish economic and diplomatic supremacy over India's neighbors, including through debt traps.

The Chinese-Pakistani Economic Corridor (CPEC) is undoubtedly China's flagship project for debt diplomacy. The CPEC will connect the southern Pakistani port of Gwadar in the Arabian Sea and the western Chinese region of Xinjiang and is of both economic and strategic importance to both China and Pakistan. According to a report by the Nikkei Asian Review, China is Pakistan's largest lender, with more than \$ 19 billion out of a total debt of about \$ 90 billion (Kamran, H. & Eric, M., November 24, 2018). As collateral for the loan, Pakistan handed over the operation of the port of Gwadar to China for a period of 40 years. According to open sources, according to the agreement, the state-owned Chinese overseas port holding company will take 91 percent of the revenue collected from terminal and maritime operations and 85 percent of Gwadar's gross trade revenue (Sudha, R., January 25, 2018). At the same time, there are reports that China wants to build a military base in Givani, 80 km west of Gwadar (Rajeswari R. Pillai, February 09, 2018). If this project materializes, China will secure enormous strategic supremacy over both India and the United States.

In addition to Pakistan, growing Chinese influence in Nepal, Myanmar, Bangladesh, Sri Lanka and the Maldives is a concern for India. Chinese investment in these places is aggressive, not only in infrastructure but also in industry and energy. Together, these sectors account for more than 80% of Chinese investment in these countries. Nepal is the next country after Sri Lanka and Pakistan, which is on the verge of falling into the debt trap. China is the largest foreign investor in the country, with investments growing from just \$ 1.81 million in 2003 to \$ 174 million in 2014-15 (Prakash, B., September 25, 2018). In 2017-18, Nepal received \$ 550 million from China, which is 84% of the total FDI received (Weida, L., August 01, 2018). This shows a 500% increase in Chinese investment in Nepal, which strengthens China's strategic position in the country and the region.

At present, China's aggressive economic approach is limited mainly to Asia (as well as Africa and the Middle East), but in the absence of full-fledged opposition, it is only a matter of time before similar scenarios develop in Europe (Vasil, G. 2020). Montenegro is currently an example of the dangers of China's debt trap, and the country is a member of NATO. There is a real danger in the medium and long term that Beijing will have enough economic influence to undermine NATO's capabilities, if not directly, then certainly diplomatically through its economic levers, as the examples of South Asian countries show.

## Conclusions

NATO and the EU face increasing and overarching challenges, both external and internal, that require innovation and adaptability. Addressing and overcoming them requires optimal levels of cooperation, both within the Union and with the EU. This article presents and analyzes only one part of this current threat, which must be taken into account, but must also be analyzed; Moscow-Beijing relations; China's investments in NATO and EU member states; Chinese state-owned companies that use Western funds to finance military technology; China's influence in South Asia; as well as the situation on the Korean Peninsula.

This, in turn, requires an increase in the Alliance's expertise, but also the need for coordination, cooperation and even possible coordination on a number of policies with the EU. Only by continuing to maintain its deterrent, technological superiority, innovative approach, levels of cooperation and exchange of good practice and experience, timely and coordinated action and operations, and to remain attractive to democracies around the world, NATO and the EU, they will be able to legitimize not only their power but also their very existence.

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