

## THE NEW SILK ROAD: THE EUROPEAN UNION, CHINA AND THE FUTURE OF TRADE

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**Abstract:** *Transport costs are one of the crucial factors that shape the world trade patterns. In order to promote transport facilitation and to create an environment for a more efficient flow of goods Chinese government launched the New Silk Road initiative in 2013. One major issue that has an impact on transport, and consequently on the future development of the initiative, is the growing trade flow between China and the European Union. An interesting fact, clearly indicated, about China is that the nation will become the world's largest middle-class market in the next decades. The recent Chinese demographic transformation –the rise of middle class consumers- is expected to have critical dynamics for the relations between China and the European Union. With growing purchasing power and more European brand preferences, China's middle income consumers are an obvious future target market for EU brands.*

**Key words:** *New Silk Road, Euro-Asia, China, European Union, Middle-class Consumers, Transportation, Trade*

**JEL classification:** *F02, R41, O18, O19, O52, O53*

## „NOVI PUT SVILE“: EVROPSKA UNIJA, KINA I BUDUĆNOST TRGOVINE

**Sažetak:** *Troškovi transporta su jedan od ključnih faktora koji oblikuju svetske trgovinske tokove. U cilju promovisanja olakšavanja saobraćaja i stvaranja povoljnog okruženja za efikasniji protok robe, kineska vlada je pokrenula inicijativu „Novi put svile“ 2013. godine. Jedno od glavnih pitanja koje ima uticaj na transport i, posledično, na budući razvoj ove inicijative su rastući trgovinski tokovi između Kine i Evropske unije. Interesantna činjenica u vezi sa Kinom, jasno naznačena, jeste da će nacija postati najveće svetsko tržište srednje klase u narednim decenijama. Očekuje se da će nedavna demografska transformacija u Kini - porast potrošača srednje klase - biti presudna za odnose između Kine i Evropske unije. Uz rastuću kupovnu moć i veću*

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*sklonost ka evropskim brendovima, potrošači sa srednjim prihodima u Kini su očigledno buduće ciljno tržište za brendove Evropske unije.*

**Ključne reči:** „Novi put svile“, Evroazija, Kina, Evropska unija, potrošači srednje klase, transport, trgovina

## 1. INTRODUCTION

International transport costs are a key component of trade costs and are among the crucial factors that shape the world trade patterns (Behar & Venables, 2010, p.1). Thus, transportation and distribution of goods are key considerations when planning for developing international trade. Choosing the right mode of transportation is essential for ensuring that import and export flows are both efficient and cost-effective. Over the last decades, while trade links between countries are expanding, the need for smooth and effective transport links has grown.

In order to promote transport facilitation and to create an environment for a more efficient and effective flow of goods, services and investments, Chinese government launched the Belt and the Road initiative in 2013. As stated in Office of the Leading Group for the Belt and Road Initiative (2017) one of the purposes of the initiative is to maintain an open world economic system by building a more balanced, equal and sustainable trade system which benefits all participating countries.

One major issue that has an impact on transport and consequently on the future development of the New Silk Road - also known as “One Belt, One Road”- is the growing trade flow between Europe and Asia. In order to understand the economic significance of the European Union (EU) and China both at the regional and the global level, it is crucial to discuss the impact of the New Silk Road initiative on their future trade trends. Moreover, the emergence of middle income groups and economic expansion of China towards an inland area and smaller cities is expected to have significant implications on the future trade patterns. In this framework, a deeper trade analysis of New Silk Road on countries -especially China and the EU - by taking into account the impact of rising middle income class is crucial.

This study approaches the New Silk Road project, from both Chinese and European viewpoint by paying special attention to EU-China trade. The paper consists of six sections. After a brief introduction, the relevant literature is reviewed. The following section introduces the crucial aspects to shed light on the evolution process of the initiative. The future trade patterns of China and the EU by taking into consideration two crucial developments - namely, the launch

of the initiative and the rising Chinese middle-class consumers - will also be discussed in the following sections. In short, the paper aims to shed light on whether the ongoing expansion of the EU-China trade has been a driver of the New Silk Road Initiative. In this context, the presentation of the nature and pattern of trade in the next decades and a discussion of the consequences of China's rapid urbanization and rising consumer market for the future trade patterns lies at the heart of this paper. Finally, the conclusions summarize the findings of this research and point out which aspects could be further studied by academia.

## 2. LITERATURE REVIEW

As a consequence of the fast pace of globalization, rapid technological development, constant fall of communication and transportation costs, and the fast growth of international supply chains, Asia and especially China became a global production and investment hub. Thus, the last decades have witnessed a huge transport growth between China and the developed world such as the US and the EU which led to congestion and delays in the ports. Countries in the Eurasian region have become increasingly aware of the importance of Eurasian transport links for the development and integration of their economies. Since its introduction in 2013, an increasing number of analyses have focused on the New Silk Road initiative. Bolle and Kortsari (2014) mention the need for diversification of existing transportation routes, and the opening of new ones between Europe and Asia. It is also believed that the establishment of New Silk Road will lead to improvements in transport infrastructure and reduction in transportation costs/time and impact on Eurasian trade. Jovanovic, Damnjanovic and Njegic (2018) indicate there are important long-term opportunities for the overland two-way transport of goods between Europe and Asia, but there is a lack of coordination among different transport-related initiatives.

Starr, Cornell and Norling (2015) indicate the primary driving force of the New Silk Road is the expanding trade between the EU and China. There exist several other reasons for the launch of the New Silk Road project by the Chinese government. For instance, Holslag (2017) indicates a shift in Chinese economic policy from defensive mercantilism, which aims to protect the domestic market from foreign competition, towards offensive mercantilism, which seeks to gain market shares abroad. He adds that the New Silk Road serves as a strategy of offensive mercantilism. Holslag also mentions that China considers New Silk Road to be a response to an increasingly challenging international economic environment. The global economic slowdown and the ongoing slowdown of the Chinese economy with falling exports are among some of the economic reasons for the launch and acceleration of the New Silk Road initiative. As Leer and

Yau (2016) indicate the Belt and Road initiative is also a national strategy that will provide an impetus for China's long-term goals, and a key pillar of its *going global* strategy. Thus, it is expected that it will have a great impact on the future development of China's economy and its relations with a large number of countries in Asia, Africa, and Europe. Leer and Yau also state that the purpose of the initiative is revitalizing ancient trade routes, increasing Euro-Asian connectivity to enhance trade flows and spurring long term regional economic growth and development among the participating countries. In this framework, the initiative will be an effective and integrated way to stimulate trade and exports with China's neighbors and increase export demand for Chinese capacity as well as increase international use of Renminbi. Similarly, Zimmerman (2016) points out China's desire to find new markets to absorb the products of its excess industrial capacity and to improve access to energy supplies as its domestic demand continues to grow. Konings (2018) indicates that increased connections of transportation in Euro-Asia with the establishment of the New Silk Road may have potential implications on international trade. She adds that since the trade between Asia and Europe (excluding intra-EU trade) accounts for 28% of global trade, smooth transportation networks will have large potential impact. Moreover, she indicated that a halving in trade costs between countries involved in the New Silk Road could increase world trade by 12%.

### **3. THE REVITALIZATION OF THE NEW SILK ROAD**

The New Silk Road initiative is not a new idea and it is considered as the revitalization of the Ancient Silk Road dating back to the Han Dynasty of China. The Ancient Silk Road - the world's oldest trade link - served as the main network for trade and communication between the East and West for centuries. Along the Ancient Silk Road, commodities were transported by a series of routes and agents, passing through many hands before they reached their final destinations (Wood, 2002, p.9). In the premodern world the sea route was cheaper, safer and faster than land route. Commodities originally transported towards the West via the overland route, but the stability of the early Roman Empire increasingly made the Indian Ocean the preferred route between East and West for most goods, including silk (Bernstein, 2008, p.4).

Silk - a highly value added product of its time - was among the most important products traded between East and West. Several other products such as chemicals, spices, metals, saddles and leather products, glass and paper were commonly traded via these routes as well as. They also helped development and integration of cultures and civilizations (Hansen, 2012, p.5). The Ancient Silk Road initiated the trade relations between China and Western world. The New

Silk Road launched by Chinese President Xi Jinping in 2013 integrates the historical symbolism of the Ancient Silk Road with the new requirements of today (Office of the Leading Group for the Belt and Road Initiative, 2017, p.1). The new initiative connects the developed Europe to vibrant economies of East Asian countries with huge potential for economic partnerships. A major task of the New Silk Road is increased investment and trade cooperation. One of the key objectives of the initiative is to ease bottlenecks for cross-border trade, in particular through transport infrastructure (Herrero & Xu, 2016, p.2). The benefits generated are reduced transportation costs, more frequent transportation services and different route choices, and consequently stimulation of trade between participating countries. An additional objective is to create conditions to relocate certain production lines in Central Asian countries and to profit from regional lower wages and production costs, as well as to create new supply chains (Jovanovic et al., 2018, pp. 603-605)

The New Silk Road initiative refers to the “Silk Road Economic Belt” and the “21st Century Maritime Silk Road”, an ambitious development strategy proposed by China to promote trade and economic integration among participating countries along the overland and maritime routes. ‘Silk Road Economic Belt’ is composed of land routes through the Eurasian continent, while the ‘Maritime Silk Road’ refers to shipping lanes connecting Asia with Africa and Europe. The relevant initiative is often referred to as the ‘New Silk Road’. The initiative consists of five routes and six corridors. The Silk Road Economic Belt has three major routes while the 21st-Century Maritime Silk Road has two major routes. The Silk Road Economic Belt routes are; one from Northwest China and Northeast China to Europe and the Baltic Sea via Central Asia and Russia; one from Northwest China to the Persian Gulf and the Mediterranean Sea, passing through Central Asia and West Asia; and one from Southwest China through the Indochina Peninsula to the Indian Ocean. The 21st-Century Maritime Silk Road has two major routes: one starts from coastal ports of China, crosses the South China Sea, passes through the Malacca Strait, and reaches the Indian Ocean, extending to Europe; the other starts from coastal ports of China, crosses the South China Sea, and extends to the South Pacific. The six corridors are: the New Eurasian Land Bridge Economic Corridor (China, Kazakhstan, Russia, Belarus, Poland Germany), the China-Mongolia Russia Economic Corridor, the China-Central Asia-West Asia Economic Corridor (China, Kazakhstan, Kyrgyzstan, Tajikistan, Uzbekistan, Turkmenistan, Iran, Turkey), the China-Indochina Peninsula Economic Corridor (China, Myanmar, Cambodia, Vietnam, Laos, Malaysia, Thailand), the China-Pakistan Economic Corridor, and the Bangladesh-China-India-Myanmar Economic Corridor (Figure 1).

Today, indeed the New Silk Road initiative covers a massive geographical area. An interesting feature of the New Silk Road is that its participating countries differ in terms of their development levels ranging from high to low income countries. At the time of writing, it included 65 countries from East, South and South East and Central Asia, Middle East, Africa, East Europe and Russia, but more countries are expected to join in the future as the initiative expands. Moreover, the initiative covers more than half of the world's population, around 30% of the global economy and about a quarter of the trade of goods and services (Leer & Yau, 2016, p.5). Two significant economic actors, namely the EU and China, account for 25 % of world population and one third of the global GDP. If the initiative is successful in the future, a large number of economies will benefit from increased welfare.

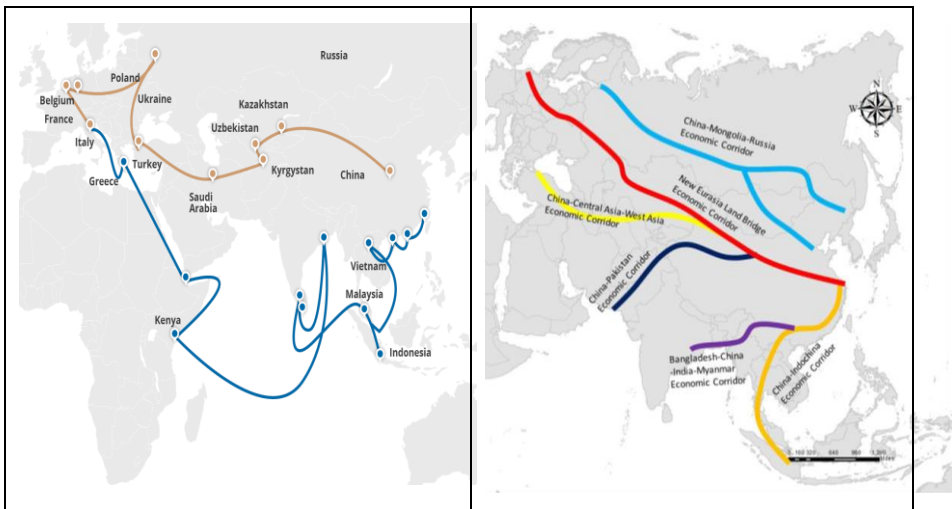


Figure 1. The New Silk Road and Economic corridors within the BRI countries

Note. Retrieved from *Silk Road Finance Cooperation* and “Connectivity along Overland Corridors of the Belt and Road Initiative” from Derudder, B., Liu, X., & Kunaka, C. (2018). *MTI Global Practice Discussion Paper*, 6.

Europe is the final destination of China's New Silk Road initiative. In this framework, China considers Central and Eastern European Countries (CEECs) - including 11 EU member states - as an entry gate to the European continent. In 2011, China launched its CEEC 16+1 mechanism with a group of 16 CEECs, namely Albania, Bosnia and Herzegovina, Bulgaria, Croatia, the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Macedonia, Montenegro,

Poland, Romania, Serbia, Slovakia and Slovenia to strengthen cooperation and connectivity through the New Silk Road.

The New Silk Road is expected to have significant effects on the future development of China's economy and its relations with a large number of countries. China has maintained close economic and trade relations with the New Silk Road participating countries, which has greatly boosted the local economies and industrial development (Office of the Leading Group for the Belt and Road Initiative, 2017, p.24). As Zimmerman (2016) states China identifies transportation bottlenecks as a primary barrier to regional economic integration and thus, free trade. The initiative could eliminate the bottlenecks in Eurasian integration and connectivity by developing transport infrastructure. In this framework, the launch of the initiative also shows how ambitious China is to further integrate itself with the region and increase its economic relations with Europe.

#### **4. THE EXPANSION OF THE EU-CHINA TRADE: A DRIVER OF THE NEW SILK ROAD INITIATIVE?**

New Silk Road is currently considered to be a potential Chinese approach to (re)shaping global trends in world trade. The New Silk Road is launched in 2013 and its completion is due by 2049. As a large, long-term and open-ended programme, it could take many years to realize the impacts of the initiative (Konings, 2018, p.1) In this context, impacts of the establishment of the New Silk Road on global and regional trade are crucial.

Advances in transportation are among one of the most important factors that have shaped trade across the continents. Maritime routes are a vital part of the transportation networks linking East to West and South to North. Maritime transport is currently the dominant mode of cargo transport between Asia and Europe. The land route between Europe and China through Central Asia is relatively short. For instance, a container ship too large for the Suez Canal must make a 24,000 km. journey while trains make an 11,000 km journey to reach Europe (The Economist, 2017). However overland trade is still very low since routes are currently inefficient (Starr et al., 2015, p.11). Rail transport may be the preferred and the most economical overland mode of transport between Europe and Asia in the future. Road transport is possible and it is used, but it may not always be highly efficient. Road infrastructure is poor in some areas, and may be unsafe, especially at night (Jovanovic et al., 2018, p.606). The maritime transportation - the lowest container transportation cost available - carry a high share of goods traded between the EU and China. Air transport is another dominant mode of transportation which has realized huge reductions in costs and increased availability over the last decade (Figure 2).

The volume of trade between Europe and Asia has been growing rapidly in recent years. This is driven mainly by the development and emergence of new economies in Asia and economic expansion in China. Indeed, a high percentage of Asian exports go to Europe. Asia’s imports come mainly from Europe and Asia, demonstrating the growth of Asia’s intraregional trade. Thus, proposed initiative is expected to foster Asian countries’ social and economic connections to European routes, as well as the following connections of intraregional trade.

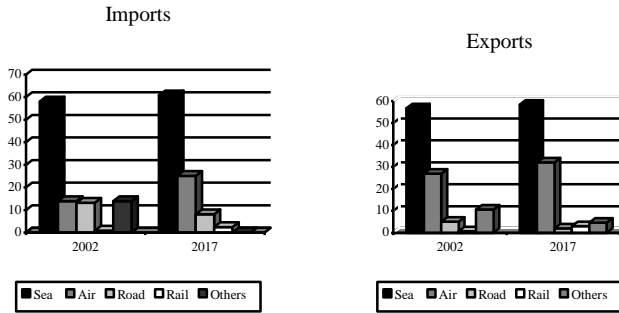


Figure 2. EU’s Trade with China by modes of Transportation in 2002 and 2017, (%)

Note. Retrieved from Eurostat Statistics, *Extra-EU Trade by Mode of Transport*. Others include post, fixed mechanism, inland waterways, self-propulsion and unknown.

According to Amighini (2017) trade creation will occur within the New Silk Road participating countries through two major channels. First, through the expansion of trade ties between the countries which are already important trade partners; second through the establishment of new trade routes which will be new trade ties between isolated countries. Figure 3 shows that the New Silk Road regions’ global exports have increased over the last decades.

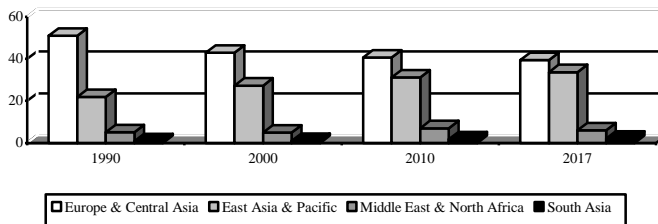


Figure 3. Share of New Silk Road Economies’ Merchandise Exports in Global Exports (%)

Note. Retrieved from World Bank, *World Development Indicators: Structure of Merchandise Exports*.



China has domination in Asia's trade with Europe. Trade volume between the parties is growing as their economies are strongly interlinked. China and the EU remain major trading partners and, the EU is among China's top trading partners. However, the EU continuously had a trade deficit with China over the last decade. The EU imports of goods from China increased significantly from 2007 to 2017 (Figure 4).

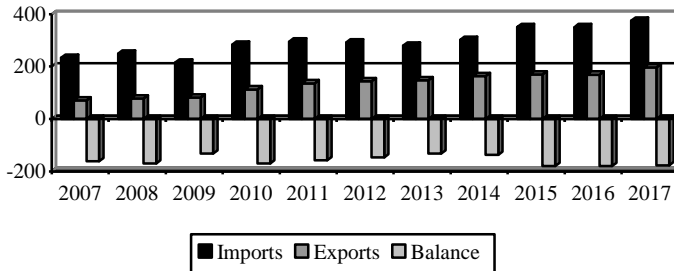


Figure 4. EU's trade with China, 2007-2017 (EUR billion)

Note. Retrieved from *European Union, Trade in Goods with China*. (2018). European Commission, Directorate-General for Trade.

Eurostat statistics show that China's share of the EU's trade increased dramatically from 2002 to 2017. As of 2017 China has been EU's largest partner for imports (20.2 % of EU imports) and second largest partner for EU exports (10.5 % of EU exports), following the US, which had a 20% share of EU exports (Figure 5).

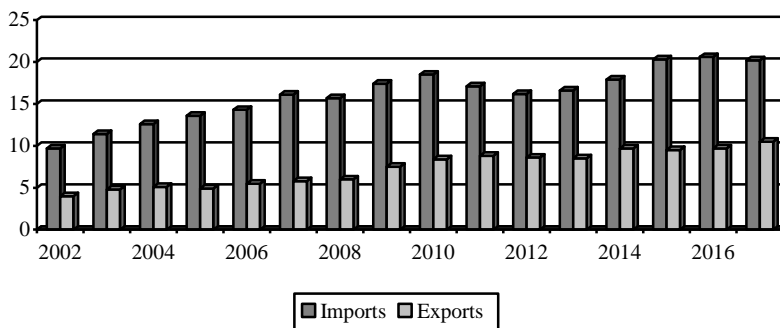


Figure 5. EU's Trade with China, 2002-2017 (% of total exports and imports)

Note. Retrieved from *Eurostat Statistics, Extra-EU Trade by Partner*.

Bilateral trade trends at the commodity level between the EU and China are also remarkable. The EU's main imports from China consist of mass consumption goods. The main causes of the EU's trade deficit are the machinery products, textiles and clothing, and other manufacturing products such as personal and household goods. The EU exports in particular machinery and transport equipment, and chemicals, but increasingly also agro-food products.

China has seen a substantial increase of its trade surplus in manufacturing goods with all of its major trading partners. In the global economy, China's position in the global economy was characterized by as a major assembler of lower value added goods, while EU companies provided higher value-added goods and branding. This pattern is now gradually changing as China's exports increasingly contain more value-added goods (Herrero, Kwok, Xiangdong, Summers, & Yansheng, 2017, p.9).

## 5. THE MIDDLE INCOME CLASS: CHINA'S DEMOGRAPHIC TRANSFORMATION AND EU-CHINA TRADE

An interesting fact about the countries participating in the New Silk Road project concerns their recent demographic transformation. Recently, countries in the developed world have had the world's fastest growing middle income class. The highest increases will be realized in Asia. By the year 2030, Asia-Pacific region may represent two-thirds of the global middle-class population (Table 1). Moreover, it is indicated that China will become the world's largest middle-class market in the next decade (Chunrong, 2016, p.33).

Table 1

*The share of global middle income groups by region (%)*

	2015	2020	2025	2030
<b>Europe</b>	24	20	16	14
<b>Asia-Pacific</b>	65	60	54	65
<b>M. East &amp; N. Africa</b>	6	6	6	5

*Note.* Retrieved from "The Unprecedented Expansion of the Global Middle Class: An Update" from Kharas, H. (2017). *Global Economy and Development, Working Paper* 100.

Currently, China is the largest developing country and the world's second largest economy. Additionally, China is in a transition from rapid growth led by trade-related infrastructure investment and labor intensive exports, to more sustainable growth levels led by domestic consumption, services and higher-value added manufacturing sectors. If China is to be successful in this long transition process, then its rising middle income group, their changing lifestyle

and behaviors will play a substantial part in this transition. As shown in Figure 6, it is estimated that in 2022, the Chinese upper middle class will increase to 54 %, while the mass middle will decrease to 22 % of Chinese urban households.

China's demographic transition also seems to have important implications for future trade relations and the pattern of trade over the next decades. A recent study by Islam and Subran (2017) indicates that three groups will benefit if China were to become the largest consumption market in the world. According to their study, the first group will be the high-quality goods (e. g. automobiles, pharmaceuticals, food) producers from the developed world such as W. European countries (e.g. Germany, Switzerland and France), and Asian countries (e. g. Japan and Singapore). Cheap commodity producers from the neighboring countries such as Indonesia and Malaysia (in mining and energy), Russia (in energy) and Australia (in mining) will be the second beneficiary group. The third group of countries comprises the strategic and cheap manufacturing producers. With rising labor costs in China, companies are set to outsource part of their low technology and labor intensive manufacturing industries to lower cost markets such as South Asian markets (e.g. Pakistan, Bangladesh, Sri Lanka) and ASEAN countries (e.g. Cambodia, Myanmar, Laos and Vietnam).

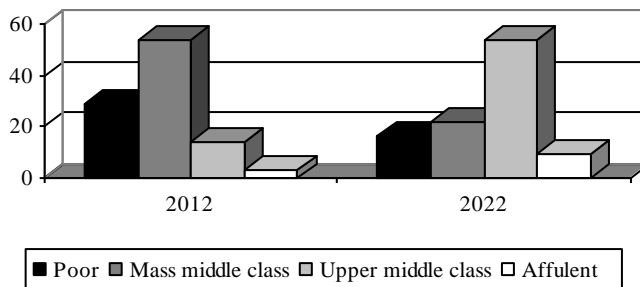


Figure 6. Share of Middle Income Class in China, 2012 & 2022 (%)

Note. Retrieved from “Mapping China’s Middle Class” from Barton, D., Chen, Y. & Jin, A. (2013). *McKinsey Quarterly*, June.

In the long-run, it is widely expected that China's importance as a strategic trade partner of Europe will increase. Taken into consideration the deep and extensive economic and trade relations between China and Europe, the New Silk Road initiative and the rise of Chinese middle-income class is likely to have crucial impacts on future China-EU trade patterns. Jovanovic et al. (2018) indicate that China's middle income class has an ever increasing size and income, and it involves about 600 million consumers, which is more than the

entire population of the EU. They also point out the difficulty of calculating the household income of the middle income class and the whole of China due to its enormous volume and the lack of availability of the reported relevant data. In this context, it is anticipated that the trade between China and Europe will become more and more two-way and will grow in the future.

Indeed, a fast growing consumer market and an increasing number of middle-income consumers makes China an attractive market for the EU countries. In this context, the New Silk Road may also offer many new opportunities for economic cooperation and trade between Europe and Asia. For instance, Chungrong (2016) adds that along European industries and advanced manufacturing industry, services will also benefit from the rise of middle-class market. Starr et al. (2015) suggest restored trade routes across Eurasia would mean that China and Europe could exchange high-value goods more efficiently. Thus, the New Silk Road is expected to enhance opportunities and cooperation for firms and investors from both the EU and China. As Barton (2013) and Chungrong (2016) indicate, China's middle class high spending power, coupled with an outward-looking attitude toward foreign brands, presents new and huge market opportunities for both domestic and EU companies.

The rise of Chinese middle-income class is expected to play a crucial role in the economic and social development of China. The behavior of today's middle-income class also provides various insights to China's future trade patterns. Relative to the mass middle class, Chinese upper-middle-class consumers are becoming more willing to pay a premium for quality products, have a high level of trust in well-known brands and are more likely to spend more of their income on discretionary products as opposed to basic necessities such as food, clothing and shelter. They are also much more international in their outlook and open to, even eager for international brands (Barton, 2013, p.140). For instance, global Chinese luxury spending showed strong growth and represented 32% of the global luxury market, followed by the US (22%) and the EU (18%) consumers in 2017. New Chinese consumers, mostly millennials have been major contributors to the luxury market growth (Global Private Equity Report, 2017, p.5).

Chunrong (2016) suggests the recent Chinese demographic transformation - the rise of middle class consumers - will have critical dynamics for the relations between China and the EU. With growing purchasing power and more European brand preferences, China's middle income consumers are an obvious future target market for EU brands. According to Economist (2014) the "Made in Italy" labels outrank the "Made in China" labels. Thus, as China's economy rapidly matures from an export-driven model to a consumption-based model, the demand for more refined and foreign goods is increasing. Furthermore, the

growing weight of the middle-class increases the significance of new and smooth transport links for Euro-Asian trade.

## 6. CONCLUSION

Since its launch in 2013 the New Silk Road initiative has attracted considerable global attention and is assumed to have a crucial impact on the future economic development of the participating countries and the world. New transportation routes will enable New Silk Road countries to enjoy lower transportation costs, faster freight times, more reliable transit links with new and increased trade opportunities. The New Silk Road initiative is a long-term grand infrastructure and development strategy which is currently at its initial stage of implementation. Upon its completion in the next decades, it is expected to increase integration between Asia and Europe and stimulate the flows of goods and services between China and the EU.

The trade volume between China and the EU is increasing, but strategically, the pattern of trade may be subject to an interesting change due to China's demographic transformation in the long run. If trade volumes increase and transportation costs come down, it could become viable to transport substantial proportion of goods between the parties.

In the context of external trade, issues such as increasing economic openness by reducing tariffs and non-tariff barriers should also be top priority. Additionally, a successful development of Eurasian trade requires an effective coordination among the countries involved. In this context, the interests and concerns of participation in the New Silk Road initiative should be clearly defined. The impact of the initiative at the national and the EU level also deserves special attention.

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