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RESEARCH ARTICLE

Demystifying the Role of Chinese Commercial Actors in Shaping China's Foreign Assistance: The Case of Post-war Sri Lanka

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Hedging against its potential exclusion from the Trans-Pacific Partnership and other mega trading agreements, China embarked on its 21st Century Maritime Silk Road agenda to generate growth through supply chain integration and infrastructure construction in South Asian economies. However, the characteristics of China's business-led and elite-oriented overseas development practices created policy gaps in high-risk countries. Based on interviews and fieldwork focused on Chinese State-Owned-Enterprises (SOEs) in Sri Lanka, this paper explores how globalization changed the nature of these SOEs: from policy executor to both policy maker and market actor in host countries and in China. However, these changes in nature and influence of key Chinese economic actors in host countries are actually not reflected by, and are in fact out of step with, the 1994 regulation that lays down the principle of non-interventionism in foreign assistance. Such a mismatch between expansionist business and restrained regulation leads to a new paradigm where businesses, especially SOEs, serve as a bridge between the host country and Beijing to identify areas where business interest and development needs intersect, thereby shaping development financing distribution in a way that facilitates SOEs' ascension of the global value chain. However, the exclusion of the local private sector from expressing the most pressing needs makes the new paradigm insufficient to integrate the local supply chain. This, in turn, implies the new paradigm is less able to address debt sustainability problems, and geopolitical and ethnic tension in high-risk regions. In order to redress this imbalance, this paper proposes the inclusion of the private sector and civil society into China's mainly business-led overseas development paradigm.

Introduction

There is much discussion and speculation regarding the nature of China's development assistance projects around the world. Deborah Brautigam and Xiaoyang Tang view Chinese development assistance as part-and-parcel of a developmental state, where government plays a major role in directing or guiding profit-seeking companies to initiate specific economic activities in assistance-seeking host countries (Brautigam & Tang 2012). Beijing's role is filling information gaps, providing financing, or helping cushion against costs of operating in risky environments. Others view such projects through the lens of economic statecraft,

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arguing that such massive state-directed investments are oriented more towards strategic and political purposes with economic gains being secondary. Thus, 'commercial actors face commercially undesirable consequences yet still have economic activities in spite of the commercial costs because the state directs them to do so' (Norris 2010). A third interpretation contends that China's movement into other developing countries is largely driven by resource security, with the reimbursement from aid or development programs being secure access to resources (Brautigam & Tang 2012).

Central to all three interpretations of Chinese foreign assistance is the emphasis on the role of the state, which guides public and private investment towards fulfilling certain pre-defined purposes in an assumptive manner. The roles, interests, and incentives of Chinese firms involved in foreign assistance projects are not widely discussed and are often assumed only to be enforcing the directives of the state. Such a blind spot skews the current debate in a way that overemphasizes the significance of China's 'grand strategy': either characterizing China's foreign assistance as 'rough aid' shaped essentially by the imperative of developing new international alliances or claiming that China—like other Southern donors—is still very much within the existing framework of aid politics and less of a threat to current international aid architecture (Naim 2007; Quadir 2013). However, as is the case with any other form of economic diplomacy, fully understanding the formation of the policy goals and outcomes of foreign assistance requires a two-level game analysis involving Chinese commercial actors and the overall political framework (Woolcock 2011). By presenting empirical evidence regarding the key role played by commercial actors, this paper argues that Chinese foreign assistance is in fact driven by increasingly autonomous State-Owned Enterprises (SOEs) rather than any obscure 'grand strategy.' Moreover, freewheeling SOEs can undermine the interest of other state agencies and make it harder for China to pursue a coherent national strategy. Therefore, this paper serves as a corrective to the relatively skewed debate regarding the determinants of China's foreign assistance strategy. The analysis of the key role played by commercial actors complements the work of Graeme Smith (2014).

At the outset, it is important to note that an overemphasis on the determining role of the Chinese state is understandable for two reasons. Firstly, China's foreign assistance program was formally institutionalized between 1993 and 1995 under a socialist market economy when the state still played a dominant role in economic decision making (State Council 2011). However, the forces of economic globalization after 1994—including China's accession to the World Trade Organisation in 2001—have significantly transformed SOEs, the main conduits of foreign assistance, into market entities driven by fiduciary responsibility. This change was not reflected in the 1994 institutions or framework and therefore research that continues to take these arrangements as a point of reference tends to downplay or miss the role of commercial actors.

Secondly, most of the research on China's foreign assistance has focused on resource-rich Africa. The natural resource endowment of Africa will inevitably attract investment and development financing. However, the strategic nature of natural resources tends to divert research to China national resource security and away from the role of SOEs and private firms in shaping foreign assistance-led investment. Therefore, studying regions with differing natural resource endowments such as South Asia and the Pacific—can offer fresh insights into the political economy of foreign assistance. In South Asia, with the exception of India, national economies are neither the most significant markets for Chinese products nor the most vital source of natural resources. Studying the dynamics of Chinese aid in this region can better illustrate a general trend of how commercial actors facilitate and determine foreign assistance projects independent of larger strategic and security considerations.

With a view to demystifying Chinese foreign assistance, this paper will look at assistance through the lens of the changing nature of SOEs. Drawing on empirical evidence gathered from secondary literature as well as interviews with key informants, it maps the dynamics and political economy of Chinese assistance to Sri Lanka by throwing light on the relationship between the host country (Sri Lanka), profit-seeking economic actors (SOEs), and Chinese state institutions. In particular, the paper explains how commercial actors—reshaped by the forces of economic globalization—play a critical role in bridging the gap between the host country and Chinese state; shaping foreign assistance policies that fulfill their commercial interests to ascend the global value chain. As outlined in this paper, the political economy of contemporary Chinese foreign assistance only serves to underline the embedded challenges of economic globalization—namely distributive justice—and the importance of a multilateral and multi-stakeholder approach (Kessler & Subramanian 2013).

Part one of this paper outlines the 1994 paradigm of Chinese foreign assistance. Part two, the main section of the paper, describes how this paradigm is in fact exceeded by current practice and sketches a 'new,' four-step paradigm. This is illustrated with a brief case study of Chinese SOEs in Sri Lanka. Part three discusses the implications of this new paradigm for Sri Lanka and Chinese policymaking as well as underlining how both are being transformed. The paper concludes by highlighting the significance of developing critical assessments of Chinese foreign assistance and stressing the importance of engaging with the challenges presented by the power of Chinese capital, especially through multi-stakeholder engagement.

Apart from secondary literature—part academic and non-academic—this paper draws on official Chinese policy documents as well as from a range of interviews with key individuals in Sri Lanka and China, including those working within Chinese SOEs active in Sri Lanka. Their identities have been masked or kept anonymous at their request.

Part 1: The 1994 Paradigm of China's Foreign Assistance

The early 1980s witnessed a major philosophical shift in China from 'economy serves diplomacy' to 'diplomacy serves economy' (Zhang 2006). That's why, in 1983, the efficiency-focused Four Principles replaced the original Eight Principles of Foreign Assistance.[1] The maxim of 'economy serving diplomacy' was manifested in competition between China, the Soviet Union, and the United States during the Cold War and resulted in China devoting massive resources into foreign assistance to 'third world' countries. The shift towards 'diplomacy serves economy' was triggered by the de-escalation of Cold War tensions in the 1980s and consequent phase of capitalist economic globalization. Prevailing international and domestic conditions required China to adopt a new approach of foreign assistance.

After the collapse of the Soviet Union, economic liberalization and privatization took hold in newly independent countries, which saw foreign aid not only as friendly assistance but also as vital foreign investment. Moreover, independence movements receded and the pursuit of economic cooperation, exchange, and development became priorities. As representatives pointed out at the Tokyo International Conference on African Development, trade facilitation and foreign investment were more efficient than state-state cooperation (Zhang 2006). All of these changes demanded that China develop a new approach.

In the meantime, China's agenda for economic reform had reached a point where foreign assistance was not advancing—and was even hindering—its own goals of modernization (Liu *et al.* 2011). For example, prior to 1980, the major means of achieving

'Common Development' were grants to socialist and newly independent countries. These appropriations ranged from 0.097 per cent to 2.052 per cent of GNP; an average 0.89 per cent (Fu 2003).[2] A re-articulation of its goals for economic development and modernization, combined with related concerns over access to resources and markets, called for a more efficient and strategic approach to foreign assistance. China responded by confirming its commitment to foreign aid, but restructured it in such a way as to support its own economic modernization (Liu *et al.* 2011).

In was in this context that the 1994 paradigm of foreign assistance came into being, marked by the establishment of the China Export-Import Bank and the introduction of concessional lending (State Council of China 2011). This resulted in a shift in focus from grants to concessional loans. In essence, the 1994 paradigm reflects the reality of China as a socialist market economy in which foreign assistance is shaped by a top-down decision making structure. Here are the basic steps:

> **Step 1:** Role of the Recipient Country
> The recipient country proposes a foreign assistance project to the concerned Chinese embassy, which in turn forwards it to the Ministry of Foreign Affairs.
>
> **Step 2:** Role of the Chinese Government
> The Ministry of Foreign Affairs informs the State Council, which convenes a meeting with the Ministry of Commerce and other stakeholders—including SOEs and affiliated agencies—to consider the proposal and respond. Then Chinese policy banks provide grants and subsidized and/or interest-free loans to the host country government or financial institutions.
>
> **Step 3:** Role of Chinese Businesses
> If approved, Chinese SOEs, other government-affiliated, and private entities engage in competitive bidding to implement the project, with or without foreign partners.

Figure 1 below illustrates the foreign aid dynamics as envisaged by the 1994 paradigm.

However, over the last two decades, economic globalization has coupled with changes within Chinese political economy to transform the nature of businesses, especially SOEs. With SOEs being increasingly forced to embrace fiduciary responsibility (previously a concern of the state), they have been pushed towards becoming market actors and deepening connections with major stakeholders—including governments in assistance-recipient countries—to achieve market expansion. Therefore, even while China's top-down 1994 aid policy paradigm remains intact, this normative superstructure is not reflective of the changes in the political economic base.

Contemporary Chinese Foreign Aid: A Paradigm beyond 1994

There are two features of China's current foreign assistance realities that the 1994 paradigm cannot explain. Firstly, SOEs and government-affiliated agencies—which were once mainly project implementers—are in fact active in generating demand for partnership opportunities in host (aid-receiving) countries.[3] Secondly, with the appreciation of the Chinese Renminbi affecting the export performance of major enterprises, foreign assistance projects with subsidized loans have become an alternative route for capital inflow. While the first feature reflects a fundamental change in the political economic character of Chinese firms, the second reflects a change in their stakes in foreign assistance programs. Acting in concert, these two features capture the new reality of Chinese SOEs, which have moved from being policy implementers to full-fledged market actors. This causes them to both fulfill and exceed the 1994 paradigm, necessitating a new framework that can explain the current political economy of Chinese foreign assistance.

Based on empirical evidence from Sri Lanka, this section will outline the 'new' paradigm within which China's foreign

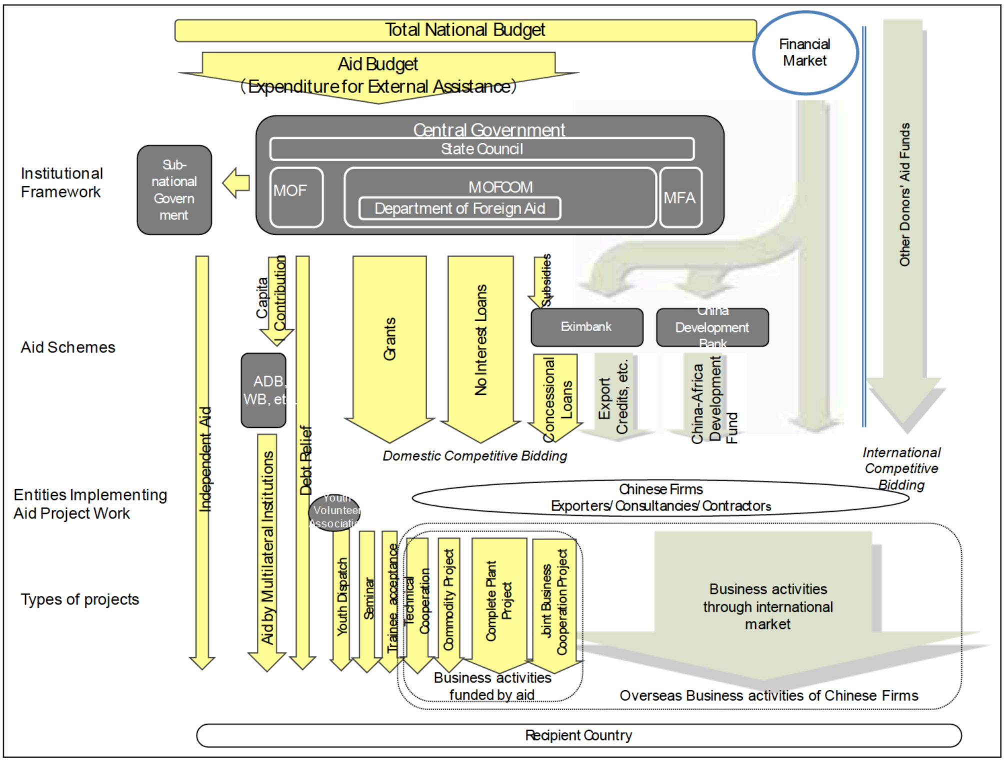

Figure 1: How funds are funneled to foreign aid projects (Kobayashi 2008).

assistance currently operates. It is important to note that this paradigm is not legislated, officially formalized, or otherwise widely discussed, but it is very much evident in—or emerges from—actual practice. But before outlining the new paradigm, it is important to outline the three main underlying factors shaping it: economic globalization, China's constitutional commitment to 'common development' via sharing its own experiences, and host country political-economic dynamics.

The Impact of Globalization, China State's Commitment to Common Development, and Host Country Factors in Shaping Current Chinese Foreign Aid Practice

Globalization factor: The shifting economic base of foreign assistance

This paper credits the forces of economic globalization with the increasingly market-oriented nature of Chinese SOEs and industrial champions. In 1984, China's SOEs started a reform process by adopting the principles of self-operation, self-financing, self-development, and self-restraint (CPCC 1984). In 1990s, the 'modern enterprises system' reform urged all SOEs to transform into shareholding companies, which has resulted in the establishment of 122 major SOE conglomerates as of 2015. These reforms also introduced a three-tier-system of ownership, with ministries as the investors of state assets at the top of the hierarchy; SOE as direct shareholders (such as conglomerates) at the second level; and SOEs themselves at the third level. Presently, many SOEs are publicly listed on domestic and foreign stock exchanges (OECD 2009). These reforms set Chinese SOEs on the pathway to becoming market-driven entities. In addition, the steady appreciation of the Renminbi implied depression in export earnings and financing for foreign assistance projects emerged as an opportunity to generate alternative capital inflows to compensate (China EXIM Bank 1996; Anonymous from Agri-SOE 2014). Furthermore, the market for sectors such as transportation infrastructure in China was nearing saturation (Anonymous - CCCC LTD 2014). Thus, the 'Going Global Policy'—launched in 1999 and meant to encourage Chinese firms to enter the Global Fortune 500 list—incentivized SOEs to seek greener pastures, climb up the value chain, and increase market share akin to other international commercial actors in the context of globalization (GOSCPPC 2006). And the foreign assistance route provided opportunities to do so. All of these factors led to SOEs and government-affiliated agencies—which were designed to implement, rather than drive, policy according to the 1994 paradigm—becoming increasingly pro-active in seeking and generating new projects.

Constitution factor: The shifting superstructure of foreign assistance

In addition to economic globalization, commitments in the Constitution of China provide legal backing for the framework of foreign assistance. The two key commitments are non-interventionist policy, based upon the Five Principles of Peaceful Coexistence, and supporting developing countries in their struggle to develop their national economies (National People's Congress of People's Republic of China 2004).

After 1994, the first commitment—to refrain from political intervention in countries receiving assistance—essentially manifested as government-to-government framework, which recognizes the host country government as the sole legitimate representative of the polity's development and economic interests.[4] Regarding the second commitment of supporting international development, the substantive content of it is shaped by China's own approach to economic modernization at different historical economic stages. For example, after 1994, especially after the reform of SOEs, a new trajectory of economic modernization emerged in China. Central to this was the 'government-led investment-driven model' that led to domestic economic success, wherein SOEs in strategic sectors played a significant role. Shifts in the domestic economic base and modernization trajectory led to the second commitment—the economic development of aid-recipient countries—being translated into the active promotion of a 'government-led investment-driven growth model' with host countries. More specifically, the result was promoting investment in transport and trade facilitation infrastructure, setting up free trade zones in developing countries channeled through bilateral negotiations, and the development of special economic zones to integrate industries in host countries into the global supply chain (Ramachandran & Walz 2011).

These economic priorities favor Chinese companies, especially SOEs, which have a natural advantage in these areas. Therefore, at the firm level, the commercial interests of SOEs are met as they gain platforms to improve competitiveness and ascend the global value chain. At the same time, the growing centrality of SOEs and Chinese businesses in expanding the legitimacy of the Chinese economic development model have actually given the former increasingly greater power and say in economic diplomacy. This has altered the exclusively government-to-government relationship and strict non-intervention paradigm as Chinese economic actors seek ways to leverage and influence foreign assistance investment.

Host country factor

The third factor relevant in this discussion is the structure and character of political decision-making and governance in the host country. Of particular importance is the opportunity structures created by a combination of the socio-political order and context that bears the imprint of post-colonial continuities and changes in social, economic, and political arrangements; the nature and agendas of political and economic elites; and other specific factors such as the location or presence of conflict. As discussed below, a set of host-country factors in Sri Lanka—including the 2004 tsunami, the political and development orientation of President Mahinda Rajapakse's regime, and the post-war demand for reconstruction and infrastructure—all played a part in shaping the role of Chinese SOEs and foreign assistance in general.

Outlining the Function of the New Paradigm

The operation of the new paradigm may be illustrated in the abstract by a four-step model:

> **Step One:** As part of the 1994 paradigm, Chinese SOEs establish a foothold as policy implementers in the host country via donor-based assistance projects. This enables them to access and interact with key stakeholders in the host country; understand the local political and economic context; and engage with key interests, agendas, and demands—even though none of this is envisaged in the 1994 framework.
>
> **Step Two:** Now in the recipient country, the SOEs identify areas where local development priorities intersect with their own business strengths/commercial interests and leverage this to mutual advantage. They seek openings and opportunity structures generated by the local political and economic context and suggest specific development projects to the host country government that maximize their leverage. Theoretically, the 1994 paradigm envisages the host government undertaking this, though in reality it neither encourages nor forbids SOEs from doing so (as the paradigm never conceived SOEs as having such capacities).
>
> **Step Three:** The host country government makes a proposal to Beijing for assistance and support to particular projects that address key development gaps and needs. But unlike previously, this proposal may already reflect the input of SOEs and other Chinese actors present within the host country as well as the interests/agendas of host country political elites. As envisaged by the 1994 paradigm, the Chinese and host country government undertake a bidding process before awarding the contracts. The Chinese firm that assisted the host country with the proposal is in a strong position to win the bid. Projects proposed in partnership with the host country government can significantly lower the barrier for Chinese firms to obtain subsidized development financing whereas proposals coming only from Chinese firms are less likely to be supported by Beijing.
>
> **Step Four:** With their expanding footprint, Chinese SOEs and industrial champions evolve into market actors by undertaking commercial projects outside of the Chinese foreign assistance programs. The 1994 Paradigm is thus simultaneously addressed and exceeded.

The Case of the China Harbour Engineering Group (CHEG) in Sri Lanka

We will now outline this new paradigm using the China Harbour Engineering Group, a major Chinese SOE in Sri Lanka, as an example.

> **Step One:** CHEG enters Sri Lanka as an aid-policy implementer following the 2004 Tsunami
>
> The Indian Ocean Tsunami hit Sri Lanka—already in the midst of a civil war—in 2004. The Sri Lankan government opened the door for international humanitarian assistance to deal with the resulting massive levels of destruction. The Chinese government responded by asking CHEG to carry out the repair of a fisheries port in Hambantota, a district in the south of the country. By successfully completing this project, CHEG won

the trust of the Rajapaksa administration (Xia 2014). During this process, CHEG acted purely as an implementer of policies agreed upon by the Sri Lankan and Chinese governments, in tune with the 1994 paradigm. Therefore, CHEG entered Sri Lanka through a non-market-oriented foreign assistance process.

Step two: CHEG identifies areas of convergence with Sri Lankan government interests

Given President Mahinda Rajapakse's strong emphasis on developing infrastructure and commitment to ending civil strife—represented by the Mahinda Chintana, a ten-year development plan—there was ample opportunity for the Sri Lankan government's development priorities and CHEG's commercial interests to converge. While the original plan was to build a fisheries port in Hambantota, CHEG—driven by its own increasing fiduciary responsibility and need to move up global value chain—proposed a more ambitious plan. CHEG believed that Hambantota had the potential to become a major international port in South Asia with relatively high internal rates of return based on feasibility study conducted by CHEG pro-bono. Likewise, they believed that investment-driven development would reinvigorate the post-war economic infrastructure (Xia 2011). This proposal signaled CHEG's transition from a policy-implementer to a policy-influencer, a role that is not formally accommodated within the Chinese foreign assistance framework.

Step three: Colombo and Beijing connect through CHEG

In 2007, the Chinese state came into play as President Rajapaksa visited China and brought up the question of financing the Hambantota port. This project was included in the Memorandum of Understanding (MoU) signed by Sri Lanka and China. However, after Sri Lanka prepared its application, the conditions set by the Chinese bank changed. An additional 3 per cent insurance fee was added on to the original 6 per cent interest rate, and this meant it exceeded the financing terms offered by Japan and Korea. Yet, Sri Lanka still agreed to China's offer and CHEG won the project (Xia 2011).

At this stage, it is important to observe that the interests of all three parties are fulfilled. The large-scale project meets the economic and infrastructural requirements of post-war re-construction and, at the same time, strengthens the Rajapakse administration, therefore served the interest of host country. Given the pressures of economic globalization, the Hambantota project helped firms such as CHEG enhance their capacities, meet their fiduciary responsibilities, and climb the global value chain through higher internal investment return. In this case, CHEG was able to transform from a contractor for donation-based aid projects to the implementer of a massive Build-Operate-Transfer (BOT) model-based project with higher investment returns. That's how the interest of globalization factor, represented by the business pursuit of commercial actor, is fulfilled. The interests of China's constitution factor are also met as such a project fulfilled China's commitment to international development by enabling Sri Lanka to enhance its own economic infrastructure.

Nevertheless, we cannot assume that the interests of Chinese SOEs and government agencies will always overlap. The Chinese policy bank, a government owned institution, refused to give CHEG an upper hand against Korean and Japanese competitors.[5] However, CHEG managed to leverage their trust from and influence on the Sri Lankan political leadership which ultimately accepted the aforementioned higher terms.

Step four: CHEG evolves into a full-fledged market actor in Sri Lanka

	1994 Paradigm	New Paradigm
Role of China Factor (Chinese governments and policy banks)	Decision-maker and Funding Provider	Supporter with preferential policies and financing
Role of International Organization	None	Supporter with financing
Role of Host Country Government	Projects proposer	Projects proposer
Role of SOEs and Industrial Champions	Policy implementer for China	Involved in proposing projects and policy implementation

Table 1: The two aid paradigms.

Similarly, while CHEG utilized Chinese foreign assistance to enter and gain a foothold in Sri Lanka, it has not confined itself to Chinese government funded projects nor has it shied away from financial investments beyond Chinese government sources. As with other global market actors, CHEG continues to explore ways to achieve higher returns via opportunities opened by the host government. In addition to the previously discussed port, CHEG has partnered with the Export-Import Bank of China to build an airport in Hambantota as well as with the Japan Bank for International Cooperation to construct a Southern Expressway and Ring Road Expressway for Colombo (Ministry of Commerce of People's Republic of China 2009; ADB 2012). CHEG believes that foreign development assistance contracting is at the lower end of the global value chain. In order to ascend, it has engaged and invested in full-scale commercial projects such as the Colombo Port City Project, an undertaking at US$1.4 billion at first phase that includes infrastructure, land, and real-estate development. This project was estimated to attract further investment around US$13 billion. This is seen as an important step in establishing CHEG at the higher end of the global service value chain (Mo 2014).

In fulfilling its own commercial interests, CHEG is responding to the imperatives and opportunities of economic globalization and drifting away from Chinese foreign assistance institutions. SOEs like CHEG have already evolved from being pure policy enforcers into market actors intent on expanding their footprint within the host country and international capital. Xia has stated that CHEG started out as a contractor for cash-based aid projects, moved on to foreign assistance projects under MoU, and finally became a developer of high-end commercial projects (Xia 2011). This progression reflects its efforts to climb up the value chain in the global market. However, it is crucial to note that the 1994 paradigm made this progression possible in the first place by allowing SOEs to enjoy exclusive access to donor-based foreign assistance projects (**Table 1**).

CHEG is not an isolated case in Sri Lanka. Other SOEs have also moved from being aid policy enforcers under the 1994 paradigm to market actors who influence or provide policy proposals for the development of large infrastructure projects, where the returns are at their highest. The China National Machinery Import and Export Corporation is another case in point. After the 2004 tsunami, it provided services worth US$200 million before proposing the Southern Railway Reconstruction Project to the Sri Lankan government the following year (Tao 2005). It leveraged the opportunity opened up by humanitarian aid to move up the value chain through market-oriented foreign assistance, first through the Matara-Kataragama Railway

Extension Project and then the Norochcholai Coal Power Plant Project (the latter of which was backed by a bilateral MoU and financing from the China Import-Export Bank). Most of these foreign assistance projects were included as part of the aforementioned Mahinda Chintana (Ministry of Finance and Planning of Sri Lanka 2010). Ultimately, it was through such projects that Chinese SOEs in Sri Lanka gradually transformed themselves from executing donation-based aid contracts, to BOT contracts, to becoming major commercial developers in their own right.

Of course, one must avoid over generalizations that all Chinese SOEs behave as policymakers or influencers in assistance-receiving countries. It is also important to acknowledge that many projects currently funded by Chinese foreign assistance were initially designed by Western countries – the Colombo-Katunayake Airport Expressway is just one example. However, volatile security situations, financial risks, and other related political exigencies led to these projects being left incomplete by Western, Japanese, or Korean agencies and contractors. In such cases, the Chinese state (and its commitment to 'Common Development') came into play by providing subsidized financing and other guarantees that offset possible risk-induced losses to contractors. Hence, it is believed that Chinese SOEs have a higher tolerance for operating under high-risk conditions (Anonymous - CMGC 2014). In such cases, SOEs were largely policy implementers in the 1994 paradigm, fulfilling commitments, rather than influencing policy and behaving as market actors in the new paradigm.

Implications of the New Paradigm

From non-intervention or involvement: Shaping host country development policies

Even based on the limited evidence from Sri Lanka, we can state with confidence that Chinese SOEs become powerful market actors in host countries. Leveraging China's Constitutional commitment to 'Common Development,' SOEs conveniently introduced the 'government-led investment driven growth model' into Sri Lanka's development agenda; this allowed for easier access to subsidized loans from Chinese policy banks for large infrastructure projects. Therefore, even though the principle of political non-intervention in host countries is ostensibly safeguarded, economic intervention is a reality and shaped largely by Chinese firms in their struggle for profits. As the above case shows, the economic intervention from Chinese firms manifests itself in selection of development projects; a simple fishery in Sri Lanka was transformed into a major port in the Indian Ocean at the advice of CHEG and other major projects followed, all integrated into the ten-year national development project plan.

Even as the involvement of Chinese firms enables them to ascend the global value chain, it also raises questions regarding how the process and outcomes relate to—or even reshape—a host country's most pressing real development priorities. It is evident that Chinese SOEs currently possess dual roles. On the one hand is their role as commercial actors in Sri Lanka, where they have transitioned from merely implementing foreign assistance projects to becoming independent economic actors capable of influencing development agenda setting in host country. On the other hand they are still officially regulated as policy implementers in nation-state based 1994 paradigm. This means that Chinese SOEs are not required to collaborate with the local private sector, non-governmental organizations, or communities regarding feasibility studies and needs/impact assessments (even though such efforts could be more efficient, reduce overall risk, and enhance sustainability), assuming such work is the responsibility of host country government.

This dual role of SOEs has an important implication for the relevance of Chinese projects to the developmental needs of the host country. When an SOE is functioning as the first to set a development agenda, this SOE is governed by their second role, which does not see engagement with local stakeholders as a necessary. For example, one interviewee from a major SOE believes the host country government—which is the only agency permitted to apply for foreign assistance from the Chinese government—best represents the interests of all citizens and that working exclusively with the government is the only way to incorporate the interests of all domestic stakeholders (Anonymous - CMGC 2014). Needless to say, SOEs are reluctant to break away from this model as it simplifies their involvement. In other words, at present the Chinese foreign assistance framework is marked by a contrast between proactive commercial actors (Chinese SOEs) and a regulatory framework that cannot quite regulate them. Such a combination is not conducive to ensuring coherence and consistency in setting aid priorities. Moreover, it also militates against other, non-governmental stakeholders involved in setting the host country's development priorities.

Therefore the way in which Chinese foreign assistance projects are established may be at odds with most pressing development priorities. In Sri Lanka, it is clear that Chinese foreign assistance is overdetermined by the 'new' paradigm (i.e. the commercial interest of Chinese SOEs). It is characterized by an excessive focus on large transportation, trade facilitation, and physical infrastructure—sectors in which Chinese SOEs enjoy a comparative advantage. In the Sri Lankan context, this presents at least three important risks.

The first concern pertains to debt sustainability. Sri Lanka's external borrowings at non-concessional commercial terms have already increased significantly (IMF 2014). This would not be a serious concern if foreign exchange earnings were boosted through improved exports, facilitated by advanced infrastructure. This is the reason why infrastructure is considered the most efficient aid for trade (Vijil & Wagner 2012). However, in reality, Sri Lanka's export is not increasing as fast as its debt accumulation. Sri Lankan foreign debt-servicing to export earnings has increased from 13.2 per cent in 2011 to 25.3 per cent in 2013 (Sanderatne 2014). One reason appears to be the distribution of development financing projects is skewed towards infrastructure and away from productive sectors, such as agriculture and fishery. Not only is the gestation period for most of the supported infrastructure projects relatively long, they are also concentrated within a relatively small timeframe (Sanderatne 2011). At the same time, agriculture productivity programs—believed to be a priority for improving trade and an area in which China can provide effective support—are not a significant part of Chinese bilateral foreign assistance (Dhanapala & Gooneratne 2012). Similarly, climate change mitigation—believed to be an important development gap—is not given much attention (World Bank 2014). As a result, the debt repayment pressure starts to build up before export productivities are promoted. This poor supply chain linkage between infrastructure projects and local productive sector indicates the lack of voice of exporting productive sector of Sri Lanka in agenda setting for such infrastructure projects.

The second risk is the prospect of political 'clientelism' (Dornan 2014). The policy of non-intervention is predicated upon the belief that the host country government best represents interests of all communities and that government-to-government communication is the only way to respect sovereignty and effectively respond to pressing development concerns. However, such intentions may not be based on a solid understanding of the political economy of host countries. In fact, research has shown that officials in host countries systematically favor their home constituencies (Barkan & Chege 1989; Moser 2008; Horowitz & Palaniswamy 2010; Burgess *et al.* 2011; Green 2011; Do *et al.* 2013). Quantitative analysis suggests that China's assistance projects are vulnerable to regional favoritism while qualitative assessments have pointed out that projects can be easily exploited for political gain (Dreher *et al.* 2014; Brautigam 2009; Mthembu-Salter 2012; Jansson 2013). Ruben Gonzalez-Vicente argues that the absence of political intervention influences economic assistance is such a way as to empower political elites in host countries (Gonzalez-Vicente 2015). In Sri Lanka, some have interpreted China's assistance as favoring only the ruling party (Anonymous - UNP 2013). The massive Chinese investment in the south of Sri Lanka—including in Hambantota, President Rajapakse's political base—only adds fuel to this perception.

From this flows the third risk, namely the exclusion of war-affected and ethnic Tamil-dominated northern Sri Lanka. The geographic distribution of Chinese assistance projects is predominantly in the south, despite significant post-war reconstruction needs and development priorities in the north and east. An absence of programs in these areas has coupled with concerns about disproportionate political power and crony-capitalism to contribute to a negative perception of Chinese aid amongst the beleaguered populations in the north and east.

In other words, there are significant questions about whether Chinese assistance is responding to the country's most pressing development needs or prioritizing the interests of contractors and political elites. Indeed, the Chinese state has much to be concerned about. In a country transitioning from war and conflict to peace, foreign capital flows without appropriate distributive mechanisms are vulnerable to stimulating latent or existing tensions (UN Global Compact). In the long run, development driven by the agendas of SOEs and political elites may drive up economic inequalities and imbalances as well as renew ethnic grievances due to economic exclusion. In other words, the structure of foreign assistance carries the risk of precipitating political instability and undermining China's long-term goal of an economically prosperous, politically stable neighborhood conducive to its Maritime Silk Road Agenda.

Reshaping Chinese policy

The changing nature of Chinese SOEs and commercial actors and their growing economic and political influence is impacting both host country and Chinese policymaking. At the heart of these challenges is the increasingly complex nature of interactions involving the host country, the Chinese government, and SOEs and other enterprises—which are becoming economically autonomous and politically influential—in a way that the 1994 paradigm simply cannot accommodate. As the Chen Deming—the Chinese Minister of Commerce—has admitted, the supervision and regulation of China's foreign assistance projects is not sufficient (Chen 2010).

Firstly, the reformed ownership structure determines that SOEs are naturally inclined to influence host country governments to propose projects to Beijing that reflect their own core businesses and commercial interests. In other words, SOEs are actually shaping—albeit indirectly through host country governments—Chinese foreign assistance policy so that it aligns with their own commercial interests (as well as those of other key corporate actors). It is no surprise then that most issues on the Silk Road Agenda, such as transportation and trade facilitation, reflect the comparative advantage of Chinese SOEs (Xi 2014). For instance, the special economic zone in Tomsk, Russia was the result of the active lobbying of the host government by Northwestern Forestry (a provincial company in Shangdong); the company was allowed to take the lead in the construction with subsidies from the Chinese government (Brautigam & Tang 2012).

Secondly, such a public-private partnership without proper regulation on firms oversea activities—which can be summarized as 'enterprises first government convoy (企业先行政府护航)' — brings its own risks as the interests of the Chinese state and Chinese businesses do not always align (Jiang & Xiao 2011). As SOEs evolve into autonomous economic actors, they tend to view the Chinese government as a facilitator in matters of financing, risk management, ensuring preferential trade and investment policies. But these public-private partnerships, while meant to be mutually beneficial, can also generate conflict. This conflict of interest between firms and state is not only limited in Sri Lanka but can also be seen in Sudan, Myanmar, and other developing countries. For instance, under the pressure of 'self-financing,' China National Petroleum Corporation (CNPC) won oil exportation rights in 1992 in a way that served economic needs of host country and CNPC, which made 'going abroad' an official national strategy in 1997 (Xu 2007). From that point on, one might have expected a positive correlation between China's diplomatic credits and the profits of China's oil SOEs. But this has not always been the case. During the Darfur crisis, the Ministry of Foreign Affairs worked overtime to ensure that China's various diplomatic interests—such as relations with the west and Chad as well as the broader perception of the country's 'peaceful rise'—were protected. However, oil companies such as CNPC were single-mindedly pursuing resource gathering irrespective of other political and diplomatic considerations; a policy which resulted in conflict within the Chinese establishment (McGregor 2008).

Thirdly, SOEs and other enterprises might deploy political narratives to access development financing. The normative rigidities of the 1994 paradigm offered no formal process through which SOEs could engage with both the host country and Chinese governments to express their commercial concern. This lack of collaboration may push commercial actors utilizing political narratives, such as security threats, to win attention of policy makers on distributing development financing thereby advance their economic concerns to the detriment of Chinese diplomacy (Reilly 2013; McGregor 2008).

An example of this is the Myanmar gas/oil pipeline, envisioned as an alternative method of maritime shipment through Malacca Strait. While the pipeline is a legitimate economic goal, its broader political legitimacy and strategic importance are tied to security concerns in the Malacca Strait. However, many Chinese scholars criticize this narrative as a false proposition. Wang Zhen believes that both the Myanmar pipeline and Malacca sea-lane present an equal or comparable measure of risk; thus the Myanmar pipeline is not really a strategic alternative but simply a diversified import channel serving more commercial purposes (Wang 2013). Some argue that the driving force behind the pipeline is the competition between CNPC and the China Petroleum & Chemical Corporation (SINOPEC) for market share in South China (Li *et al.* 2013). To effectively compete in the southeastern Chinese market, CNPC had to transport imported oil and gas through Myanmar to refineries in Yunnan (Li *et al.* 2013).[6] James Reilly has argued that provincial officials and commercial actors in Yunnan stoked fears of a 'Malacca Dilemma' in order to launch the project—despite the potential threat to both political stability in Myanmar and diplomatic goals in Beijing (Reilly 2013).

With the transformation of SOEs into powerful market actors, their relationship with the Chinese government is also changing. The largely top-down relationship between policymaker and policy-implementer is giving way to a more horizontal partnership. Such a partnership, not envisaged under the 1994 paradigm, presents both new opportunities and challenges. As SOEs have expanded and become more powerful in the host country, their commercial agendas and political influence have become harder to disentangle.

Last but not the least, the dictates of economic interest also imply a less taken-for-granted relationship between the government and commercial actors. As noted in the case of Hambantota port project, the EXIM Bank of China did not support CHEG through more favorable interest rate against

Japanese and Korean competitors. On the contrary, EXIM Bank of China added insurance interest rate of three per cent. CHEG was saved by its own networking efforts with the Sri Lankan government. Therefore, sometimes the host country government can prove to be a stronger supporter of Chinese SOEs and enterprises than the Chinese government and its policy banks.

The transition of Chinese SOEs into market actors necessitates the evolution of the Chinese state from a controller and supporter to a proactive regulator. This includes taking greater responsibility for the evaluation of corporate practices including the investigation of corruption and the monitoring of credit ratings for firms engaged in overseas foreign assistance. This latter suggestion is echoed in Articles 35, 36, and 37 of the latest Administrative Measures for Foreign Assistance issued by the Ministry of Commerce of People's Republic of China (Ministry of Commerce of People's Republic of China 2014).

The prioritization of profitability and fiduciary responsibility implies that SOEs are increasingly defining their own economic agendas independent of broader Chinese interests. Not only are they actively pursuing resources from multilateral development agencies and other non-Chinese investors, but also diversifying their procurement. For example, there has been a significant increase in the use of local labor in CHEG's Hambantota project and much of the equipment for the airport expressway project was procured from Malaysia and India (Mo 2014; Anonymous - CMGC 2014).

These trends will continue as more Chinese firms start borrowing from foreign investors in the face of domestic credit drying up (Wei 2014). The move from a top-down to a horizontal relationship between the Chinese government and its SOEs may result in more loosely knit partnerships and eventually shift the foreign assistance paradigm away from an exclusive nation state-based framework towards a more multilateral and multi-stakeholder approach.

Conclusion

China's foreign assistance mechanism reveals a mismatch between the superstructure of China's assistance institutions and its economic base. China has to deal with the reality that SOEs turning into market actors has a profound impact not only on policymaking in host countries but also on shaping China's strategic preference and economic assistance in a way that serves firm-level market and commercial interests.

The normative and institutional gaps and tensions this has created is a result of practice exceeding the boundaries of the 1994 paradigm. China needs to officially implement to a new aid paradigm that accounts for the unsustainability of state-centered mechanisms. It is vital that such a paradigm creates processes and platforms through which the Chinese government and commercial actors can engage with host country governments and other stakeholders in private sector to address strategic political and development concerns as well as commercial interests. The intended result of this would be a greater positive impact on human development outcomes in the host country.

In particular, Chinese foreign assistance to countries like Sri Lanka must grapple with the 'missing middle,' especially at a time when distributive injustice has threatened confidence regarding globalization. The key here is multi-stakeholder engagement, especially in the private sector, and going beyond sole reliance on the government as the best representative of collective interest. The nature of the elite-dominated political and economic structure in many host countries, including Sri Lanka, precludes such a possibility. Moreover, under such circumstances, Chinese aid risks being leveraged by the political elite to further their own agendas. The resulting exclusion and political instability, especially in post-conflict contexts like Sri Lanka, may very well undermine China's long-term political, strategic and economic interests.

This paper suggests that it is no longer productive or accurate to view the Chinese state as monolithic. Its command over economic diplomacy and foreign assistance is increasingly shaped by the power of Chinese SOEs—now behaving like market actors—and businesses. These actors are also shaping policy choices in host countries like Sri Lanka by leveraging opportunity structures and using their own influence. This combination of disaggregated states and powerful capital is unlikely to guarantee distributive justice. It is in this context that a reassessment of Chinese foreign assistance policies assumes such importance.

Notes

1. Four Principles on Sino-African Economic and Technical Cooperation Zhao, Ziyang, *People's Daily*. Adjusted from a speech in 1983. Available at http://world.people.com.cn/GB/8212/72927/73386/4988583.html.
2. Fu worked on foreign assistance finance in Ministry of Finance of China.
3. This is an insight that emerges from my own research and literature (English or Chinese). The research is scarce but Brant and Dornan 2014 is instructive.
4. This is enshrined in the *Declaration on the Inadmissibility of Intervention in the Domestic Affairs of States and the Protection of Their Independence and Sovereignty.*
5. Policy banks are obligated to finance government policies and projects regardless of the market principles.
6. In 2011, CNPC signed a MoU with Saudi Aramco declaring streamlined cooperation on resources, processing, and marketing. The construction of refineries in Yunnan under the MoU is a supporting project for Myanmar oil and gas pipeline, helping to transport Aramco oil into the southeastern Chinese market (Saudi Aramco 2011).

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