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CHINA'S TWO OCEAN STRATEGY: Controlling waterways and the new silk road

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The "Two-Ocean" Strategy (双海战略) began to appear in the literature around 2005 as a pre-conceptualized project set by the Communist Party of China (CPC) and representing a strategic objective to achieve. The narrative behind this is that China ought to gain back control of the waters surrounding it as not only a symbolic end to its "Century of Humiliation"[1] and the neglect of its own navy since the country's economic ascension. Kaplan[2] posits this idea that the navy was neither capable nor adequate to achieve such an objective in the mid to late 2000s. Any talk of such a strategy back then was merely projections. However, since the implementation of the "One Belt, One Road" Initiative (OBOR), the Two-Ocean Strategy has gained renewed relevance and momentum. If earlier versions of the strategy emphasized areas around certain coastal cities (primarily Tianjin) at the time, the focus has undoubtedly changed and a fully sketched out strategy is evident.

As such, this research note dissects and analyses the current Two-Ocean Strategy and its relationship with the One belt road. Consisting of four sections, this paper demonstrates that while the two ocean strategy has military roots, it is nonetheless focused on economic security and furthering China's economic interests. Therefore, the latter is best understood against the backdrop of the OBOR.

The first section is a two part literature review which begins with detailing the history of the strategic development and thinking of the People's Liberation Army Navy (PLAN); the latter is used as a spring board into examining the Two-Ocean Strategy. The second section analyses the geopolitical implications of this strategy. The third section briefly examines the economic problems facing China in the present context; and the final section amalgamates the Two-Ocean Strategy and the OBOR so as to produce a cohesive national strategy for China that is centred on economic security and prosperity.

THE PEOPLE'S LIBERATION ARMY NAVY AND THE LEGACY OF LIU HUAQING

During the Mao Era (1949-1976), the PLAN's activities were subordinate to that of the Army, due to the mere geopolitical reality that most of the threats facing China at the time did not necessitate a deep-sea navy[3]; thus, its role and zone of operation was limited to that of "coastal defence" or "near-shore" (近岸).[4] However, during the subsequent era whereby the reins of the CCP leadership were handed over to Deng Xiaoping and when the country began its process of reform and opening up (改革开放), the navy also underwent a reformation. Such reformation occurred despite the "Four Modernizations" agenda which had set national defence last in terms

[1] The period beginning with the First Opium War and ending with China's economic rise in the 1980s - whereby the country was helpless to prevent the invasion of foreign powers - was seen as an economic failure following the victory of the Communists.

[2] R. D. Kaplan, "China's Two-Ocean Strategy," *China's Arrival: A Strategic Framework for a Global Relationship* (Washington: Centre for a New American Security 2009).

[3] For example, the dangers during that period were embodied by the U.S. presence in the region, the Soviet Union in the North, and a Nationalist Taiwan.

[4] S. Kondapalli, "China's naval strategy," *Strategic Analysis* 23(12) (2008).

of priority, especially with the ascension of Liu Huaqing 刘华清[5] who, in 1982, was promoted to commander of the PLAN. Heavily influenced – to the extent that scholars have dubbed him as "China's Mahan"[6] – by the American naval officer and historian Alfred Thayer Mahan's seminal work, *The Influence of Sea Power upon History: 1660-1783*, Liu began to adapt the ideas found in Mahan's work as the basis for reforming the PLAN, both materially and strategically.

Mahan's core tenets were that since seas act as a highway and are a common resource for all states, there lies great importance in controlling them as there is much to be gained. Furthermore, control of the seas is imperative for a state to grow and extend both its power and wealth, by exploiting commerce and subsequent trade routes during peacetimes on one hand; and by exploiting the seas for military purposes during times of war on the other hand.[7] What is especially important for Mahan are the sea lines of communications (SLOCs) which encompass supply lines. SLOCs become even more important in today's globalized world since, while they still face the same threats as centuries ago such as piracy and war, the consequences of their disruption and interruption in present times result in even greater damages. As such, not only does a state's navy serve to protect trade routes, but the SLOCs are equally significant and become increasingly valuable as a state rises in wealth and power.

Influenced not only by Mahan but also by the changing economic conditions of China at the time, Liu argued: "as the strategic position of the Pacific is becoming more important… and as China is gradually expanding the scale of its maritime development, the Chinese Navy will have to shoulder more and heavier tasks in both peace-time and war".[8] Nevertheless, it had become quite clear, with the new economic reforms in full swing, China is and will be entering into new economic and geopolitical realities, as well as difficulties; thus, the PLAN must adapt to changing conditions. As such, Liu expressed that the PLAN "is an organization to handle the issue of 'maritime rights' in struggles of manipulation, plunder and counter-plunder, which have always existed between maritime nations"[9]. With this, the PLAN under Liu's command entered into a new strategic phase whereby its role and zone of operation was expanded to "offshore defence" or "near-seas" (近海).

The economic necessity of reforming the PLAN so as to eventually protect China's SLOCs was evident, and the military necessity also became increasingly obvious as demonstrated by two events. In 1988, scrimmages between China and Vietnam over the Johnson Reef in the Spratly Islands highlighted the need for a navy capable of operating and fighting in the seas adjacent to

[5] Liu Huaqing was arranged as the "military nanny" 军事保姆of Jiang Zemin by Deng Xiaoping after the events of Tian'an Men square. Liu was then named Vice-President of the CMC in October 1989 by Deng Xiaoping and subsequently became a member of the Standing Committee of the Politburo (1992-1997). That said, no military officer has since held this position since Liu's departure.
[6] J. R. Holmes and T. Yoshihara, *Chinese Naval Strategy in the 21st Century: The Turn to Mahan* (London and New York: Routledge 2008).
[7] A. T. Mahan, *The Influence of Sea Power Upon History: 1660-1783* (New York: Courier Dover Publications 1987).
[8] B. Hanh, "Navy Pursues Major Maritime Role," *Pacific Defence Reporter* 16(8) (1990).
[9] Ibid.

China.[10][11] In 1991, the decisive and swift victory of the United States in the First Gulf War shook the Chinese military community – policy-makers and academics alike –: it not only accentuated the difference in military capabilities between China and the US, but also gave impetus to the speed of military reform in China.[12] It is likewise important to note that, currently, the PLAN is in the second phase according to Liu's plan. Moreover, it is evident that the PLAN's modernization has been merged with the OBOR, so that the goals of the two projects can mutually benefit one another.

As a result, Liu argued that the PLAN ought to operate as a separate arm of the military, and not merely as an accessory to the Army. Furthermore, the PLAN must be able to command the seas as opposed to merely operating in the latter to disrupt enemies' naval operations. Thus, in order to properly bring the PLAN to its offshore/near-seas phase, the PLAN needs to undergo complete modernization. Liu's vision of the PLAN's modernization process consisted of three major periods.[13] The first period is for personnel and formations training, as well as the renovation and upgrading of present ships. The second period consists in improving the PLAN's combat capabilities in the near-seas by constructing light aircraft carriers and buying additional warships to form carrier fleets. The final period for modernization remains rather ambiguous. The goal is to make the PLAN a major maritime power with blue-water capabilities. This meant that, effectively, the PLAN would be able to operate far beyond the near-seas. As such, the final period extends the PLAN's zone of operation into the "far-seas" (远海). Furthermore, each period carries its own objectives. The first period seeks to allow the PLAN to fight efficiently - that is, quickly and at a low risk -, as well as to deter regional threats. The second period intends to turn the PLAN into a regional maritime power in the Western Pacific and make it able to travel globally. The last period seeks to have the PLAN able of consolidating SLOCs, conducting and maintaining surveillance, projecting power further outwards, and deterring international threats.[14]

Liu did not view the PLAN's modernization as merely military. Rather, his Mahanian influence allowed him to view the role of the navy in the broader context of the future direction of China as a whole. Indeed, he asserted that "nautical aims must be enfolded within China's national strategy".[15] This is what elevated Liu above his contemporaries, for he was able to draw up a blueprint for the future of the PLAN which would coincide with China's growing economy and exports. In essence, far from being purely a military doctrine, Liu's work was integral in bringing

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[10] T. J. Bickford, H. A. Holz, and F. Vellucci Jr., *Uncertain Waters: Thinking About China's Emergence as a Maritime Power* (Alexandria: CAN China Studies 2011).

[11] It is worth noting that Liu, who sided with the conservative elements of the Party, was one of the top commanders in charge of implementing martial law during the Tian'an Men protests.

[12] R. Cliff, J. Fei, J. Hagen, E. Hague, E. Heginbotham, and J. Stillion, *Shaking the Heavens and Splitting the Earth: Chinese Air Force Employment Concepts in the 21st Century* (Santa Monica: RAND Corporation 2011).

[13] Kondapalli, "China's naval strategy," *Strategic Analysis*.

[14] Specifically speaking, the first period up until 2000 is for personnel and formations training, and the renovation and upgrading of already possessed ships. The second period, 2001 to 2020, is for improving the PLAN's combat capabilities in the "near-seas" by constructing several light aircraft carriers and buying additional warships to form carrier fleets. The final period for modernization, 2021 to 2040, remains rather ambiguous.

[15] Holmes and Yoshihara, *Chinese Naval Strategy in the 21st Century: The Turn to Mahan*: 31.

about an understanding in China that the country's survival was due to become increasingly bound to economics and geopolitics.

UNDERSTANDING THE TWO-OCEAN STRATEGY

Before beginning a proper analysis of the strategy, it is necessary to first identify which "oceans" the name refers to. In this sense, the strategy can be understood in both a broad and narrow manner. Broadly speaking, the geological boundaries of the strategy correlate to the capabilities of the PLAN, and this builds the macro-structure of the strategy. As such, the near-seas/far-seas distinction (**近海**/远海) is best suited for explaining the broad perspective.

In the current context, the near-seas consist of the waters adjacent to China's borders, i.e. the East and South China Seas, and the Yellow Sea. On the other hand, the far-seas consist of all water channels beyond the aforementioned areas. This is due to the fact that, currently, the PLAN cannot operate outside of the adjacent waters in an effective manner, due to a combination of a lack of experience and a lack of a deep-water fleet. However, as previously noted, the definition of what the near-seas and far-seas are will change as the PLAN progresses with its reforms and modernization.

In its narrow definition, the strategy – as it is today – specifies the "two-oceans" as being the Pacific Ocean and the Indian Ocean. This is due to two reasons. Militarily speaking, the Pacific Ocean – the regions which are close to China – carries many concerns for the country's political and military elite. For example, Taiwan is still considered a "rogue" state; American presence in South Korea and Japan still remains a thorn to China's side; and disputes over territorial claims with Japan, the Philippines, and Vietnam are too close to home for China. Moreover, in the event of a full-scale war with the US, much of the naval combat would occur in this theatre. For instance, the South China Sea acts as a maritime buffer for the southern Chinese provinces in any conflict with Taiwan; and any naval blockades would also be concentrated on this region.[16] As such, it is imperative that the PLAN is capable of effectively operating in this ocean. The Indian Ocean, on the other hand, is considered to be a top region for naval training for the PLAN, and the next-step in China's sea power projection. To the former point, since the Indian Ocean is considered to be part of the far-seas, it provides conditions for the PLAN to navigate and operate in a deep-water region. And on the latter point, China is due to establish its first overseas military base in Djibouti for logistical facilities geared for naval rest and supply. Moreover, China also has numerous economic and trading interests in the regions bordering the Indian Ocean. For example, one port in Pakistan and another in Sri Lanka are due to receive Chinese shipping lines. As a result, this provides excellent opportunity for the PLAN to practice convoying and protecting Chinese commercial fleets.

From an economic perspective, the Pacific Ocean and Indian Ocean are home to most of China's SLOCs – commerce and energy supply lines. For instance, nearly 80% of China's oil imports pass

[16] M. T. Fravel, "China's Strategy in the South China Sea," *Contemporary Southeast Asia* 33(3) (2011).

through these two water regions.[17] Moreover, in a more global context, over one-quarter of all maritime cargos and one-third of maritime traffic cross these two regions.[18] Crucial to China is the Strait of Malacca where most of its energy imports must pass through. China's reliance on the strait and the subsequent fears of having an embargo or blockade placed on its energy imports has risen to the top of its national strategic concerns – so much so that in 2003, President Hu Jintao coined the term "Malacca Dilemma." To this point, certain scholars have raised their concerns on the issue of economic security. For example, Zhang[19] opines that in the absence of a powerful navy and in the event that some nations want to embargo China, the latter would be rendered helpless. Likewise, Yang[20] argues that insofar as China is unable to completely protect its supply lines by itself, the state of its economic security remains vulnerable. Underpinning the concern over economic security lie two uncertainties. Firstly, the risk of war and subsequent embargos and blockages is always present. Secondly, the reliance on external markets[21] means that China depends on its commercial supply lines. As such, it is by no means a stretch to argue that China's economic lifelines depend on the freedom of navigation in these two maritime regions. Chinese economic interests in these two oceans are abundantly clear.

Aside from a potential embargo or blockade by a state actor, another problem worries Beijing: piracy in the Indian Ocean is a major problem for commercial fleets navigating the region. And with China's massive commercial fleet, piracy can result in substantial economic losses and drive up insurance premiums. Consequently, this consolidates the need for the PLAN to expand its zone of operation into the far-seas – to protect Chinese commercial interests. And as previously mentioned, the sheer global trade volume that passes through these two maritime regions necessitate protection from piracy, and it will be expected that China play an increasingly greater role to ensure that the global SLOCs are not disrupted. Therefore, the paramount importance of guaranteeing economic security together with the need to modernize the PLAN make the Pacific Ocean and Indian Ocean the two goals of the strategy.

GEOPOLITICAL IMPLICATIONS OF THE TWO-OCEAN STRATEGY

There are three major implications inherent to this strategy. First and foremost, the PLAN will continue its course of modernization, and as such, extend its zones of operation. Ultimately, China's influence and power projection will radiate outwards along with the PLAN. In fact, in recent years, the PLAN has begun to acquire a wide array of naval weapons such as anti-ship and anti-aircraft missiles, long-range ballistic missiles, cruise missiles, air-defence systems, attack

[17] M. Lelyveld, "Mideast oil drives China disputes," *Radio Free Asia*, July 18, 2011.
[18] J. deLisle, "Troubled Waters: China's Claims and the South China Sea," *Orbis* (2012).
[19] W. Zhang, "Sea Power and China's Strategic Choices," China Security (2006).
[20] Yang, Y, "Navigating Stormy Waters: The Sino-American Security Dilemma at Sea," *China Security* 6, no. 3 (2010).

[21] Markets, in this sense, encompass both export and import markets, and not merely energy markets, but consumer and commodity markets as well.

aircrafts, land-to-sea and land-to-air missile systems, among others.[22] In addition, the PLAN has also greatly expanded its submarine fleet. The PLAN is well aware that vis-à-vis the current naval hegemon – the US –, it would lose a full-scale naval war as its traditional fleet is significantly weaker. Therefore, it would need to exploit the usage of a submarine fleet as a way to contest the US' dominance over the seas.[23]

Naturally, this will be met with increasing resistance from regional actors (both in the Pacific Ocean and the Indian Ocean). Notwithstanding the already vocal protests of the Philippines, Japan, and Vietnam over territorial claims; while India is also becoming increasingly wary of Chinese naval presence in the Indian Ocean. As both are ascending countries with international economic and geopolitical aims, the Indian Ocean becomes a hot-spot of conflicting interests. While both India and China have a vested interest in safeguarding maritime security for the purposes of conducting commerce, the tug-of-war to become the dominant regional maritime actor persists. Indeed, some point to the possibility of cooperation between the two countries on the basis of forging and maintaining maritime security; but they nonetheless remain sceptical as the window of opportunity fades with progress being made by the PLAN's modernization.[24] Others have voiced their concerns regarding the inevitability of China's eventual committed presence in the Indian Ocean via pinpointing China's increasing naval capabilities, and its especially fragile energy and economic dependence on the region.[25]

On the other hand, other regional actors welcome greater Chinese presence. For example, Pakistan and Sri Lanka have leased the Gwadar Port and the Hambantota Port, respectively, to China for commercial purposes. While this has been met with popular protest in Sri Lanka,[26] the deal was not blocked. Likewise, Arab Gulf states understand China's need for oil which would yield for them a large volume trading partner that is neither the US, nor the European Union (EU). Furthermore, with its growing investments and projects in Africa, Chinese presence would be welcomed in the Indian Ocean by its African trading partners; not to mention the increased security so as to drive down piracy levels. Finally, all of the regional developing states can find comfort in the fact that as one of the key actors in the Asian Infrastructure Investment Bank (AIIB), China would be able to extend lines of credit for such states in the region.

In sum, China's projection of power via the PLAN in the Pacific Ocean and the Indian Ocean is already generating dissatisfaction from regional players. However, insofar as China is able rein in its perceived militarism and focus on commerce, there will be lots of opportunities ahead as it can – as it has done already – gain invaluable allies; which will be crucial in helping to dissipate the suspicions that other actors are harbouring.

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[22] J. R. Holmes, "China's Way of Naval War: Mahan's Logic, Mao's Grammar," *Comparative Strategy* 28(3) (2009).

[23] O. R. Coté, *The Third Battle: Innovation in the U.S. Navy's Silent Cold War Struggle with Soviet Submarines* (Newport: Naval War College 2003).

[24] G. S. Khurana, "China's Maritime Strategy and India: Consonance and Discord," *Maritime Affairs: Journal of the National Maritime Foundation of India* 7(2) (2011).

[25] P. S. Das, "India's Strategic Concerns in the Indian Ocean," *South Asia Defence and Strategy Year Book* (New Delhi: Panchsheel 2009).

[26] ABC News, "Clashes erupt as Sri Lankans protest China port deal," 7 Jan 2017. Accessed 22 February 2017. http://www.abc.net.au/news/2017-01-07/sri-lankans-protest-china-port-deal/8168110

Secondly, there will be an expansion of both "hard" and "soft" Chinese economic presence. Hard economic presence entails physical infrastructure, an increase in trade volume and subsequently Chinese goods, and the presence of Chinese enterprises. Soft economic presence means trade deals, central bank currency swap agreements, lines of credit, foreign direct investment, and perhaps even efforts aimed at creating a trading bloc. As the PLAN becomes increasingly capable of protecting China's SLOCs, Chinese economic presence will naturally expand. Furthermore, since America's exit from the Trans-Pacific Partnership (TPP), regional actors in the East and Southeast Pacific, as well as Australia, have begun to coordinate with China for a new trade plan. As such, it is expected that China will capitalize – as much as it can – on the opportunity that the Trump Administration has created for China in the Pacific, which strikes a significantly different tone from that of Obama's "pivot to Asia" strategy[27].

As previously mentioned, Chinese invested/owned ports in Sri Lanka and Pakistan are but a taste for what is to come of China's economic expansion. Overseas physical infrastructure must increase should the PLAN want to operate effectively within the Indian Ocean. Therefore, the Djibouti base and the aforementioned ports are likely the flavour of expansion of infrastructure in the coming years. Moreover, the "Road" portion of the OBOR - which is the maritime route - will necessitate Chinese, if not bilateral, investment into ports – especially deep-water ports – for countries that want to join.[28]

The final implication of this strategy amalgamates the previous two points and that is the expansion of overall Chinese presence from being a mere regional actor. In recent years, China has increased its contributions to UN peacekeeping missions.[29] Moreover, through the Shanghai Cooperation Organization (SCO), China has repeatedly demonstrated its commitment to combating terrorism, religious extremism, regional security, drug trafficking and related criminal activities. While the six original members of the Organization are not actors involved in the Two-Ocean Strategy, membership will be expanded to include Pakistan and India in 2017; thus once again marking China's commitment to expand its presence into the Indian Ocean region. Notwithstanding the dialogue and rhetoric on security, the issues that the Organization tackles are indeed issues which pose a significant problem for Beijing. For example, the porous borders between Pakistan and China means that it is very possible for religious extremists to cross from the former and engage or plot attacks in China – especially in the Xinjiang region where Muslim Uyghur's discontent with the Party and government is at an all-time high. Likewise, the nuclear triangle of China, Pakistan, and India poses a security problem for all actors in the region. Not only is the problem exacerbated by the fact that Indo-Pakistani

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[27] It appears, at the time of this writing, that the Trump administration has given China a *carte blanche* in the region. However, it is not so much that the administration wants to do so, rather the confusion in the White House, the neutralization of the State Department, and the preoccupation with domestic issues (Obamacare, Kremlingate, etc.) has *de facto* resulted in a loss of faith in American exceptionalism and desire to intervene.

[28] I argue that the OBOR should be seen as the "hardware" of China's economic expansion, while the trade deals and policies that follow it should be viewed as the "software." That is to say, having one without the other would substantially slow down the pace and effectiveness of expansion.

[29] C. J. Fung, "China's Troop Contributions to U.N. Peacekeeping," *Peacebrief*, 26 July 2016. Accessed 23 February 2017. https://www.usip.org/publications/2016/07/chinas-troop-contributions-un-peacekeeping

relations are still on rocky grounds, but also by the fact that China's support for Pakistan sidelines India while at the same time, the PLAN is planning to expand its operations into the Indian Ocean.

As such, China has already demonstrated its intentions to become more involved internationally. However, notwithstanding the UN peacekeeping commitments and the efforts to combat regional issues through the SCO, Chinese presence must increase in the coming years for three specific reasons. Firstly, its military presence must expand to protect its valuable supply lines, both land and maritime – as per the OBOR. At the same time, in order to combat the issues that are the focus of the SCO, it will also necessitate the presence of the Chinese military abroad. Secondly, as its hard and soft economic presence expands, it will require both Chinese civil servants and business elites. Finally, in terms of geopolitical strategy, it is likely that – as the OBOR progresses closer to the Middle East – China will play an increasingly greater role in arbitration in the conflict zones of the Middle East. Essentially, Beijing has a vested interest in ensuring peace in this region, so as to allow the construction of the "Belt" portion of the OBOR to pass through. Moreover, insofar as peace and economic development can occur in the region, China would gain valuable sources of oil and gas imports. As such, it is expected that Chinese presence in the Middle East will increase in the coming years.[30]

This section has outlined three geopolitical implications for the Two-Ocean Strategy. Chiefly, that the expansion of the PLAN's zone of operation into the Indian Ocean will be met with resistance from regional actors, but there are also opportunities for China to capitalize on; that Beijing will expand its hard and soft economic presence in the form of physical infrastructure and trade deals, respectively; and that the level of overall Chinese presence will increase internationally as it seeks to confront regional issues and to become more involved via the UN, especially in regions where the OBOR will pass through so as to protect its economic interests.

CHINA'S STRUCTURAL ECONOMIC PROBLEMS

Since the opening up and reform era led by Deng Xiaoping in the late 1970s, China has pursued an export-led growth model, and it is from this model that much of its domestic structural economic imbalances have developed. As a testament to the extent and depth of these imbalances, the CCP has specifically designated the transition into a more domestic consumption based growth model, and the internationalization of the Chinese currency – the Renminbi (RMB) – as economic goals outlined in its recent Five-Year Plan. As such, this section looks at imbalances in two sectors: finance and banking on the one hand, the export and domestic markets on the other.

[30] This carries with it wide-ranging implications for geopolitics, regional security, and counterterrorism in the Middle East. Having China with its own set of interests join into an already vastly complicated geopolitical situation will only further complicate whatever little progress has been made.

Decades of pursuing an export-led growth model have resulted in a repression of the domestic financial and banking sectors.[31] This repression has given preferred access to capital and more elastic interest rates to firms of size, as opposed to quality, efficiency, and competitiveness; in short, state-owned enterprises (SOE) win out against any pure private sector competitor. Chinese SOEs are an integral part of the economy as they provide energy, infrastructure, heavy industry, and of course, they employ a significant portion of the population. Since the Reform Era, SOEs have led the way in economic development; however, they are inefficient, expensive, and require substantial government intervention in the economy for them to survive.[32] At the same time, the savings rates for private individuals are actively suppressed so as to effectively channel the capital towards SOEs, hence their ability to access such elastic funding. SOEs necessitate such a regime of financial repression whose costs are presently outweighing the benefits.[33]

There are two major issues associated with this repression of the finance and banking sectors. Firstly, private savings are subject to tax. The tax proceeds are then transferred via the state-backed banks and other channels to the SOEs as funding. While this has no doubt aided in the development of SOEs in the initial decades, the issue of SOEs becoming increasingly unproductive is pressing, as this can develop into large public liabilities. Secondly, financial repression has resulted in the rise of the shadow banking sector.[34] Since large SOEs enjoy elastic lending interest rates by the state-backed banks, small and medium enterprises are unable to get a sufficient share of the pie, as they are faced with much higher interest rates. This is largely due in part to the upfront collateral requirements demanded by the banks of which small and medium enterprises are unable to produce. In turn, this renders high rollover risks in small and medium enterprises, and this hinders the development of this sector. Ironically, the sector of small and medium enterprises has been shown to have better growth prospects as a whole vis-à-vis the SOEs.[35]

Another issue in the finance and banking sectors is that of China's dependency on the US Dollar. Firstly, due to Beijing's large holdings of US securities, Chinese foreign exchange reserves are heavily affected by US monetary policies. The quantitative easing (QE) policies of the US Federal

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[31] J. Aizenman, "Internationalization of the RMB, capital market openness and financial reforms in China," *Pacific Economic Review* 20(3) (2015).

[32] Zhu Rongji recognized this problem which led to the first wave of SOE reforms and liberalization. The "catch the big, release the small" (抓大放小) campaign was aimed directly at this, that is, to keep the big SOEs under government control and liberalize the smaller ones. The success of the reforms has not only made the Chinese economy more efficient and competitive, but also cemented China's entry into the WTO.

[33] SOEs are a major interest group against the internationalization of the RMB. Since RMB internationalization requires interest rate liberalization, the SOEs would no longer enjoy the financial benefits under the current regime. See: A. He, "Domestic sources and RMB internationalization: A unique journey to a major global currency," *CIGI Papers* 67 (Waterloo, ON: Centre for International Governance Innovation 2015).

[34] For example, the rise of hedge funds especially, as well as other financial intermediaries such as money market funds.

[35] Likewise, data demonstrates that despite the financial repression on this sector, it still exhibits better productivity than the SOEs, and the gap is becoming increasingly greater. See: Z. Song, et al, "Growing (With Capital Controls) Like China," *IMF Economic Review* 62 (2014).

Reserve[36] after the 2008 financial crisis led to a continued devaluation of the US Dollar. This naturally resulted in substantial capital losses of China's foreign exchange reserve. This reliance on the US Dollar has become an increasingly greater concern for Chinese leaders. The depreciation of the US Dollar subsequently resulted in an appreciation of the RMB, which cut into the competitiveness of Chinese exports. In addition, since QE policies effectively enlarge the monetary supply, in the case of the US Dollar (as the *de facto* international currency), the global monetary supply was enlarged which led to an excess in liquidity, globally. This resulted in "short-term capital inflow, inflation and asset price increases in emerging countries, including China".[37] The flow of "hot money" contributed to the volatility of the Chinese stock markets, while inflation and asset price increases led to the further development of housing and property bubbles. In essence, the QE policies of the US following the 2008 financial crisis managed to calm the markets in the US at the expense of global financial stability. This goes to show that the reliance on the US Dollar has rendered the monetary supply of China and its exchange rate heavily affected by US monetary policies. Furthermore, the QE policies following the 2008 financial crisis not only demonstrated the extent to which the RMB is affected by US monetary policies, but also highlighted the systemic weaknesses of China's current monetary regime. Ultimately, the costs of this monetary reliance on the dollar (the Chinese economy is subject to both international market fluctuations and US monetary policies, and the foreign exchange reserves' capital losses and unwarranted RMB appreciation) are outweighing its benefits (the ability to control the RMB exchange rate in order to make exports competitive).

The Chinese exporting sector is facing a myriad of problems, of which some are directly related to the issue at hand. Firstly, internationally, the mismatch between the developed markets' annual GDP growth and China's GDP growth demonstrates a clear trend: the inability for the developed markets to continuously absorb Chinese exports. The fault in the logic of China's export-led model is that in order for the latter to grow continuously, the world has to consume Chinese exports at pace; if not, the country will exhibit a production surplus, and this is already happening. Xu and Wu[38] explain that an economically healthy and innovative industrial sector should display about 85% utilization rate of its production. However, the authors explain that in June 2013, it was reported that the industries of steel, cement, glass, aluminium, and processed coal were only operating at 70% to 75%; while the international standard of market competitiveness is around 80% to 85%. According to a report by the IMF[39] made in 2012 on the level of production surplus in China, it was discovered that before the 2008 financial crisis, utilization rate only reached 80% at its peak. This declined to a meagre 60% in 2011. The IMF report also states that they believe China's production surplus to have begun over a decade ago. It is clear that the issue of production surplus is becoming increasingly urgent. The production

[36] It should be noted that the EU also pursued QE policies. Since the Euro does not make up the majority of China's foreign exchange reserves, its depreciation did not result in capital losses. The depreciation did, however, appreciate the RMB which made Chinese exports less competitive when being sold to European markets.

[37] He, "Domestic sources and RMB internationalization: A unique journey to a major global currency," *CIGI Papers*: 4.

[38] Z. Xu and D. Wu, "One Belt, One Road crafting new economic opportunities and the study of the three new normals" (yidai yilu sujiu xin jingmao guanxi yu sange xin changtai yanjiu), *Huaqiao University Journal Philosophy and Social Sciences Edition* (huaqiao daxue xuebao zhexue shehui kexue ban) 2 (2015).

[39] IMF, "People's Republic of China 2012 Article IV Consultation," *Country Report No. 12/195* (2012).

surplus is also revealing of another problem. Since the 2008 financial crisis, the Chinese GDP growth rate has been on the decline – compared to previous years. This reflects, on one hand, the declining global aggregate demand for Chinese exports as a result of dwindling consumer confidence and market uncertainty in the wake of the 2008 financial crisis. On the other hand, appreciation of the RMB in nominal terms versus the U.S. Dollar[40] has steadily increased over the last few years. Since 2005, the RMB has appreciated around 30% in nominal terms against the U.S. Dollar. This undoubtedly has made the exporting sector less profitable and thereby cutting China's trade competitiveness.

Production surplus also fuels another problem: both private and public debt. As most of the production surplus is produced by SOEs, and along with their elastic access to capital, SOEs take on government contracts which usually – for the time being – channels the surplus into the construction of unproductive, inefficient, and unnecessary state infrastructure projects. Not only does this absorb unemployment, but it also allows the SOEs to maintain their economic size and continue to access elastic funding. However, the merely creates a supply chain of production and construction SOEs with the circular logic of building unnecessary infrastructure and overproduced commodities in order to maintain unemployment at Party sanctioned levels, and prop up otherwise failing SOEs. How long this charade can last is questionable. Nonetheless, the bigger problem is that of mounting levels of non-performing loans – bad debt. On one hand, the debt that banks take on to fund SOEs is rarely paid back due to two reasons. Firstly, the SOEs can simply refinance themselves through elastic funding. Secondly, production surpluses mean that most SOEs are operating at a loss and do not make profitable returns. Moreover, the sheer size of the SOEs in terms of employment means that its overhead costs are extremely high, not to mention that they are usually plagued by low productivity and inefficiency. This contributes to the rising stock of private non-performing loans. On the other hand, since most of the contracts the SOEs take on are for unproductive – and unprofitable – infrastructure, the governments, especially at the provincial and municipal levels, are unable to pay back the debt. As a result, the stock of public non-performing loans is – while not as bad as the private ones – also on the rise.

In terms of the domestic sector, consumption is still considerably low. For example, per capita GDP growth has been steadily increasing with 2014 marking 6.7%[41] and averaging 7.5% per year between 2011 and 2014.[42] Clearly, the Chinese population is becoming richer. However, the domestic market size is still relatively small, especially with regards to consumption (Chinese household final consumption expenditure as a percentage of GDP reached 36.5% in 2014, and in using the latter as a proxy for domestic market size, this means that consumption only accounts for just over one-third of the GDP). Compare this with the US where household final consumption reached 68% in 2014, and in Canada, where it reached 56% in the same year. Moreover, despite increasing per capita wealth, savings remain consistently high. Gross

[40] G. Guilford, "China's yuan is no longer undervalued, says IMF," *Quartz*. 26 May 2015. Accessed 27 February 2017. http://qz.com/412082/chinas-yuan-is-no-longer-undervalued-says-imf/

[41] World Bank, "GDP per capita growth (annual %)." Accessed 27 February 2017. http://data.worldbank.org/indicator/NY.GDP.PCAP.KD.ZG

[42] This calculation was done by the author based on the same World Bank dataset.

domestic savings as a percentage of GDP was 49.9% in 2014,[43] and the previous years' data hovered around the 50% mark. Compared to countries such as Canada or the US where this figure was only at 23.1% and 16.8%, respectively, China's savings are much greater. While there are arguments which derive from a cultural perspective as to why this is the case, I am more inclined to argue that this is due to macroeconomic imbalances. Without question, it is clear that people are not spending nearly enough, and much of it has to do with the imbalances in the finance and banking sectors as outlined previously. However, this will become increasingly difficult as non-performing loans mount up in both private and public sectors. The de-leveraging process will be long and difficult, and insofar as this imbalance remains unfixed, shifting the country's growth model from one of export to one that is more consumption based remains unlikely.

Two minor factors also exacerbate the low levels of domestic consumption. Firstly, the low exchange rate of the RMB, while advantageous for exporting, makes importing more expensive. In addition, with certain tariffs placed on imported goods, the elevated cost of purchasing such goods in the domestic market drives people to either travel abroad and make purchases there, or simply forgo the consumption and shore up the money in their savings. Secondly, another feature of the domestic financial markets is that while they are deep (volume of capital), they are not broad (the range of possible financial instruments and securities, and investment opportunities available), nor open (China's capital account is not fully open which means that capital controls are in place for inbound and outbound capital flows). Moreover, the lack of transparency in China's financial markets –lack of proper bankruptcy laws, lack of experience in pricing instruments and securities, and lack of strong and able credit rating agencies – makes investing in China a daunting task. As such, the financial markets in China are unable to absorb excess domestic savings to the extent that they are capable of in the Western world.[44]

Before this section draws to a close, it is important to analyse these structural economic problems as not exclusively economic, but rather socio-political. As a one-party state, the legitimacy of the Communist Party is derived not from elections, but through the continued delivery of socio-economic goods, and economic growth. As such, the very survival of the regime is linked to the health of the economy. Consequently, the Party has to implement policies which, at times, sacrifice economic productivity and efficiency so as to maintain employment. This is due to the very fact that mass unemployment in China will lead to social unrest, and subsequent problems of governing for the Party. Thus, while the aforementioned infrastructure projects make no economic sense and rack up debt, they can, however, absorb unemployment temporarily as the Party searches for new avenues of economic development. The underlying logic is not economic, but socio-political. At the same time, the Party cannot take a "shock therapy" approach to shift away from the export-led growth model. Firstly, the exporting sector simply employs too many people and thus will require years of unwinding before the sector can

[43]All percentages are taken from: World Bank, "Gross domestic savings (% of GDP)." Accessed 27 February 2017. http://data.worldbank.org/indicator/NY.GDS.TOTL.ZS

[44] Recently (February 2017), Guo Shuqing 郭树清 – Shandong's ex-governor – was appointed head of the Banking Regulation Commission in order to tackle some of these issues and help the now ageing Zhou Xiaochuan 周小川 (Governor of the People's Bank of China since 2002). It is worth noting that both are protegés of Zhu Rongji's.

be reduced in size. Simultaneously, the Party will have unwind the finance and banking sectors as well by implementing policies which can promote higher domestic consumption. This economic transition will necessarily have to be slow; for if it is rushed, it would create the potential for an economic crisis to manifest skyrockets, whose aftermath would be too costly to bear on the legitimacy and authority of the Party. Secondly, the international economic climate in the post-2008 era is too fragile and too unpredictable[45] (especially with the new wave of populism sweeping across the Western world)[46] for a rapid and successful economic transition. In order to shield - as best as they can - the domestic economy from the turbulence of the global economy, the Party will have to proceed very carefully and take the needed time to undergo a smooth transitioning of the economy. However, time is not exactly on the side of the Party. As previously examined, the structural imbalances in the present Chinese economy are substantial, and require tending to immediately. While the Party has indeed begun unwinding the imbalances, it remains to be seen which of the three forces – the onset of an economic or financial crisis, the structural imbalances' self-exacerbation, or the Party's efforts at unwinding – will emerge as the victor.

THE TWO-OCEAN STRATEGY AND THE OBOR: ECONOMIC OVER MILITARY

For those unfamiliar with the OBOR, it is a state-sponsored strategy aimed at creating a vast economic network which spans across the Eurasian continent and covers parts of Eastern Africa. The Belt portion consists of the land route of this strategy and is primarily composed of rail networks – with some highways as well – which radiate out from China. The Road portion consists of the maritime route which seeks to utilize and further construct ports and harbours to service and maximize the SLOCs already in place. Essentially, the strategy seeks to integrate all countries of the Eurasian continent into one seamless economic corridor.

This strategy will greatly benefit China in five aspects which can be split up among two major themes: economic and geopolitical. The first three aspects fall under the economic theme. Firstly, it will help alleviate some of the structural economic imbalances, especially the problem of production surpluses. The OBOR necessitates massive infrastructure investment and construction. As a result, China will and is already employing its large SOEs to undertake this process, thereby channelling production surpluses towards this – hopefully – successful and economically productive project. Secondly, by linking all of these individual markets with transport infrastructure and a free-trade plan, economic development will thrive. This subsequently opens up new and unsaturated markets that are capable of absorbing Chinese products, and thus gives its declining export sector new life. On the other hand, the opening of these new markets means that China will acquire new markets for imports as well, especially

[45] See: M. King, *The End of Alchemy: Money, Banking, and the Future of the Global Economy* (New York: W. W. Norton & Company 2016).
[46] As of this writing, the world is gearing up for the Dutch general elections in March 2017, followed by the French general election in May 2017, then the German federal election in September 2017 where by populist parties in all three countries are gaining momentum.

crucial are raw materials and energy – the Central Asian states are therefore a key target of this strategy.

Thirdly, the physical integration of these individual markets across the continent will naturally result in more financial integration as well. As products are shipped back and forth among the various countries, there will be an increased demand for commercial and investment banks, clearing houses, as well as financial markets to direct and channel capital. China, the seemingly *de facto* organizer of this giant market, will thus be able to export the RMB with ease. The country has effectively three major channels to export its currency with. Firstly, it can, under the pretence of the AIIB's mandate, extend lines of RMB-denominated credit to countries participating in the OBOR. Secondly, it can use bilateral currency swap agreements between the People's Bank of China (PBoC) and other central banks to inject the RMB into the reserves of the latter. In fact, the waves of bilateral currency swap agreements that the PBoC has signed with various other regional central banks following the 2008 financial crisis is a sign of things to come. Finally, it can issue state and/or corporate RMB-denominated bonds directly into the integrated financial markets. The ultimate goal of exporting the RMB is to shore up the currency in the financial markets in the form of liquidity, and in foreign central banks as part of their foreign exchange reserves. This will result in higher demand for the currency, thereby driving up its global share of currency usage, and catalysing its internationalization. Should the RMB attain the status of a regional currency,[47] it has the potential to become a dual-track legal tender alongside the other states' currencies within the OBOR.

Geopolitically, there are two aspects of the OBOR that are to China's benefit. Firstly, the OBOR will allow Beijing to greatly expand and consolidate its economic influence. The outer edges of a fully completed OBOR extend to Western Europe, the Middle-East, and even the eastern coast of Africa. In pure economic terms, the massive increase in trade volume and financial transactions will further cement China as an economic superpower. At the same time, these economic gains for China will, on one hand, aid in its unwinding of structural economic imbalances and consolidate the Party's legitimacy, thereby building a stronger country domestically. On the other hand, a stronger China that is not suffering from internal socio-political strife is a China that can project power more effectively. This, along with the OBOR's consolidation of its economic position, only serves to create a China that is more equipped to challenge the West's – particularly the US' – global hegemonic status. Likewise, the OBOR also gives Beijing a wide variety of economic leverage over other countries, thereby greatly expanding its arsenal of geoeconomic techniques.[48] As such, it should come as no surprise that an OBOR backed China will seek to translate its economic gains into diplomatic and geopolitical leverage.

Secondly, since the OBOR is a complex of land and maritime infrastructure networks as well as supply lines, China will seek to expand its military presence abroad. Whether it will be under the auspice of UN peacekeeping, or the pretence to protect and safeguard the infrastructure

[47] By regional I mean to say East, Southeast, South, and Central Asia. While the OBOR does extend all the way to regions such as Africa, the Middle-East, and Europe, the extent of the RMB's influence will be felt most in regions adjacent to China.

[48] For an extensive review of China's geoeconomic practices, see: R. D. Blackwell and J. M. Harris, *War by Other Means: Geoeconomics and Statecraft* (Cambridge: The Belknap Press of Harvard University Press 2016).

networks and supply lines, the physical presence of the Chinese military will become more prevalent. Moreover, what is especially concerning is the increased presence of Chinese private security forces, particularly in Africa. Therefore, it would be logical to expect more private security to take on the tasks of safeguarding the land portions of the OBOR as opposed to the actual People's Liberation Army (PLA); whereas the increased presence of the latter will likely be under the umbrella of the UN. However, the PLA can be expected to show up in conflict zones such as Africa and the Middle-East where there is a dual purpose of peacekeeping and where it will be necessary to maintain peace, so that such regions can eventually be integrated into the OBOR. However, for the maritime routes, the PLAN will take up the mantle for the sole reason that private security will be unable to fulfil that role. The use of private security has two major benefits for China. Firstly, since they are not part of the military, their presence will not tarnish China's image nor induce suspicions of Chinese militarism. Secondly, while they are technically privately employed, the line separating the private sector from the public in China is so thin that it is expected the Party will capitalize on the presence of private security personnel to engage in intelligence-related activities. Therefore, the West should take caution that Chinese private security is never private, and that the hand of the state is with them at all times.

How, then, does the Two-Ocean Strategy work within the framework of the OBOR? Previously, I have discussed the modernization of the PLAN and the expansion of its zones of operation, as well as the eventual increased presence of the Chinese military and private security abroad. These points seemingly drive one to expect that the goals of the OBOR and the Two-Ocean Strategy are not only to consolidate China's status as a global economic superpower, but also to transform it into a global military superpower capable of challenging the US; and that the two are set on an inevitable collision course. While such pessimistic and deterministic thinking does indeed make for great popular political science and international relations literature,[49] the logic is ultimately grounded in a lack of understanding of China as a political entity. As such, I argue that the military aspects of the Two-Ocean Strategy are dwarfed by the pursuit of economic security that is ultimately tied to state survival.

The Two-Ocean Strategy and the OBOR can be linked together in two ways, both of which are mutually reinforcing. On one hand, the OBOR serves the dual purpose of reinvigorating the Chinese economy, and expanding China's geopolitical influence. The latter point gives Beijing a convenient rhetoric for modernizing the PLAN and expanding its zones of operation – using the navy to protect SLOCs. Furthermore, the increased presence of the PLAN in the Indian Ocean will then provide China more rhetorical power for constructing more bases abroad so as to service the PLAN. On the other hand, the PLAN's modernization and expansion reinforces and improves China's ability to project geopolitical power. Moreover, this will also allow the PLAN to gain valuable experience in operating away from territories closer to home.

The goals of modernizing the PLAN and expanding its zones of operation are not ends in of themselves. Rather, in accordance to the Mahan (and subsequently, Liu) Doctrine, the PLAN's goals are subservient to that of the state's economic needs. In effect, transforming the PLAN into

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[49] For example, see: C. Coker, *The Improbable War: China, the United States and the Continuing Logic of Great Power Conflict* (Oxford: Oxford University Press 2015); T. G., Carpenter, *America's Coming War with China: A Collision Course over Taiwan* (New York: St. Martin's Press 2006).

a navy capable of operating in the deep-seas allows China to finally be able to rely on its own navy to safeguard its SLOCs. The targeted two oceans in the strategy give weight to this argument. It is not surprising that the Pacific Ocean and Indian Ocean are the two maritime regions in question as they comprise most of China's vital trade, supply, and especially energy lines, which are the veins and arteries of its economic system. Furthermore, it is no coincidence that the Two-Ocean Strategy has been revealed as the OBOR is entering its initial stages. As maritime trade increases, it will necessitate more patrolling of the SLOCs, not only for trade, but also for shipments of resources (especially natural gas and oil of which a shortage could cause sheer economic chaos) used to construct the infrastructure needed for the maritime route. Take this into consideration with the previously discussed structural economic imbalances ailing China at the present, and the necessity of ensuring economic security becomes obvious. In essence, through developing a deep-sea navy, China can gradually shift away from depending on foreign actors to protect its fleet of commercial ships, and instead cement its economic security through the use of its own navy by protecting its maritime supply lines. Ultimately, the less the risk that economic security poses for China's economic system through SLOCs - which are dependent on foreign actors' protection and thus exposed to sanctioning -, the less socio-political problems the Party has to contend with; and subsequently the more domestic political stability in China. Insofar as the Party's legitimacy depends on its economic performance, the Two-Ocean Strategy inherently concerns economic security tied to the survival of the Chinese regime.

Finally, there are some important projections to be made concerning the Two-Ocean Strategy and the OBOR. Firstly, the extensive discussion concerning China's power projection throughout the length of this paper may convince some readers that it is a *fait accompli*. However, it is necessary to keep in mind that there are major limiting factors which can block both the extent and intensity of China's maritime power projection. There is, first and foremost, the issue of America's strong presence in East Asia. Insofar as Taiwan (especially if there is no reunification Taiwan), Japan, South Korea, and the Philippines still have America's backing under the Trump Administration, Chinese coercion and power projection will meet a brick wall right on its doorstep. Likewise, a rogue North Korea is also deeply troubling for Beijing. The gradual decrease in China's ability to control Pyongyang renders it a geopolitical liability. On the other hand, in both the Pacific Ocean and Indian Ocean, Chinese attempts at projecting power in these regions will be met with strong suspicion, if not outright contest. Beijing will have to navigate a geopolitical tightrope whereby being too assertive will drive smaller states together – as is with the case of ASEAN –, or drive them toward another regional or international power – for example, India and the US. Moreover, too much aggression from the Chinese side while still having its SLOCs exposed in crucial chokepoints - such as the Strait of Malacca which can seriously threaten China's national security. At the same time, being too passive will render Beijing's geopolitical endeavours effectively unprofitable, and it will risk sending a message of incompetency to regional players which signal to them that China is unready (nor willing) to become the regional hegemon.

The second point here relates closely to the previous one. Given the considerable obstacles to China's power projection, and consider this with Chinese serious efforts at attempting to build the OBOR, it is probable that the country will have to tone down its aggressive stance on its territorial disputes. This is because in order to realize the maritime portion of the OBOR, Beijing cannot afford to have regional states remaining hostile and adopting an anti-China policy stance, which will then effectively block China's vision of the maritime Silk Road from being realized. There is also a domestic factor at play here for the country. These territorial disputes, insofar as China continues with its aggressive stance, are a tool for consolidating the Party's legitimacy through riling up nationalist sentiments. The problem here, however, is that the Party cannot actually control such surges of nationalism: once they are encouraged they tend to take on a life of their own. Should these sentiments become too intense, they can spill over into the political sphere and, to a certain extent, highjack the policymaking process and derail the Party's geopolitical strategy. As such, while nationalism is a tool for the Party to boost its legitimacy, it is also a serious liability. Therefore, returning to the original point, Beijing can only rely on using territorial disputes to fuel domestic nationalistic sentiments for so long before the latter gets out of hand (which targets the Party's soft stance versus regional actors). Due to this, Beijing - should it seriously want to make progress on the maritime silk road - will have to de-escalate tensions and calm the nerves of the regional states, so that it can proceed with the project (without inciting too much fervour among its most nationalistic elements).

Finally, again, continuing from the previous point, a possible measure aimed at de-escalating tensions in the maritime regions could be bilateral, trilateral, or even multilateral energy development projects directed at the vast resources underneath the East and South China Seas. Beijing, of course, would have to ensure that such a project is a win-win for all sides. For China, this would not only de-escalate tensions through their active gesture of cooperation, but it would also make economic sense. Firstly, China can once again mobilize the production surpluses of its SOEs to build necessary infrastructure for maritime resource extraction. Secondly, once such development projects are complete and are delivering returns, Beijing would then have energy supply lines right on its doorstep, making it a victory for energy security. Finally, China would have the opportunity to export more of its currency for use in such development projects and effectively block out the US Dollar. Moreover, this would be another step towards internationalizing and consolidating the RMB at a regional level. Another possible step to de-escalate tensions, and it is indeed in the making already, would be the creation of a free-trade zone. Earlier, it was briefly mentioned that after the Trump Administration's unilateral backing out of the TPP, this region is starving for a region-wide trade deal. China, therefore, is perfectly positioned to create such a deal and cement itself as the organizer of regional commerce. A region-wide trade deal would be greatly beneficial for all states involved. Firstly, Beijing would gain access to tariff-free new markets where it can export its products to and import raw materials from. Secondly, regional states would gain access to the Chinese massive domestic market tariff-free and allowing them to build a trade surplus vis-à-vis China. Finally, it would be beneficial for the latter that other states increase their trade surplus, since this would allow China to indirectly export the RMB through using it as the *de facto* regional trade settlement currency. Furthermore, allowing foreign central banks to build up reserves of RMB would allow China to issue RMB-denominated bonds in their respective markets later on, thus further spurring the internationalization of the RMB. These two possible measures would allow Beijing to de-escalate tensions and signal to regional states that it is capable of using both the carrot and the stick.

CONCLUSION

This paper has extensively analysed the Two-Ocean Strategy and its association with the OBOR. While it may seem that the former is a military strategy designed to expand the zones of operation of the PLAN, when examined within the context of the OBOR, it becomes clear that the end goal is economic; more precisely, economic security and domestic political stability. Ultimately, the PLAN's role, while it has indeed become increasingly modern and well-equipped, is to serve as – in proper Mahanian fashion – guardians of China's SLOCs. China's concern over its SLOCs is the result of not only being heavily reliant on sea routes for its commerce and energy supply lines, but also the result of having such supply lines exposed to possible foreign sanctions as the PLAN does not yet have the capacity to provide adequate protection. Moreover, China's domestic structural economic imbalances are becoming increasingly burdensome on the economy. As such, it will be even more critical for China not only to be able to secure its own SLOCs, but to also expand its commerce through the OBOR to unwind some of the structural imbalances. Here, the domestic concern is precisely that the Party's legitimacy is dependent on its economic performance, while threats and risks to its economic security are ultimately threats to the regime itself.

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CHINA'S TWO OCEAN STRATEGY: Controlling waterways and the new silk road

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