Chi on China

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MEGA TRENDS OF CHINA (3D): THE BELT AND ROAD STRATEGIC PLAN – THE REALITY OF DEBT-TRAP FINANCE

Part of diplomacy is to open different definitions of self-interest.

Hillary Clinton

SUMMARY

- There is a suspicion that China is using "debt-trap finance" through its Belt and Road Initiative (BRI) to mire developing-country partners in unsustainable debt-based relationship to advance its economic and geopolitical ambitions.
- This view assumes that China could maximise its economic and geopolitical interests by ensnaring its BRI partners in debt distress. But evidence shows that China has not always been able to reap the alleged economic benefits and that it has even been a victim of its lending missteps.
- Pushback from BRI recipient countries is increasing, leading to a decline in BRI investment already. More importantly, domestic criticism on the BRI has emerged, which will scale back, but not stop, President Xi Jinping's Belt and Road Initiative.

China's increasingly assertive foreign economic policy through its Belt and Road Initiative (BRI) has been criticised as a practice of neo-mercantilism[1] and, more recently, as "debt-trap diplomacy"[2]. These views argue that China had sought to advance its economic and geopolitical influence by purposely ensnaring some of the developing countries in unsustainable loans-for-infrastructure deals.

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[1] "*Revisiting US Grand Strategy Toward China*", by Robert D. Blackwell and Ash J. Tellis, Council on Foreign Relations, Council Special Report No. 72, March 2015.

[2] "*China's Debt-trap Diplomacy*", by Brahma Chellaney, Project Syndicate, January 23, 2017.

The conventional wisdom is that the heavier the debt burden on the recipient country, the greater China's leverage becomes when the country is being forced to sell to China stakes in Chinese-financed projects or hand over management to Chinese state-owned investors. Concerns about China's debt-trap finance have found their way into some countries' foreign policy circle, aggravating the geopolitical tensions[3].

WHERE ARE THE GAINS FOR CHINA?

Critics of China's BRI assume that its economic interests are maximised when its lending partners are in financial distress. However, there is no proof for this claim.

There is no reliable data for tracking the profit and loss of China's BRI projects. But as I argued earlier[4], we can use data on the difference between China's new foreign contracts (as a proxy to BRI projects) and completed foreign projects (as a proxy to realised foreign revenues) to gauge the performance of the BRI projects. This data shows that the BRI projects do have difficulties in generating revenues. Chinese foreign engineering and construction projects enjoyed a decade of steady revenue growth until 2015 when Beijing started prioritising the BRI. Their revenue growth has since lagged significantly behind the growth of new foreign contracts (Chart 1).

Arguably, the fall in commodity prices in 2014 and 2015 helped explain the slowdown in this foreign income as most of China's foreign projects were focused on resource extraction. But the rising gap between the contracted projects and realised revenues (see Chart 1) raises the suspicion that 1) many Chinese firms were probably responding to political pressure by rushing to sign all sorts of phony deals and then letting them quietly rot away, and/or 2) the newly signed projects just failed to bring in revenues. More crucially, the gap has kept widening, casting doubt on the alleged profitability of the BRI projects.

Anecdotally, China's lending to Venezuela has been the single most important evidence of its debt-trap finance backfired. Venezuela is the largest recipient of Chinese official finance, with the China Development Bank

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[3] "*How China's Economic Aggression Threatens the Technologies and Intellectual Property of the United States and the World*", White House Office of Trade and Manufacturing Policy, June 2018; and *"Examining the Debt Implications of the Belt and Road Initiative from a Policy Perspective*", by John Hurley, Scott Morris and Gailyn Portelance, Centre for Global Development, CGD Policy Paper 121, March 2018.

[4] See "*Chi on China: Mega Trends of China (3a): The Belt and Road Strategic Plan – Hype, Suspicion and Truth of the Belt and Road Initiative*", 14 June 2017.

lending the bulk of more than USD60 billion since 2007[5]. Since China is the world's biggest oil importer and Venezuela has the world's largest oil reserves, the commercial rationale for the loans was strong for financing long-term oil partnership between the two countries.

Yet, with Venezuela in the depths of economic and political crises since 2013, the China-Venezuela loans-for-oil relationship has gone badly wrong. The collapse of Venezuela's economy means that it has not been able to make loan repayments and even oil shipment to China. In a nutshell, Venezuela has gone from being a geopolitical asset for China in Latin America to being a liability.

Some other BRI projects have also gone worng. For example, Sri Lanka's Mattala Rajapaksa International Airport, which opened near Hambantota in 2013, is dubbed the emptiest airport in the world. Hambantota's Magampura Mahinda Rajapaksa Port is largely idle, as is the multibillion-dollar Gwadar Port in Pakistan. Chinese lending and investment in other BRI countries, including Afghanistan, South Sudan and Angola have also reportedly gone wrong.

All this shows that China debt-trap diplomacy has not achieved its intended purpose of gaining economic and geopolitical benefits through the BRI. China might just be following the footsteps of Western governments, businesses and multilateral development finance institutions in the 1930s and 1970s when they found themselves in unsustainable debt relationships that hurt debtors and creditors alike.

PUSHBACK IS INCREASING

Resistance to BRI investment is also rising. Notably, Malaysia has suspended all FDI projects, most of which (USD23 billion) are BRI-related, since May 2018 when Dr. Mahathir took over as Prime Minister and wanted to renegotiate all the projects signed by former PM Najib.

According to the US political risk consultant RWR Advisory Group, some 14% of BRI-related investment has hit trouble since 2013, mostly due to public opposition to projects, objections over labour policies and environmental damages, and concerns about national security. Chinese-financed projects often go ahead in spite of local opposition. The USD4 billion Ituango dam in Colombia, which is partly funded by China, is a case in point. Despite a well-known propensity to landslides that was highlighted in the dam's environmental impact report, repeated warnings of local activists since 2010 have been ignored. Heavy rain finally triggered a landslide in June 2018, putting the dam in imminent danger of collapse and forcing the evacuation of 26,000 inhabitants[6].

DOMESTIC CRITICISM ON BRI

It seems that these BRI problems have also caught domestic attention in China. Since June 2018, there have been signs of discontent from policy advisors, academics and even government officials with President Xi's ambitious policy agenda. One of the criticisms focuses on his excessive "foreign aid" to countries in Africa and the Middle East with obvious reference to his BRI projects.

The public airing of such a criticism may indicate the emergence of a consensus that Beijing should scale back on its BRI ambition. RWR Advisory Group's data shows that BRI investment and lending have started to decline, with lending by the Chinese policy banks falling by more than 80% from 2015 and lending by Chinese commercial banks dropping to almost nil in 2017. While the RWR data may be anecdotal, as there is no publicly available and systematic data to track the BRI activities, the point is that with criticism and resistance on the BRI policy on the rise, forces may have emerged to slowdown, though not stop, the BRI development.

[5] According to data from the Carnegie-Tsinghua Centre for Global Policy.
[6] For more examples, please see "*Demystifying China's Mega Trends: The Driving Forces That Wil Shake Up China and the World*", by Chi Lo, pp. 172-175, Emerald Publishing 2017.

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Hotline: 2533 0088 Address: 17/F Lincoln House, Taikoo Place, 979 King's Road, Quarry Bay, Hong Kong.