China’s Belt and Road Initiative: A Chance for Prosperity or Debt-Trap Diplomacy?

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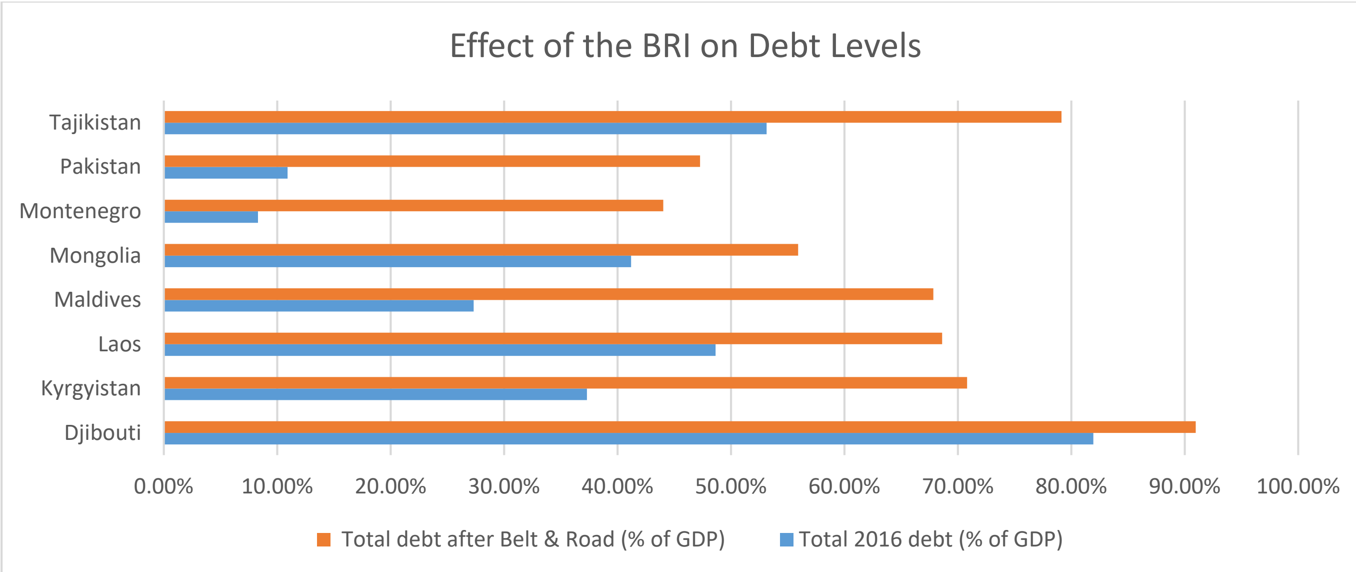
China’s Belt and Road Initiative, or BRI as it is commonly referred to, is seen as one of the most ambitious economic projects in history. With the goal of enhancing international trade through massive infrastructure outlays in a host of Asian, African, and European countries, the BRI has been met with both unbridled excitement and ruthless skepticism. To many countries where China intends to implement these projects, the BRI represents an unmissable opportunity for economic development and progress. A large portion of them, particularly in South Asia and Africa, have continuously suffered from poor governance and economic mismanagement, resulting in economies and societies lacking in the provision of a variety of goods and services. As China ramps up its foray into expanding its influence in the global political and economic spheres, the Belt and Road Initiative offers the chance for these countries to unlock the economic potential present in their economies, which have so far been untapped as nations continue to battle the corruption and civil instability ensuing from fragile or non-existent governance institutions.

But there is no free lunch. Aggregate investment that does not turn into long-term capital is common in poor and middle-income countries. Fears over the impact of the BRI were exacerbated in December 2017, when Sri Lanka handed over a port to China due to the country defaulting on the very loans that China had lent to them to build it in the first place. Abi-Habib (2018) gave insight into the events leading up to the seizure of the port after a lengthy investigation. In short, the Hambantota port was built by the Sri Lankan president at the time, Mahinda Rajapaksa, in what many believe was an attempt to celebrate his legacy, despite there being little need for a new harbor in the place. As development on the project progressed, Sri Lanka found itself pressured by ever-rising interest rates on the Chinese loans, and in December of 2017 the Sri Lankan government was forced to lease out the port to China in a deal which grants China control over the area for the next century.

Sri Lanka did try to avert the situation by going to International Monetary Fund for a $1.5 billion loan in 2016 (Mallet, 2016). However, the debt levels accumulated as a result of the BRI proved too much for the country, and the port was eventually leased out to China. The situation “intensified some of the harshest accusations about President Xi Jinping’s signature Belt and Road Initiative: that the global investment and lending program amounts to a debt trap for vulnerable countries around the world, fueling corruption and autocratic behavior in struggling democracies. (Abi-Habib, 2018)”

Economic theory, by convention, would suggest that this surge that a surge in FDI would yield unprecedented economic growth, so policymakers should – in theory – welcome these projects with open arms. In the real world, however, the decision is far more complicated; societies fear outsiders, and letting a country like China gain a stronger foothold in the economic and political spheres will raise suspicion and skepticism from those who believe that such a move will cede a nation’s control over to external forces. In addition, such projects would only bring long-term benefits if they increase potential output.

The events in Sri Lanka came as a wake-up call to many countries involved in the BRI. Many analysts speculated that numerous other countries could possibly face the same fate as Sri Lanka, in that vanity projects make the countries more vulnerable to external shocks without bringing much growth in potential output. According to The Center for Global Development, eight nations could find themselves vulnerable to the rising debt levels incurred by the Belt and Road Initiative: Djibouti, Kyrgyzstan, Laos, the Maldives, Mongolia, Montenegro, Pakistan, and Tajikistan. Coupled with the relative fragility of these nations’ economies, debt accrued due to the BRI the may precipitate currency and financial crises.



Source: Center for Global Development

Take the case of Pakistan, for example. The China-Pakistan Economic Corridor (also known as CPEC) is a USD 62 billion agreement between both Pakistan and China to build a massive port and related infrastructure in Gwadar, in the south of the province of Balochistan. That includes railways, highways, and numerous other transportation networks, as well as energy transmission lines. CPEC was met with zealous enthusiasm when announced. After all, Pakistan has throughout its 70-year history suffered from continuous domestic instability which has halted any serious economic development, resulting in a country lacking basic infrastructure and provision of public goods and services in many regions. In addition, the nation has suffered many energy and electricity crises in the last decades.

The port in Gwadar, and the CPEC initiative as a whole, was launched to usher in a new period of economic prosperity in Pakistan. However, after the Sri Lanka incident, concern amongst Pakistanis about the burgeoning Chinese influence within the country's borders increased, with the topic becoming a fervently discussed one during the buildup to the elections in 2018.

Due to an international reputation marred by the numerous incidents and speculation of terrorism, Pakistan – and a host of other countries along the BRI – find it increasingly difficult to borrow money from other countries or worldwide institutions such as the IMF (which bailed out Pakistan multiple times in the country's 70-year history). In 2018, the country was placed by the Financial Action Task Force on Money Laundering on its grey list, a move that the international institution carries out for countries that are alleged to have facilitated the financing activities of designated terrorist groups (Rana, 2018). Such a move – and the threat of international isolation should they fail to meet international standards - makes it more difficult for Pakistan to obtain financial assistance through conventional channels.

In that sense, the BRI could bring economic benefits to the country if the investments turn into capital that increase potential output. However, if the projects bear little fruit, the country could experience capital outflows to service its external debt that could lead to a currency crisis.

Another example of the tradeoffs involving the BRI comes from Malaysia. In the 2018 elections, Mahathir Mohamad – who had served as the country's prime minister before from 1981 to 2003 – became prime minister once again after ousting the incumbent government. A large focus of his campaign was on the $34.2 billion invested by China as part of the BRI.

Only time will tell what the eventual outcomes of these nations and the BRI will be, but one thing is for certain: policymakers in both developed and developing nations will always face the impossible conundrum of achieving a type of economic growth that satisfies everyone.

Questions for Discussion:

1) Analyze how expectations may change in these countries due to the establishment of the Belt and Road Initiative. Assume that investors and businesses react positively to the initial announcement of the project. As expectations change, such as in the case of Sri Lankan, what are the main macroeconomic effects?
2) Imagine you were in charge of economic policymaking in Pakistan. Would you be in favor of increasing economic ties with China? What are the potential costs and benefits of your choice?
3) Establish the short and long-term costs and benefits of a surge in FDI. In particular, in the short-run what happens to the foreign currency, labor and goods and services markets? In the long run, what should happen to economic growth and development?
4) Research a time and place in recent history when large amounts of foreign investments were largely welcomed with open arms. What was the global political order at the time and what were the short and long run economic effects of the large capital movements?

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