China’s Debt Imperialism: The Art of War by Other Means?

By David Ndii

Therefore the skillful leader subdues the enemy’s troops without fighting, captures their cities without laying siege, he overthrows their kingdom without lengthy operations in the field.” ~Sun Tzu

Colombo. On June 8, Fly Dubai’s last flight departed from Sri Lanka’s spanking new Mattala Rajapaska International Airport. It was the only airline flying there. Sri Lanka’s national airline stopped flying there in 2015. The “world’s emptiest airport” as its been known since it opened in 2013, is now officially a lily white elephant. The airport is a stone’s throw from Habantota, the world’s emptiest sea port that has made Sri Lanka the poster child of China’s predatory lending. The two are the largest of a slew of ill-fated mega-infrastructure projects that were supposed to transform Habantota, which happens to be the home town of former President Mahinda Rajapaska (for whom the airport is named, or rather, who named it for himself), into Sri Lanka’s second city.

It has not quite worked out that way. Rajapaska lost elections in 2015 in a cloud of corruption scandals, after a decade in power during which he buried Sri Lanka in a mountain of Chinese debt. After weighing its options the successor government ceded the Habantota port to China in exchange of a partial debt write-off. It has not helped. Sri Lanka is still caught in China’s debt trap. Last year, it turned to the IMF for a bailout. This year, Sri Lanka is looking to raise US$ 1.25 billion from China to keep up with its debt repayments.

Podgorica If you are an imperialist looking for a European client state, you could not do better than Montenegro. It is small (population: 620,000; GDP US$4 billion), vulnerable, and in a most strategic location on the Adriatic coast. Its hinterland includes Serbia and Hungary, both landlocked, as well as the Black Sea countries (Romania, Bulgaria and Ukraine) whose access to the sea, the Bosphorous, is controlled by Turkey.

Montenegro has been mulling a grand motorway from its port city of Bar to Boljare on the Serbian border for a long time, a distance of only 165 kilometres, but the country is extremely rugged, making the cost prohibitive. Two feasibility studies done in 2006 and 2012 for the Montenegro government and the European Investment Bank concluded that the highway was not economically viable. Then China came along.

The first 41 kilometres of the highway, built with an EUR 800 million Chinese loan, has nearly bankrupted Montenegro, forcing the government to raise taxes, freeze public wages and cut welfare spending. Borrowing close to 20 percent of GDP to build a quarter of a road is unwise. Unable to proceed, Montenegro has signed an MOU with the Chinese contractor to complete and operate it as a toll road on undisclosed terms. The fear now is that the Chinese have extracted onerous revenue guarantees. The contractor is none other than the state owned corruption scandal prone China Road and Bridge Company, the builder and operator of Kenya’s new standard gauge railway.

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Islamabad. Pakistan sits between China and the Persian Gulf. When China buys oil from the Middle East and Africa, it has to be shipped 6000 kilometres round India, through the Straits of Malacca to the South China Sea. The Malacca Dilemma refers to China’s vulnerability to a potential trade blockade on this narrow sliver of ocean between Indonesia and Malaysia.

Enter CPEC. CPEC stands for the China Pakistan Economic Corridor. Billed as a crown jewel of the Belt and Road Initiative, CPEC is an ambitious and costly modernization of Pakistan’s infrastructure centred on a transport corridor linking China’s “landlocked” hinterland to Pakistan’s Arabian sea port of Gwadar. The corridor cuts the distance of China’s western border to the sea by half, from four to two thousand kilometres. China has already taken control of the Gwadar port on a 40-year lease and is building an airport and industrial parks— effectively making it a Chinese enclave inside Pakistan. Costed at US$40 billion when it was launched in 2013, CPEC’s price tag has escalated to US$ 62 billion.

Four years on, Pakistan is in deep financial trouble. The CPEC projects are bleeding the country and destabilizing the economy. In addition to CPEC debt, Pakistan is now living on a Chinese financial lifeline —US$5 billion so far — to stave off a foreign exchange crisis. A succession of devaluations have failed to stem the tide, and foreign reserves are now down to less than two months requirements. Pakistan is now caught between the proverbial devil and the deep blue sea: to go for an IMF bailout or to settle into becoming a Chinese client state. An IMF bailout would put pressure on Pakistan to scale down CPEC and expose the secretive financing to western scrutiny.

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What is China up to?

There are two readily apparent economic objectives that China could be pursuing, one immediate, and one longer term.

The immediate objective is investment diversification. China is sitting on US$ 3.2 trillion of foreign reserves accumulated from its trade surpluses with the rest of the world, more than those of the next four countries combined (Japan $1.27 trillion, Switzerland $740 bn, Saudi Arabia $900 bn, Russia $460 bn). Most of this money is held in safe but low yielding American and European government securities, with just over a third (US$ 1.2 trillion) in US government securities. Analysts estimate that another one third is held in other US dollar-denominated securities.

The longer term objective is sustaining its economic rise. China's economy may be the world's biggest but it is still a middle-income country, with an average income of less than a fifth of Singapore. One of the big questions out there is whether China will escape the "middle income trap". The middle income trap is the observation that while many countries easily transition from poor to middle income status, only a few managed to transition from middle to high income. Of 103 countries that were middle income in 1960, according to an analysis by the World Bank, only 13 had transitioned to high income status by 2008, almost fifty years later.

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China has followed the export-led industrialization model of Japan and the Asian Tiger economies. This model will soon run its course. China's average manufacturing wage has increased three-fold in dollar terms over the last decade, and is now on a par with the poorer former communist eastern European countries. To make the transition will require China to move up the product value chain, or as a recent paper by investment bank UBS put it, from "made in" to "created in" China. This will entail moving its factories abroad, some closer to markets, some to low-wage locations. Some of the BRI initiatives do seem to be gearing up for this. CPEC is an obvious case. China's Great Wall company has a manufacturing plant in Bulgaria, which is in the hinterland of the Montenegro motorway.

It still begs the question why it needs to roll out the biggest building project since the Great Wall of China. Japan and the other Asian Tigers did not have to. And the BRI’s scale and aggression defies these rational economic objectives. If it goes to plan, it will span 65 countries, accounting for 60 percent of the world’s population and 40 percent of global economic output, and cost between four and eight trillion dollars That is not economics. It is empire building. It is not inconceivable that China is operating on a nineteenth century imperialism blueprint. Indeed, the Belt and Road Initiative graphics that litter the internet conjure images of Chinese power men around a world map sticking pins on strategic targets.

It is off to a rough start. Mahathir Mohammed, Malaysia’s comeback prime minister has cancelled three big BRI projects worth $22 billion signed by his predecessor, who is now facing corruption charges. He says he is trying to save Malaysia from bankruptcy. Even Burma’s steely generals have got cold feet. They have cancelled a port project citing fears that it could end up like Sri Lanka’s Habantota. Earlier this week, the Prime Minister of Tonga, rallying fellow South Pacific Island nations to negotiate debt forgiveness with China, expressed his fears that China could seize strategic assets.“If it happens in Sri Lanka, it can happen in the Pacific.”

Habantota is turning out to be a strategic blunder.

Did China actually set out to trap countries into debt or has the Belt and Road Initiative gone awry? It is conceivable that China is unfazed by the political blowback. Folklore has it that the Chinese take a very long term view of things. But it is more likely that China did not anticipate the blowback.

China seems to have underrated the vulnerability of its would-be client states to the vagaries of global capitalism and overrated the grip of the regimes that it is corrupting on power. China will not be the first great power to do this. The USA has been muscling and blundering its way, wreaking havoc around the world by conflating its interests and political values for the better part of a century.

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The real Achilles heel of the debt traps is that China has little recourse should any of its distressed debtors default. Western lenders can and often take concerted action on defaulters (a la Greece and “the troika”), but China is a lone ranger.

In China, economic illiteracy on this scale is not without precedent. Sixty years ago, Chairman Mao had the brilliant idea that industrialization could be drilled down to producing copious amounts of grain and steel. The government set a target of doubling steel production within a year and overtaking Britain’s production in 15 years. China’s peasant farmers were herded into communes. Villagers were forced to set up backyard furnaces. Pots, pans and other metal possessions were seized and melted up to meet production quotas. Trees were decimated and even furniture burned to fuel the furnaces. The Great Leap Forward, history’s most monumental political blunder, cost between 20 and 40 million lives.

It is noteworthy that Kenya is the BRI’s only touchpoint on the African continent.

Kenya's SGR, Uhuru Kenyatta's erstwhile legacy project, has turned out to be the bugbear that this columnist among others warned that it would be. Its freight capacity is a third of what was promised, and it cannot be competitive without a hefty public subsidy. Uhuru Kenyatta's administration has increased Kenya's foreign debt two and a half fold, from US$9 billion to US$25 billion. The railway alone accounts for a third of this increase; another third is by sovereign bonds for which the country has nothing to show.

Public debt service now stands at KSh 860 billion (US$ 8.6 billion), a staggering 72 percent of the last financial year's tax receipts. The question that is frequently asked now is whether, if Kenya cannot pay, the Chinese will take over the port of Mombasa. Word on the streets of Mombasa is that the port was pledged as security for the railway loans. In a manner of speaking, they already have. The Chinese have a concession to run the railway until 2027. That includes a take-or-pay freight assignment contract, which is to say, the Kenya Ports Authority, the port operator, has to meet the railway's freight target or pay the railway for the unused capacity. In effect, the port is working for the railway.

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"It is not uncommon for a country to create a railway, " said Charles Elliot, the Kenya Protectorate commissioner who oversaw the construction of the Uganda railway. "But it is uncommon for a railway to create a country." Almost 120 years later, after it emerged that Kenyan workers are routinely subjected to physical punishment by Chinese, following which the Chinese ambassador dismissed this as Chinese culture, Kenyans are wondering whether the railway heralds a new age of Oriental colonialism. On this, my take is that China and Kenya's political class have bitten off more than they can chew.

Seeing senior public officials grovelling and making excuses for these Chinese excesses gives perspective to history, from the chiefs who sold their people into slavery to those who signed away their lands to European imperialists for blankets and booze. We get it.

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