



Why Unsustainable Chinese Infrastructure Deals Are a Two-Way Street

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Article

The narrative that China is engaging in problematic debt trap diplomacy has taken off since 2018. Coined the preceding year by an Indian pundit, the term implies that Beijing is purposely striking unsustainable debt-for-infrastructure deals with developing countries along the routes of its ubiquitous Belt and Road Initiative (BRI). Such warnings gained added notoriety after White House officials began publicly raising the alarm. Director of the Office of Trade and Manufacturing Policy Peter Navarro lambasted China's "debt-trap financing to developing countries," and Secretary of State Mike Pompeo, like his predecessor Rex Tillerson, warned African and Latin American countries of the risks of Chinese "predatory economic activity" and influence.

Belt and Road Initiative

Sri Lanka's Hambantota port, which a Chinese state-owned firm acquired via a ninety-nine-year lease in 2017 after the Sri Lankan government could not service its loans, has been cited repeatedly as evidence that the Chinese government is practicing debt trap diplomacy. This cautionary tale does have broader global implications, but two crucial aspects tied to project selection and debt sustainability have been largely overlooked.

First, leaders in some countries, including Sri Lanka, have used Chinese lending for their own political ends. In doing so, they have actively contributed to unsound project selection and implementation. Second, the distorted commercial and political incentives some Chinese actors face as well as Beijing's limited experience in evaluating political risk help explain Chinese willingness to pursue unsustainable projects. China, partner countries, and other relevant actors must eschew wrongheaded assumptions about the relationship between infrastructure and development and instead should push for more inclusive and sustainable project selection and implementation.

An Unconvincing Debt Trap Narrative

The high-profile criticisms that pundits and White House officials have leveled at China's supposedly predatory lending are vulnerable to a number of critiques in their own right. Some analysts have pointed out that the rather chaotic implementation of the BRI undercuts claims of a carefully orchestrated Chinese scheme, while other research has emphasized that some of China's overseas lending has left its own banks and firms exposed to unanticipated political and financial risk. While most critiques of the debt trap narrative have largely focused on China's strategic intentions, other observers have noted that Beijing's partners are strategic players in their own right with an overlooked degree of agency. Yet as valuable as these critiques have been in terms of pointing out the flaws in the simplified, politicized debt trap narrative, the fact remains that a worrying amount of China's development finance has proven unsustainable.

Good Governance Is Hard to Come By

For Sri Lanka and most of China's other BRI partners, it is important to understand the history and politics of their relations with Beijing in general and of project selection in particular. Sri Lanka's historical ties to China far predate the BRI and the Hambantota deal, and this context combined with the country's recent history of politicized dealmaking with China are critical for grasping the origins and outcomes of the port deal.

Sri Lanka and China first established bilateral trade relations in 1952 by signing the landmark Rubber-Rice Pact. In doing so, Sri Lanka became one of the first noncommunist countries to establish trade relations with mainland China. Since then, China has become one of Sri Lanka's main trading partners and investors. During the island country's civil war from the early 1980s until 2009, Beijing was one of Colombo's biggest lenders, donating over \$1 billion in aid and military equipment during the final stages of the protracted conflict. Given this history, China's increasing role in Sri Lanka's post-conflict economic development should come as little surprise.

Undeniably, Colombo's increasing alienation from Western countries and India heightened the country's dependence on Chinese financing in the years immediately following the civil war. Numerous United Nations (UN) resolutions calling for investigations into human rights abuses committed late in the war intensified the country's diplomatic and economic isolation. Sri Lanka also lost access to vital trade concessions such as the EU's General System of Preferences Plus, which had afforded the country preferential access to EU markets at lower tariff rates. As other sources of international financing dried up, Sri Lanka increasingly turned to China to fill the void. Beijing's avowed foreign policy principle of noninterference in other countries' domestic affairs and its demonstrations of support for Sri Lanka at the UN also positioned China as a key partner toward the end of the conflict and afterward.

Contemporary discourse on China–Sri Lanka ties and debt trap diplomacy also largely overlooks other crucial political calculations that informed Sri Lanka's efforts to find new commercial partners, especially in the immediate aftermath of the conflict. For the government in Colombo, Beijing was not just a fallback option but a preferred lender. China's willingness to provide large sums of money, and quickly, not only insulated the former Sri Lankan government from international pressure linked to the conduct of the war. Crucially, this assistance also enabled former president Mahinda Rajapaksa to advance his broader domestic political agenda.

Right after the civil war, Rajapaksa actively sought out Chinese-financed infrastructure projects to solidify his hold on his political base by transforming his hometown of Hambantota into the country's second-largest commercial and trade hub. He used Chinese loans to build large-scale projects such as the Hambantota port and Mattala Rajapaksa International Airport in one of the least developed parts of the island. The subsequent failure of these projects, which have not generated sufficient income, has cost the Sri Lankan government billions of dollars in additional debt obligations. In short, Rajapaksa and his supporters made concerted, deliberate choices to use Chinese financing to advance their political aspirations.

Sri Lanka's white elephant projects underscore a crucial point about the nexus between host country policymaking and Chinese infrastructure finance: the politicized, opaque, and state-to-state nature of BRI project selection can render projects unsustainable. The International Monetary Fund (IMF) estimates that 30 percent of the potential benefits from emerging market public investment, including in infrastructure, typically is lost due to inefficient planning, implementation, and corruption. Such challenges are certainly true of China–Sri Lanka deals but also apply more generally to many Chinese-financed BRI infrastructure projects.

The contrast with more economically viable, China-backed infrastructure projects in Sri Lanka simply reinforces this point. Ostensibly, Chinese deals negotiated under different models such as public-private partnerships (PPPs) seem to do considerably better than those financed predominately through state-to-state loans. Crucially, such arrangements do far more to spread and balance risk because they involve actual Chinese investments rather than loan packages in which almost all the risk is borne by the host government in question.

The Colombo International Container Terminal, a \$500 million deepwater port terminal, stands as a noteworthy example. In contrast to Hambantota, the Colombo port was negotiated as a PPP between China Merchants Port Holdings and the Sri Lanka Ports Authority from the start, and the deal has been instrumental in transforming the Colombo port into a global shipping hub. In the first half of 2018, the port was among the fastest-growing container ports in the world. The port of Piraeus in Greece, in part because it was financed through a PPP-model of Chinese investments rather than loans, similarly experienced increased operational efficiency after a Chinese firm took over its management. Recent figures on the Hambantota port, which has also been renegotiated as a PPP, suggest that similar efficiency gains along the lines of Colombo and Piraeus may be possible.

Finally, the failure of some Chinese-financed infrastructure deals points to the development challenges Sri Lanka faces. Like many other countries emerging from conflict, it continues to struggle with weak policy instruments and ineffective institutions. In 2019, Sri Lanka ranked 100 out of 190 countries in the World Bank's Ease of Doing Business Index. Despite attempts to reform the country's regulatory environment, red tape and bureaucratic impasses are still pervasive. Structural economic weaknesses such as decreasing trade, rising protectionism, and declining government revenue have also contributed fundamentally to the country's inability to service foreign debt. Other political factors such as the 2018 coup, which led to a decrease in the country's credit rating, further compound these problems.

Hambantota is neither a singular issue nor a distinctive challenge for Sri Lanka. Rather, the much-maligned port deal is symptomatic of the country's broader development struggles and the particular challenges of financing and building high-quality infrastructure. Much like its middle-income counterparts around the world, Sri Lanka will continue to face these obstacles if it does not weed out corruption, strengthen governing institutions, and pursue more sustainable partnerships with all foreign lenders and investors.

China's Distorted Incentives and Weak Risk Analysis

Hambantota may be the most famous poster child for unsustainable Chinese development financing, but it is far from the only example. In Southeast Asia, China's relations with Malaysia took at least a short-term hit when Kuala Lumpur demanded that debt and infrastructure deals inked by former prime minister Najib Razak be renegotiated. Meanwhile, the controversial Myitsone Dam and Kyaukpyu deepwater port projects in Myanmar have continued to prompt local concerns. Similarly, Chinese-financed and Chinese-built ports and other transportation infrastructure projects in African countries such as Djibouti and Kenya have drawn official U.S. government scrutiny and, in some cases, have heightened local misgivings. Likewise, poorly planned and badly executed energy and infrastructure deals involving China in Latin American countries like Venezuela and Ecuador have increasingly attracted critical headlines. Even in Europe, Beijing's efforts to finance and build a railway between the capitals of Hungary and Serbia have run into obstacles and sparked backlash.

It is important to acknowledge how host countries have made poor, politicized, or simply corrupt decisions when selecting projects and striking deals with China. Yet, since similar concerns have cropped up in a host of places, it is also necessary to more fully account for the ways Beijing has fostered sometimes unsustainable debt deals with developing countries along the BRI routes. In all the examples mentioned above, each with as complex a backstory as Hambantota, China shares responsibility for facilitating or abetting poor project selection and implementation.

While accusations of China's debt trap diplomacy assume that ill-fated deals reflect a concerted strategy to weaponize Beijing's role as financier and investor, there are other explanations for problematic Chinese-backed projects that do not rely on oversimplistic, or even just mistaken, assumptions. A central problem is that almost all Chinese participants involved in this financing and infrastructure binge—including policy bankers, state-owned enterprise managers, and diplomats—face distorted economic and political incentives to ink more, rather than fewer, BRI deals. For example, a recent wave of BRI memoranda of understanding in the Caribbean has been accompanied by the signing of some questionable infrastructure projects such as a dry dock facility and industrial park in Trinidad and Tobago. Given that upfront economic and political incentives seem to generally outweigh concerns about deals going awry, it is little wonder that Chinese bankers, construction firms, and diplomats have pursued unviable projects in unsustainable ways.

These distorted and overlapping incentives are exacerbated by China's questionable or nonexistent political risk assessment. It is easy to forget that China's outbound foreign direct investment and lending is still in its early stages. Many banks, firms, and state officials have barely more than a decade of experience working outside China, and they often possess minimal background knowledge about the history, culture, or politics of the countries where they are operating. Given that many BRI projects are in developing countries with long-term economic and governance challenges, including recent or ongoing conflicts, it should be no surprise that major miscalculations and mistakes would be frequent. Especially since some projects are driven by host governments for noneconomic reasons, the lack of proper risk analysis and context-specific expertise looms all the larger.

Even if Chinese firms or officials assume they have the advantage when making deals with countries with few other options, China's own commercial interests and global reputation can be undermined when deals do go wrong. A case in point is the Hambantota port lease with Sri Lanka: even if the Chinese side did not propose the deal's terms, their tone-deaf inability to anticipate how the international community might view such an arrangement as a cynical reproduction of China's own colonial experience amounts to a colossal

own goal. The global backlash against China's supposed debt trap diplomacy is a testament to unintended, and unwanted, outcomes.

A Better Path Forward

Realizing that host governments and Chinese actors share responsibility for unsustainable deals underscores the continued relevance of perennial questions of development finance, project selection, and implementation. This realization also contains the outlines of potential solutions.

Critiques of China's investment model must move beyond statements that developing countries simply need to be more strategic in reaching economic deals with Beijing, or ill-fated predictions that backlash will lead the BRI to soon be abandoned in favor of some vaguely defined or nonexistent Western alternative. Instead, host countries, China, and other stakeholders should ask fundamental questions first: Who decides what counts as a good project, and why? Why would host governments take on sovereign loan risks when local or international investment might be a viable alternative? And, if public funds or assets are put up as collateral, why is it in the public interest to do so?

Moving beyond the highly politicized debate about debt trap diplomacy toward detailed empirical comparisons of sustainable versus unsustainable project selection and implementation is a good start. Such comparisons should look at regions like Southeast Asia, Latin America, and Africa, where Chinese-led development financing and its attendant problems long preceded the rollout of the BRI.

Addressing broad questions of good governance will be difficult, but improvements are possible. For all its flaws, the debt trap concept has tapped into a growing recognition that China's new role as a global development financier has not been all smooth sailing. For all of Beijing's general defensiveness about the term and about the broader merits of the BRI, even some Chinese government officials, business leaders, and academics are increasingly aware that the country's preferred loans-for-infrastructure model continues to face long-standing challenges.

One obvious starting point is fostering more well-rounded historical, sociopolitical, and cultural knowledge between China and its BRI partners. Such efforts should include supporting China's nascent research and training in area studies. For example, Tsinghua University recently created a new Institute for International and Area Studies, just one example of growing attempts to build a new generation of interdisciplinary expertise in area studies aimed at better understanding other countries and regions along BRI routes and beyond. Efforts to streamline China's foreign affairs and overseas aid bureaucracies may yet provide opportunities to incorporate such country and area studies expertise and therefore to implement more nuanced and empathetic policies.

Yet host governments, businesses, and societies face an even steeper learning curve as they aim to better understand who their Chinese government and commercial counterparts are, how they operate, and how improved understandings might improve development outcomes. Small countries with limited resources, especially those recovering from conflict, are often at a disadvantage in this respect. One solution is to share lessons learned within or across regions such as Southeast Asia, Latin America, and Africa, something several global nongovernmental organizations and researchers are increasingly keen to do.

At the same time, as some Chinese experts recognize that better political risk assessment and management might be in the interest of Beijing, there may be openings for new discussions and forms of cooperation. Some Chinese officials and firms have made commitments to adhere to international standards of corporate social responsibility, especially in the areas of environmental impact and conflict-sensitive investment. For example, recent work on China's role in infrastructure development in the Amazon seeks to build on such Chinese commitments by emphasizing that better project selection and implementation is only possible if the interplay among environmental, social, and economic impacts is given more careful consideration.

Given the scourge of corruption that often accompanies large-scale infrastructure projects, China could further its interests and reputation by implementing its own version of the United States' Foreign Corrupt Practices Act. Through its leadership role in the Asian Infrastructure Investment Bank and its cooperation on joint projects with regional development banks such as the Asian Development Bank, China can institutionalize its commitments to be "lean, clean and green."

Ultimately, China, partnering countries, and other interested parties alike all must commit to interacting more readily with the full range of actors most directly affected by large-scale infrastructure projects. This includes civil society and nongovernmental organizations, media outlets, and small and medium-sized private businesses. To date, the Chinese government and the developing countries it partners with too

often have failed to consult sufficiently with the people most directly affected by grandiose infrastructure projects. Critiques of the debt trap diplomacy narrative that rely on claims about developing countries' agency in making deals with China on infrastructure and other matters will ring hollow until such issues are addressed.

Recent work by the EU on its proposed Europe-Asia connectivity strategy focused on "sustainable connectivity" contains instructive ideas. By emphasizing commercial, financial, social, and environmental sustainability and by providing tools to measure them, the EU has offered some concrete (albeit initial) steps toward more sustainable infrastructure financing and investment. The challenge will be whether China and partnering countries view such prudent guidelines as economically and politically affordable.

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