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Role of China's Belt and the Road Initiative in Global Development Finance

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Role of China's Belt and the Road Initiative in Global Development Finance

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***The views expressed in this paper are those of the author and does not necessarily be attributed to the institutions he is and has been associated with.**

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Abstract

China's Belt and the Road Initiative (BRI), introduced in 2013 by China's President Xi, has been a major milestone in global development finance. Resonating with the historical 'Silk Road", BRI attempts to connect many countries and continents around the world. Matching its humongous size of nearly $1 trillion, it covers about 165 countries around the world. Even as the BRI benefitted some of the recipient countries, it has built a mountain of debt among many developing countries. This paper suggests an efficient, equitable, and representative method of resolving the BRI debt-distress through the formation of a BRI Club, which should include China as well as representatives from developing countries that borrowed under the BRI.

Role of China's Belt and the Road Initiative in Global Development Finance

I. Introduction

On September 2013, China's President, Xi JinPing, initiated a massive infrastructure development program named 'The Belt and the Road Initiative'(BRI). The BRI was aimed at connecting many countries and continents across the world through both land and maritime routes (Ahmad 2016, 3 June). It is also reminiscent of the legendary Silk Road that existed during 202CE - 220CE. Since its inception, the BRI has been a hotly debated issue in international Affairs (Asia Society 2021, 16 September). "…Supportive or not, everybody has to take it seriously" (Zou 2018, July, 4-5). As the BRI has just about completed its tenth anniversary, it is an opportune time to assess its role in global development finance.

The rest of the paper provides: a rough order of the magnitude of the BRI investments, the projects it finances, and its geographical composition (Section 2); the many intricate issues involved in understanding the very nature of BRI debt (Section 3); policy options to resolve the whopping BRI debt-distress (Section 4); and key conclusions (Section 5).

2. The Size and the Composition of BRI Projects

"For a long time, China's foreign aid was best described in the words of Winston Churchill: 'a riddle, wrapped in a mystery, inside an enigma" (Murphy, 2017, 31 October). China's BRI contracts insert a confidentiality clause, requiring both the lenders and borrowers not to disclose the terms and conditions of the loans (Gelpern et.al. 2021, March). Until recently, "apart from its massive scale, the most notable feature of China's capital exports is its opacity" (Horn et.al 2020, 16 April).

Encouragingly, AidData, a research lab at an American University -- William & Mary -- located in the State of Virginia analyzed a large sample of the BRI contracts. AidData found that the BRI debt stock in 2021 amounted to $843 billion, financing 1347 projects in 165 countries. A 2023 report estimated that BRI investment had reached $962 billion by 2022 (Nedopil 2023, January).

Nearly 47 % of the 1347 BRI projects are located in Africa, followed by Asia (26%), Latin America (12%) Oceana (7%) Europe (5%), and the remaining in the Middle East (Horigoshi et. al., 2022 October; Nedopil 2022 July; Nedopil 2023 January). Of the $843 billion, Asia accounts for 29%, followed by Africa (25%), Latin America (23%), Europe (18%) and the remaining spread across other regions. By sector, BRI investments are largely in industry and mining, construction, energy, transportation and storage (Nedopil 2022, July; Nedopil 2023, January). By income category, high income countries accounted for 24% of the BRI loans, middle income countries for 56%, and low-income countries for the remaining 20%. Of the $843 billion, Asia accounts for 29%, followed by Africa (25%), Europe (16%), and the remaining 5% spread across other regions.

Although more than 300 Chinese government institutions are involved from the lenders' side, four institutions -- China Development Bank, China Export-Import Bank, Industrial and Commercial Bank of China, and China Construction Bank, funded most of the BRI projects (Malik et.al., 2021). Interest rates on BRI loans have been higher and the maturity period shorter than other bilateral loans (Cheong 2022,18 September).

However, interest rates varied depending upon the bargaining power of the borrower countries. Interest rates on BRI loans to Myanmar, Indonesia, and Vietnam have been substantially higher than loans to Malaysia, Philippines, Cambodia and Laos (Cheong et.al 2022, 18 September). A typical loan from China has 4.2% interest rate and a repayment period of less than 10 years, while a comparable loan from the members of OECD's Development Assistance Committee members like Germany, France, or Japan carries a 1.1% interest rate and a repayment period of 28 years (Wooley 2011, 29 September).

3.BRI: Issues and Challenges

3.1. A Quick Look

In the initial years of BRI, countries across the world welcomed it with open arms, with a one-liner: if not China, who else? The ease of borrowing under the BRI framework made China an attractive lender – a "financier of first resort" (Malik et.al. 2021). In 2020, Ken Wu, the then China's ambassador to Germany, portrayed BRI as 'a route of life and opportunity' (Wu 2020, 7 June).

The BRI weds China's expertise in infrastructure construction and the need for infrastructure in developing countries (Narins and Agnew 2021). Fewer conditions and quicker financing were cited as BRI's major advantages, while lack of local capacity building and poor project quality were considered as the major disadvantages (Horigoshi, et.al. 2022, October).

3.2. BRI's Debt Covenants and Practices

As the celebrated Chicago economist, Milton Friedman famously said: "there is no free lunch in this world". Almost echoing that, China placed its own conditionalities on its BRI loans (Gelpern et.al, 2021, May).

A few conditions were common to most BRI loans. First, BRI financial assistance came with a 'secrecy clause" – neither the lender nor the borrower would share the loan details with a third party. Second, BRI loans did not allow cross-loan set-offs -- earnings from one loan cannot be used to set-off against losses from another loan. Third, there was a 'no-Paris CLUB clause' that rules out BRI debt to be brought under the purview of the Paris Club. Fourth, BRI loans are to be repaid to China on a preferred creditor basis.

Fifth, BRI loans were secured against the collateral of the assets that it helped to finance – ports, railways, power stations, so on and on. If the recipient country failed to repay its BRI loan, the Chinese company that financed the project had the right to acquire those collaterals (Gelpern et. al. 2021, May). However, realizing that it could be hard to seize the physical assets from foreign countries on a large scale, China keeps the option of debiting funds from the minimum amount of money that borrowers are required to hold in a lender-controlled bank (Kuo 2021, 29 November).

The sixth covenant is inbuilt in the way China finances the BRR projects. BRI lenders directly disburse the finance to the Chinese contractor firms implementing the projects abroad -- a "circular" lending strategy (Horn et. Al. 2020, 16 April). The Chinese Contractor firms then bring their own labor from China to build the BRI projects. BRI investments thus resemble a "closed-loop project" in which the recipient country does not even get the benefit of employment opportunities for the borrower countries (Madhur 2019, June). To boot, the poor project quality in many cases adds fuel to the fire (Dana 2023, 8 February). The Business and Human Rights Center estimated that at least one-third of BRI projects involved corruption, environmental problems, and violations of labor-standards (Business and Human Rights Resource Center 2022, 8 October).

The uneven allocation of risk between the lenders and borrowers, or power imbalance, is built into foreign investments in emerging markets, irrespective of whether the projects are financed by China, U.S., or European donors; it is a deeper systemic issue in foreign financing of infrastructure in emerging economies (Guild 2021, 12 October). There are instances of Western countries exaggerating their development aid by clever book-keeping and dubious accounting practices (Mitchell and Birdsall 2022,14 September).

3.3. BRI Debt Build-Up, Despite Gains

The BRI projects are in line with the 'infrastructure-led-growth model' that China had experimented with success back home (Ansar, et.al. 2016). However, infrastructure projects take a long time to yield stable financial returns. With its exceptionally high domestic savings rate, China could afford those long lags. Even today, Chinese households save one-third of their incomes – China's savings conundrum (Ma and Song, 2023, 16 March).

Mueller notes that, on an average, three years after the implementation of a large infrastructure aid project, per capita gross domestic product (GDP) increases by nearly one percentage point (Mueller 2023, 26 January). Others do see a mixed record of the BRI program (Duster 2022, 7 November). In 2017, the World Bank highlighted that improving access to quality infrastructure in Africa could raise the region's GDP per capita by 2.6 percent per year (World Bank 2017, April). It is thus possible that the BRI projects must have helped the people of the loan recipient countries in Africa.

On a different note, one could also claim that BRI has already crowded in $600 billion dollars of investment in developing countries by the G7 Countries over the next few years (Shalal 2022, 27

June); € 300 billion by the European Union (EU) through its Global Gateway Initiative (Teevan 2022, June); $300 billion by Japan for infrastructure development in Asia (McBride and Berman, 2023, 2 February). Indeed, China's BRI investment in Africa has already begun to fall, as the Western countries spend more (Nikkei Asia 2023, 25 March).

Meanwhile, a number of BRI borrowers across the world have built up unsustainable levels of BRI debt, irrespective of whether the projects under the program have been completed or fallen into disarray. Some of them may have reached a dead end, while others have lingered on (Buchholz, 2022,19 August). China's credit portfolio in debt-distressed countries rose from about 5% in 2010 to a whopping 60% by 2022 (Horn et.al. 2022, 11 April).

The China-funded Gwadar Port in Pakistan is emblematic of the BRI debt-distress, as the port has failed to generate enough volume of maritime traffic (Aamir 2022, 21 December; Hussain and Ahmad 2022, 2 August; Hafeez 2023, 12 January; Waheed 2022, 22 November). In addition, in response to the galloping inflation, the State Bank of Pakistan raised its policy interest rate to 20%, the highest figure since October 1996 (Nikkei Asia 2023, 2 March). Even after the Industrial and Commercial Bank of China approved a rollover of $1.3 billion for Pakistan to be done in 3 instalments, Pakistan continues to be in deep BRI debt-distress.

Lao – a small Southeast Asian country – had to sell its electricity transmission grid on 21 September 2021 to a Chinese State-owned enterprise for $600 million, in a debt-for-equity swap (Daily Sabah 2021, 19 December). It's BRI-funded railway line connecting the country's capital city, Vientiane, with China's Kunming city, is sitting up on a mountain of debt (Strangio 2021, 3 December; Jiang, 2022, 1 July; Sims and Scali 2022, 1 November). Annual inflation averaged 23% in 2022, while more than one-fifth of the country's workforce remained unemployed (Strangio 2023, 8 February). On 14 June 2022, Moody's – the international credit rating agency -- downgraded Laos' credit rating, further aggravating the country's BRI debt-distress (Whong et. al. 2021, 2 December; Jiang 2022, 1 July; Sims and Scali 2022, 1 November).

Indonesia's142 kilometer long high-speed railway project financed under the BRI connecting the country's capital with Bandung in the West Java province has developed hick-ups just months before its scheduled beginning in June-July 2023. The railway line is raising potential concerns about its safety, profitability, and accessibility, not to mention the huge cost overrun (Nikkei Asia 2023, 11 February).

Unlike other Southeast Asian countries, Vietnam adopted a guarded approach to the BRI: avoiding opposition to a major rising power – China -- as well as diversifying its relations with other major powers such as Japan (Dung and Do 2023 17 March). Vietnam's only BRI project – a bridge connecting Vietnam with China has been hamstrung by cost overruns. Initially, the project cost was estimated at $552 million, with Chinese loan to cover $419 million. The price tag soon went up to $891 million, requiring an additional loan of $250 million from China's EXIM Bank (Hiep 2018).

Further away from Asia, BRI projects from Ecuador to Zambia in Africa have experienced construction flaws, even as their BRI debt kept rising (Dana 2023, 8 February). In January 2022, Nicaragua officially joined the BRI, one month after severing its diplomatic relation with Taiwan (McBride et.al. 2023, 2 February). Ecuador's hydroelectric power built at a cost of nearly $3 billion, has developed huge cracks that could knock the entire project down (Dana 2023, 8 February). In Uganda, resorting to the 'collateralization' clause, China took possession of the Entebble airport in November 2021, as Uganda failed to repay the $ 200 million it had borrowed from China in 2015 (Dana 2023, 8 February). Djibouti, whose annual GDP is equivalent to two hours of Chinese output, is in deep BRI debt-distress (Vertin 2020, June; Vines, et. al. 2022, December). Yet, China has a loan commitment of $1.4 billion for infrastructure, including a free-trade zone, a port, a railway line, and a water pipeline.

Italy, the only G7 country that joined the BRI (in 2019), is facing multiple problems (Delfanti and Bohane 2023, 28 February). Prato – a small city in the country, is now full of Chinese migrants who came to work on the BRI project but stayed on in Prato. There are now Chinese accountants and notaries in Prato working for Chinese companies (Delfanti and Bohane 2023, 28 February). Prato is now nicknamed as 'Santo Beijing' (Delfanti and Bohane 2023, 28 February).

More generally, after spending about $1 trillion on the BRI projects, things are looking bad for both lenders as well as borrowers. To boot, poor project quality in many cases adds fuel to the fire (Dana 2023, 8 February). In 2022, China accounted for 37% of poor countries' debt and the World Bank is now seriously concerned about an intensifying debt-distress for many of these countries (Gold 2022,19 January; Gold 2022, 6 December; Martin 2023, 25 January).

Based on interviews with policy makers and social activists in Cambodia, Laos, Myanmar, and Vietnam, it seems that BRI investments resemble 'a brand extractivism with Chinese characteristics' (Pichamaon 2019, October). Often, Chinese overseas projects are geared towards exploiting the region's natural resources to serve Chinese interests (Dana 2023, 8 February). The multilateral institutions like the IMF and World Bank recently requested China to take a cut in its debt to Zambia, but China is reluctant to do so (Gold 2022, 19 January; Gold 2022, December; Martin 2023, 25 January).

4.BRI Debt Distress and its Resolution

4.1. Perceptions of BRI Projects

Many experts refer to the BRI projects as: China's debt-trap diplomacy (Chellaney 2017, 23 January; Guzman 2023, 16, January; Ahnoti 2022, 11 October); all about banking, and not about development (Garver 2021, 1 October); part of China's neo-mercantile policy to raise its global presence (Yu 2017); a Chinese 'Trojan Horse' (Scarponi 2019); a sovereign-debt bomb (Krueger 2023, 13 January); 'China's empire of debt' (Snell 2022, 7 January); China's footprints in Latin America

(Wintgens 2022, September); Other experts foresee the BRI debt-distress hampering the growth prospects for developing countries in the near future (Narins and Agnew 2021; Rodrik et. al. 2022).

China uses its BRI loans to arm-twist its members to support its positions on international affairs (Nagy 2023, 1 February). Recent examples of such actions include China's efforts to lobby and create a coalition of BRI members to vote down a motion to discuss a UN Report into China's human rights violations in Xinjiang, as also compelling BRI member states to abstain from a resolution on "Russia's aggression against Ukraine" (Nagy 2023, 1 February). Indeed, China pressured four countries in Latin America – The Dominican Republic, El Salvador, Nicaragua, and Panama – to downgrade their diplomatic recognition of Taiwan – a period in which China's investment in those countries peaked (Guzman 2023, 16 January; McBride et.al. 2023, 2 February). The European Chamber of Commerce in China has expressed its huge dissatisfaction on the BRI program (Graupner 2020, 16 January).

4.2. The Likely Response from the BRI Borrowers

When the BRI was started, it was considered as the project of the century that would reshape the global order with China at the center (Dana 2023, 8 February). However, it is unclear how many positives can be said about the BRI. Already, there is a "BRI backlash" across the world (Dana 2023, 8 February).

Given these recent developments, there is an urgent need for belt-tightening on both the sides – lenders as well as borrowers. Further delay in developing such an amicable BRI debt resolution method may indeed force the political leaders of the BRI indebted countries to throw up their arms and say: "what else, if not a default?". The more countries build up unsustainable BRI debt, the more difficult it would be to resolve their debt-distress.

At some stage, if some of the BRI debtor countries collude and collectively decide to default on their BRI loans, China would be in a weaker position in resolving the growing debt-distress. Indeed, those who rely on a China's debt-trap narrative do not seem to appreciate that "BRI debt is as much a problem for China as it is for the borrowing countries" (Vines et.al. 2022, 27 December, 10). From Africa and Latin America in the 1970s and '80s to Asia in the 1990s, history has shown that over-exuberant lending by transnational banks and investors contribute to the boom-bust cycles of 'casino capitalism' (Liao, 2021, 27 December). According to a recent report, countries in financial distress now hold about 60% of China's overseas loans, up from 6% in 2010 (Horn et.al. 2022, 11 April).

Far from being a sophisticated strategy to expropriate African assets, "profligate BRI lending may have created a debt trap for China – deeply entangling it with increasingly obdurate African partners" (Vines et.al. 2022, 27 December, 10). On top of all this, Russia's invasion of Ukraine has added to China's woes, as Ukraine has been a key regional hub for the BRI program in central Asia (Bin 2022, 11 April; Horn et.al. 2022, 11 April).

4.3. BRI Debt-Resolution

On its part, China's situation is complex. China is not a Paris Club member (Reiffel, 2021, 30 April). Chinese lenders are understandably wary of taking losses, not only due to financial reasons but also to potential breakout of public wrath within China. China's banks are already hit hard by bad loans on their property loans (Nikkei Asia 2023, 11 April). China's banks have shown a willingness to extend loans, but not write-downs (Sobel 2023, 10 February). At the same time, BRI loan recipient countries are now suffering from 'buyer's remorse' (Kuo 2021, 29 November).

China has two key differences with the Paris CLUB practices on debt resolution. First, China maintains that two of the largest lenders under BRI – China Development Bank and the China Export-Import Bank – should be treated as private commercial lenders and hence they should thus be out of the ambit of a debt-resolution program. However, the China Development Bank maintains that its loans are not private (Sobel 2023, 10 February). China has to sort out these internal disagreements.

Second, and more importantly, from a geopolitical perspective, China prefers to be an active rule-maker rather than a passive rule-taker on global issues (Reiffel 2022). It is also good to remember that the Paris Club too took decades to evolve from a case-by-case decision making to a more general form of debt relief model by now (Reiffel 2022). China's creditors should have a big 'say' in the decision-making on resolving the BRI debt-distress, and indeed more generally on global economic governance in the twenty-first century (Madhur 2012; Madhur 2019).

That said, China's decision making is far less monolithic than is generally thought about. It is a highly fragmented system with far too many bureaucratic politics (Brautigam and Rithmore 2021, 6 February; Brautigam 2023, 20 February). As Mao was quoted as saying "There are parties, outside our party, and there are factions within our party, and this has always been the case" (quoted in Cai 2022, 6 September). Arriving at a consensus on debt-relief in China, therefore, tends to be a long and protracted process.

However, President Xi continues to be a strong leader and a quick decision maker. To his credit, China's President demonstrated his global leadership skills by brokering a diplomatic deal between arch-rivals, Iran and Saudi Arabia, although China is unlikely to drive the U.S. out of the Middle East anytime soon (Octorbaeu 2023, 10 April). China is increasingly wanting to be at the center, not in the periphery, of decision-making on many international affairs (Madhur 2024). However, "in order to gain hegemony, a state further needs intellectual and moral leadership Therefore, the concept of hegemony brings coercion and consent together" (Demir 2023, p.10).

Zambia is the real test case for China in BRI debt resolution. China's 18 different kinds of creditors hold 31% of the country's external debt. After a long silence, China's 18 creditors have now decided that the Exim Bank would represent them for negotiations on Zambia's debt. However, once the IMF came out with the estimate that Zambia would require a 50% debt reduction, China became recalcitrant to shoulder such a huge loss on just one of its many BRI debtors, partly to avoid the build-up of high expectations on the part of other BRI debtor countries. Hence, China is persuading multilaterals to partake in Zambia's debt reduction (Brautigam 2023, 20 February).

In general, debt relief take two major forms: 'debt cancellation' or 'debt-write-off, under which the creditor cancels part or all of debt, resulting in a reduction of the face value of the loan or 'debt restructuring/debt reprofiling' the interest rate, maturity and grace period, or various fines are relaxed in favor of the debtor, without reducing the face value of the loan (Acker et.al. 2020). China's creditors prefer debt-reprofiling to debt cancellation.

That said, China also realizes that it would need to strike a compromise between debt- cancellation and debt-reprofiling. China's Multilateral Cooperation Centre for Development Finance (MCDF) that has been established to handle BRI debt-distress will have to play a substantive role in developing a method of debt relief in close consultation with its borrowers (Vines et al., 2022, December). An U.S.-China great- power rivalry could drag the world economy into the well-known Thucydides trap (Guangqian 2014, 9 January). More recently, in an offensive response to China's bullying the Philippines on the South China Sea dispute, Philippines and the U.S. jointly held the biggest-ever military drill (Nikkei Asia 2023, 11 April).

Some conceive the plausibility of China transiting through a Dutch-style hegemon – a middle path - wherein, driven by self-interest, a country grudgingly obeys the existing international architecture (Danner and Martin, 2019). Some are flagging concerns that the world economy is experiencing fragmented globalization (El-Erian, 2023, 8 March), while others think that the world is already deglobalizing (Goldberg and Reed, 2023, 19 March). At the least, China and the United States seems to be locked in a robust great power rivalry (Acharya, 2022, 21 June). More generally, some experts see the need for reforms in the existing international architecture to address the demands of the newly emerging economic-cum-political powers (Karatsli (2023, January).

Moving forward, China will have to be willing to accept debt cancellation as well as debt reprofiling. This paper suggests a four-fold method of resolving the BRI debt as an appropriate policy option. For the low-income countries in debt-distress, it is reasonable to write off the distressed BRI debt. For the middle-income countries, it is preferable to offer various reprofiling options, rather than debt cancellation. For the high-income countries participating in the BRI, neither debt cancellation nor debt reprofiling would be needed, as these countries should be able to sustain their BRI debt without any debt relief.

Outside of these three income-based categories, China may like to have a few 'special category states' that are important for China, say, for diplomatic or geopolitical purposes. For those special categories of states, the debt relief measure should be at the discretion of China. To implement such a "rules-with-discretion" system of debt-resolution, there is merit in forming a 'BRI Club'. China will be at the core of this BRI Club, and the debtor countries could choose one representative from each the three income categories of debtors, if needed on a yearly rotating basis.

It is also encouraging that in 2022, China seems to have made quite a few changes to the BRI structure – dubbed as BRI-2 in China's internal government circles – which would evaluate new projects more rigorously and allow for debt negotiations (Dana, 2023 8 February). "Looking ahead, the Africa-China economic engagement will be influenced by four factors: Africa's public-debt distress, China's changing approach to development finance, a deepening focus on soft power and diplomatic relations on both sides, and the changing composition of African economic interests" (Were 2023,13 March, 1).

5. Conclusion

The BRI has been a unique piece of economic-cum-political statecraft marking China's entry into global development finance. BRI's first decade has been a momentous one. It has also been one of the most controversial initiatives in global development finance. Although the BRI has promoted overall growth in recipient countries, the initiative has also built up a huge amount of debt. That is driving the debtors and the creditors alike to find a viable and amicable method of addressing the BRI debt distress, through the formation of a BRI Club. This paper has developed with such a policy option for resolving the growing BRI debt

In one of his speeches, President Xi had made a remarkable statement: "China needs to learn more about the rest of the world, and rest of the world needs to learn more about China" (Xi 2012, November 15). This brilliant idea articulated a decade ago is even more applicable in today's global geopolitical configurations. Now that President Xi has formally been elected for a third term, he should be on a firmer ground to take decisions on BRI debt resolution.

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