

Research Paper

Lee Jones and Shahar Hameiri

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# Debunking the Myth of ‘Debt-trap Diplomacy’

## How Recipient Countries Shape China’s Belt and Road Initiative



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## Summary

- The Belt and Road Initiative (BRI) is seen by some as a geopolitical strategy to ensnare countries in unsustainable debt and allow China undue influence. However, the available evidence challenges this position: economic factors are the primary driver of current BRI projects; China’s development financing system is too fragmented and poorly coordinated to pursue detailed strategic objectives; and developing-country governments and their associated political and economic interests determine the nature of BRI projects on their territory.
- The BRI is being built piecemeal, through diverse bilateral interactions. Political-economy dynamics and governance problems on both sides have led to poorly conceived and managed projects. These have resulted in substantial negative economic, political, social and environmental consequences that are forcing China to adjust its BRI approach.
- In Sri Lanka and Malaysia, the two most widely cited ‘victims’ of China’s ‘debt-trap diplomacy’, the most controversial BRI projects were initiated by the recipient governments, which pursued their own domestic agendas. Their debt problems arose mainly from the misconduct of local elites and Western-dominated financial markets. China has faced negative reactions and pushback in both countries, though to a lesser extent than is commonly believed, given the high-level interests at stake in the recipient countries.
- To improve the quality of BRI projects, Chinese policymakers should develop a coherent, integrated decision-making system with sufficient risk assessment capacities and strict, clear and enforceable rules. This would involve tackling vested interests within China, particularly among commercially oriented agencies and in the state-owned enterprise (SOE) sector.
- Recipient governments must take greater responsibility for the evaluation of potential projects to ensure their viability and financial sustainability. They must also develop their ability to bargain with Chinese partners to make certain that local people benefit from the BRI. Since China continues to place great emphasis on host-country regulation, BRI partners must bolster their laws and regulatory environment.
- Policymakers in non-BRI states should: avoid treating the fragmented activities of the BRI as if they were being strategically directed from the top down; provide alternative development financing options to recipient states; engage recipients and China to improve BRI governance; and help improve the transparency of ‘megaprojects’.
- Civil society and political opposition groups in recipient countries should focus their efforts on demanding transparency and public participation around the design, feasibility, selection, pricing, tendering and management of megaprojects.

# 1. Introduction

Launched in 2013, the Belt and Road Initiative (BRI) is widely understood as a geopolitical strategy to create a new, Sino-centric order in Eurasia or even across the entire world.<sup>1</sup> The typical view is that the BRI comprises a ‘well thought-out Chinese grand strategy’ pursued ‘to reclaim geopolitical dominance in Asia [...], challenge] US dominance and [...] create a Chinese-centered order’ (Bhattacharya, 2016: p. 2). Think-tanks and scholars alike describe the BRI as a ‘geopolitical and diplomatic offensive’ (Godement and Kratz, 2015: p. 2), aimed at ‘nothing less than rewriting the current geopolitical landscape’ (Fallon, 2015: p. 140), or even ‘world dominance’ (Fasslabend, 2015).

Despite Beijing’s protestations that this view misrepresents a policy intended by China as a benevolent initiative, it has quickly taken hold in Western policymaking circles – particularly in the US. In December 2018, the then National Security Advisor John Bolton (2018) stated that the BRI was about ‘advancing Chinese global dominance’. During his term in office, Secretary of State Rex Tillerson (2017) claimed in October 2017 that Chinese loans to finance infrastructure projects were a form of ‘predatory economics’, designed to result in ‘financing default and the conversion of debt to equity’. Indeed, China is often said to be pursuing ‘debt-trap diplomacy’: luring poor, developing countries into agreeing unsustainable loans to pursue infrastructure projects so that, when they experience financial difficulty, Beijing can seize the asset, thereby extending its strategic or military reach. This claim, which originated in a New Delhi think-tank in 2017 with respect to Sri Lanka’s Hambantota Port, has been widely repeated in the media and among senior policy elites across the world (Bräutigam, 2020). US Vice-President Mike Pence (2018), for example, criticized China in October 2018 for using debt-trap diplomacy in Sri Lanka to establish a ‘forward military base for China’s growing blue-water navy’.

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This paper demonstrates that such views are mistaken for a number of reasons. First, the BRI is primarily an economic project; second, China’s development financing system is too fragmented and poorly coordinated to pursue detailed strategic objectives, notwithstanding leaders and central agencies’ efforts at loosely guiding the BRI’s broad direction; and, third, Chinese development financing is heavily recipient-driven. China cannot and does not dictate unilaterally what is built in the name of the BRI. Developing-country governments are not hapless victims of a predatory Beijing; they – and their associated political and economic interests – determine the nature of BRI projects on their territory. Far from unfolding according to a Chinese strategic blueprint, the BRI is actually being built piecemeal, through diverse bilateral interactions. Political-economy dynamics and governance problems on both sides often result in badly conceived and poorly managed projects with substantial negative economic, political, social and environmental implications – however, this paper argues that these are often unintended consequences and do not represent part of a clever plan hatched in Beijing. Moreover, these negative effects are generating a form of blowback, forcing China to adjust its BRI approach.

This paper presents detailed case studies of Sri Lanka and Malaysia, the two most widely cited ‘victims’ of debt-trap diplomacy. In reality, the most controversial projects in these states were initiated not by China but by the recipient governments, in pursuit of their own domestic agendas. Their debt distress has not arisen predominantly from the granting of predatory Chinese loans, but rather from the misconduct of local elites and Western-dominated financial markets. China has also not benefited strategically from the upsets in these cases. It has instead faced negative reactions and pushback, though to a lesser extent than is commonly imagined, given the interests at stake in the recipient countries.

Policymakers and civil society organizations in the West and recipient countries should stop responding to the BRI as though it were a well-planned grand strategy and recognize it for what it is: an often fragmented, messy and poorly governed set of development projects. What is needed is not so much a geopolitical pushback against the BRI, but the introduction of more selective interventions to improve transparency around – and the governance of – ‘megaprojects’, supported by the provision of alternative forms of development financing.

## 2. The Economic Drivers of the BRI

Interpretations that emphasize the geopolitical strategic aspects of the BRI are dominant because it is easier to see the project as part of a wider narrative about declining Western power, and the ‘rise of China’, than to examine its more complex economic drivers. While President Xi Jinping clearly aims to signal China’s great-power status through the BRI, it remains a plan mainly aimed at addressing deep crises within the Chinese economy. The Chinese government launched the BRI primarily in order to help address these systemic problems by unlocking overseas demand for Chinese industry, construction projects and loans.

### China’s growth model in crisis

China’s annual rate of economic growth has slumped from an average of around 10 per cent during the 2000s to less than 7 per cent since 2015, reflecting the increasing exhaustion of its investment-, infrastructure- and export-led growth model. Fundamentally, Chinese growth was produced by debt-fuelled infrastructure investment, which enabled export-oriented industrial clusters to form, generating export surpluses that repaid the original debt and allowed the cycle to repeat. Historically, in other countries this growth model has always yielded diminishing returns, as the domestic economy cannot absorb additional investment productively or efficiently, causing falling rates of return. In China, this problem was exacerbated by decentralization, with local governments creating new industries in competition with each other, generating irrational duplication and vast surplus capacity (Zhou, 2010: Ch. 7). By 2008, China’s western regions already experienced ‘oversupply of infrastructure’, thanks to the BRI’s forerunner, the Great Western Development Campaign (GWDC), which stimulated growth through financing local and cross-border infrastructure projects (Qin, 2016: p. 213). The problem was exacerbated by Beijing’s introduction of a RMB 4 trillion (\$586 billion) stimulus package following the 2008 global financial crisis – 38 per cent of which fuelled further infrastructure spending (Qin, 2016: p. 204). With demand for Chinese exports also falling, surplus capacity increased to 20–30 per cent in most basic industries (European Union Chamber of Commerce in China, 2016).

The early 2010s saw a slump in profitability. The rate of return on domestic infrastructure projects fell to 3.1 per cent in 2012, below capital costs (Leutert, 2016: p. 89). By 2015, every RMB 5 of investment generated just RMB 1 of economic growth (Arase, 2015: p. 32).

This situation has compounded related crises of overaccumulation and indebtedness. Persistent export surpluses and high savings generated domestic deposits of \$5.14 trillion and foreign reserves of \$4 trillion by 2014 (IMF, 2019; World Bank, 2019). Collapsing domestic profitability compounded financial institutions’ struggle to find productive outlets for this capital. Perversely, indebtedness has also risen sharply, thanks to debt-fuelled stimulus spending. From 2008 to 2016, local government debt rose from RMB 5.6 trillion (\$864 billion) to RMB 16.2 trillion (\$2.5 trillion), while corporate debt – 60 per cent of which is held by state-owned enterprises (SOEs) – grew from \$3.4 trillion to \$12.5 trillion between 2007 and 2014 (McMahon, 2018: Chs. 2, 3).

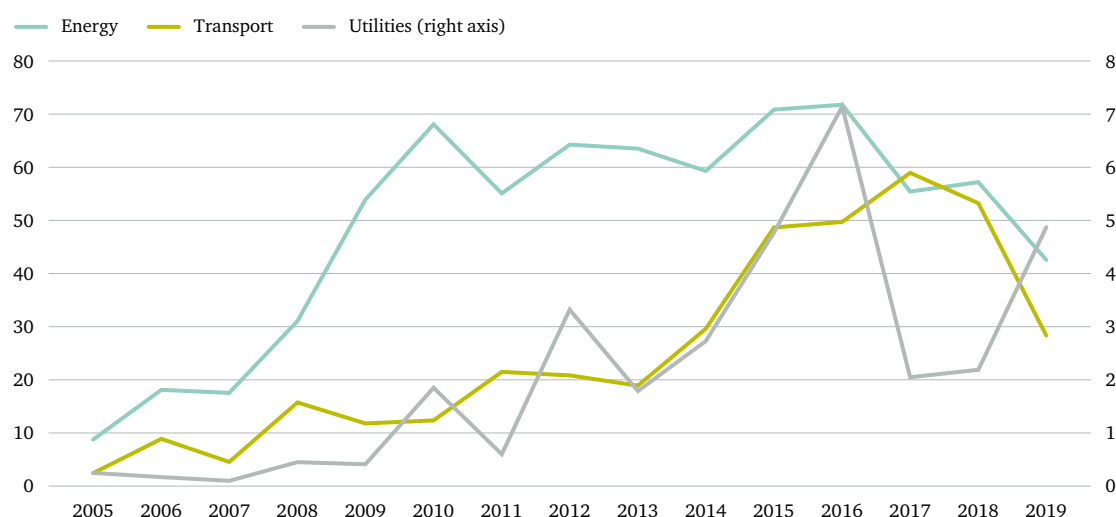


## BRI to the rescue

For the Communist Party of China (CPC), whose legitimacy rests heavily on continuous economic growth, these structural problems within the economy represent an existential crisis. The BRI is intended to address these issues by stimulating external demand for Chinese goods, services and capital.

Externalizing domestic problems is a well-worn Chinese strategy. In 2000, Beijing’s ‘Go Out’ policy encouraged SOEs facing dwindling domestic resources and markets to seek opportunities overseas – which oil companies and hydropower dam-builders had already been doing. The GWDC spurred road- and rail-building companies to follow suit, followed by firms in the energy, logistics and other infrastructure-related sectors, generating steady increases in overseas investment and contracting (see Figure 1). The BRI simply scales up this strategy, repackaging and rebranding many existing projects and supporting new ones.

Figure 1: Chinese overseas investments and contracts (\$ billion)



Source: American Enterprise Institute (2019).

The BRI’s primarily economic rationale is reflected in its governance. The project is led by China’s National Development and Reform Commission (NDRC), the agency responsible for domestic economic planning. The NDRC is overseeing the translation of Xi’s vague slogan, ‘One Belt, One Road’, into policy frameworks to guide the wider party-state. This has mainly involved consulting provincial economic agencies that competed ferociously to advance their pet projects, some of which date back to the 1980s (Jones and Zeng, 2019: pp. 1421–5). The NDRC also services the State Council’s Leading Small Group on Advancing the Development of One Belt One Road, which loosely guides the BRI. The NDRC designed the BRI as an extension of its domestic spatial planning, seeking to shift lower-value-added activity to China’s less developed provinces and overseas, facilitating continued economic expansion and industrial upgrades (Summers, 2018: Ch. 5). The NDRC has also issued key policy documents alongside the Ministry of Commerce (MOFCOM) and the Ministry of Foreign Affairs (MFA) (see NDRC, MFA and MOFCOM, 2015). However, as an MFA researcher acknowledges, the historically weak ministry ‘is not very powerful’, having only a ‘fake role’.

with no influence over projects. ‘It makes the MFA really embarrassed. MFA is supposed to be the hub for diplomacy’, but since the BRI is ‘mainly economic’, the NDRC, MOFCOM and other agencies are actually in control (Interview, September 2017).

Consequently, approved BRI projects follow the logic of economics, not of geopolitics. Outbound investment does not even correspond to the six ‘corridors’ outlined in Beijing’s rather imprecise BRI policy documents, but remains heavily concentrated in East Asian and developed economies, with non-BRI investment growing faster than BRI investment (Dollar, 2017; Chen and Lin, 2018: pp. 11–12). Official documents show that BRI projects were ‘not regulated or guided’ by government policy frameworks; ‘the main motivation’ was ‘industrial overcapacities’, with provincial governments even appropriating BRI funds to bail out domestic SOEs (Ye, 2019: pp. 12–14). Funding has been skewed heavily towards state-linked construction firms facing collapsing domestic demand. In 2014–18, 63 per cent of the \$404 billion allocated for BRI projects went to construction projects, with SOEs netting 96 per cent of construction contracts (Joy-Perez and Scissors, 2018).



### 3. Governing the Belt and Road

Those who insist on seeing the BRI in geostrategic terms may acknowledge these economic motivations, yet still claim that China is using ‘economic statecraft’ to pursue strategic ends. If ‘strategy’ is understood to mean a specification of the goals to be achieved, combined with a set of tactics describing how to reach those goals, clear directions for specific actors, and appropriate resource commitments, then China’s BRI does not qualify (Jones and Zeng, 2019). In reality, leaders and central agencies attempt to shape the overall direction of the BRI through (often vague) policy statements and broad commitments to particular countries or regions, but the institutional fragmentation of China’s development financing regime and its recipient-driven nature means that projects emerge in a piecemeal, non-strategic and bilateral manner.

#### China’s fragmented development financing regime

From the 1950s to the 1970s, Chinese aid served strategic purposes, funding sympathetic movements and governments in other countries. Since the 1980s, Chinese development financing has been explicitly reconfigured to support China’s own economic development. Accordingly, the vast bulk of development financing now comprises export credits and loans that effectively subsidize SOEs’ global expansion through tied ‘aid’ projects (Dreher et al., 2016). Hence, the China Development Bank (CDB) and the Export-Import Bank of China (EXIM) are China’s main ‘development’ financiers, ahead of the far more widely discussed Asian Infrastructure Investment Bank (AIIB) (Hameiri and Jones, 2018).

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Officially, China’s development financing system works as described in the first column of Table 1. However, as the second column shows, there are numerous flaws in this system. Moreover, the formal process is often bypassed through ad hoc arrangements, as the case studies in this paper illustrate. Importantly, the process is dominated by economic agencies, not diplomatic, political or military ones – reflecting its orientation towards supporting SOEs’ overseas expansion, not towards geostrategic objectives. Moreover, the process is recipient-led and typically begins with requests from foreign governments. These are often initiated in the first place by SOEs prospecting for overseas business, who lobby foreign governments to seek funding for projects in the hope of winning related contracts. Accordingly, projects emerge in a ‘bottom-up’, piecemeal manner, evaluated on a case-by-case basis, not according to a top-down strategic masterplan.

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**Table 1: China’s development financing regime**

Formal process	Issues and problems
1. Would-be recipient government applies to Chinese embassy’s economic office, staffed by MOFCOM officials.	<ul style="list-style-type: none"> <li>Chinese SOEs may lobby foreign governments to apply for project funding.</li> <li>Local MOFCOM officials see their role as supporting SOEs’ expansion; local MFA officials are largely bypassed.</li> <li>The application/scrutiny process may be bypassed by high-level political contacts, or there may be other ad hoc approaches.</li> </ul>
2. Request sent to MOFCOM, which discusses it with more than 20 other agencies. MOFCOM and NDRC must approve projects over \$100–\$300 million, depending on sector.	<ul style="list-style-type: none"> <li>Inter-agency coordination is poor.</li> <li>Agencies have limited capacity to assess the viability and risks of projects.</li> <li>Strategic/diplomatic agencies like the MFA are marginal players.</li> <li>Functional ministries (e.g. health, education) dispense aid independently of this process.</li> </ul>
3. Financial support is negotiated, typically with CDB or EXIM. The Ministry of Finance must agree to cover any gap between commercial and concessional loan rates.	<ul style="list-style-type: none"> <li>Financiers have limited capacity to assess the viability and risks of projects. Lenders lack in-country officials, making them dependent on information supplied by applicants and SOEs.</li> <li>Financiers mainly wish to recoup loans, not ensure positive developmental outcomes in other countries.</li> <li>As long as borrowers provide sovereign guarantees, and SOEs obtain risk insurance, lenders may approve even ill-conceived applications.</li> </ul>
4. The project is awarded to the SOE and contracts are finalized. Chinese financiers dispense money directly to the SOE. Work commences.	<ul style="list-style-type: none"> <li>Awards are often made non-transparently, without competitive tendering.</li> <li>Tendering may be influenced by SOE lobbying in China or the recipient state. SOEs behind an original application are particularly well placed (i.e. they effectively manipulate Chinese development financing to support their overseas expansion).</li> </ul>
5. The SOE is regulated by MOFCOM, SASAC, the policy banks, functional ministries and industry associations.	<ul style="list-style-type: none"> <li>Agencies’ inspection and enforcement capacities are very low. Only MOFCOM has any in-country officials, who rarely scrutinize SOEs closely.</li> <li>Chinese regulations are typically vague, exhortatory guidelines, not hard-and-fast rules and laws; despite recent tightening, they fall short of international best practice.</li> </ul>

Source: Compiled by the authors.

Overall guidance from the government exists, but operates loosely, steering the system towards broad objectives rather than specifying detailed outcomes (Jones, 2019). Chinese leaders may announce spending initiatives, such as the commitment of \$2 billion in assistance to the Pacific Islands in 2013, the pledging of a \$60 billion package of grants, loans and export credits to Africa in late 2015, or the BRI itself. However, detailed, concrete plans to implement such initiatives are always made by other agencies (Jones and Zeng, 2019). Similarly, top leaders’ desire to strengthen bilateral relations with a particular country may encourage agencies to support projects there, easing permissions and funding, but specific projects are still determined on a case-by-case basis and bilaterally. Even where top leaders support specific projects, typically at foreign counterparts’ request, policy banks and SOEs may refuse or stall their participation if they cannot extract sufficient profit. For example, SOEs directed to build nuclear power plants in Romania as ‘flagship’ BRI projects have not done so, due to profitability concerns (Zhang, 2019). Similarly, a number of coal-fired plants proposed under the China–Pakistan Economic Corridor (CPEC) have been scrapped because SOEs could not secure their desired margins (Rafiq, 2017: pp. 17–19).

This highlights the fact that the SOEs – the key agencies involved in implementing (and sometimes initiating) Chinese development projects – are quasi-autonomous, profit-seeking firms, not simply instruments of economic statecraft (Jones and Zou, 2017). Theoretically, President Xi could order an SOE to undertake a particular project, but there is scant evidence of this actually happening. The agency that oversees SOEs, the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), is primarily concerned with safeguarding and maximizing the value

of state assets. Decisions on how to do that are delegated to SOEs themselves and, although SOE leaders are CPC appointees, their performance is primarily evaluated against economic targets. Consequently, SOEs are mainly profit-seeking entities; their overseas projects predominantly seek to expand their market share, secure future revenue streams, and help them climb the value-added ladder. SOEs thus resist unprofitable projects while harnessing national frameworks to subsidize others. CDB and EXIM Bank are also profit-oriented, explaining why Chinese loans are typically costlier than those from traditional development banks.

Finally, and crucially, this loose system of governance, and SOEs’ own inexperience in global markets, have facilitated many poorly conceived overseas projects. In 2006, only half of Chinese overseas investments were profit-making (Zhang, 2010: p. 161). By 2014, Chinese enterprises’ \$6.4 trillion of overseas assets were still yielding a net loss (Lu et al., 2016: pp. 198–9). For example, surplus capacity and capital spurred Chinese enterprises to partner with Southeast Asian governments to establish many industrial parks after 2000, but they remain underutilized, loss-making, and dependent on Chinese loans to survive (Song et al., 2018). Thus, irrational investment and surplus capacity at the domestic level are often replicated internationally, creating ‘white elephants’.

## The recipient side

China’s development financing system has always been recipient-driven, with projects being formally initiated through requests from foreign governments. Beijing frequently emphasizes this to distinguish Chinese development assistance from that provided by traditional donors. Accordingly, we must consider recipients’ agency in shaping the BRI, which is neglected – or implicitly denied – in simplistic accounts of debt-trap diplomacy.

Even if China had a global connectivity ‘master plan’, specifying all the projects it wishes to build to advance its geopolitical grand strategy, it could not force other nations to accept projects on their territory. Recipients must agree to allow Chinese SOEs to undertake projects, secure their operations, and agree the loans financing their work. Naturally, recipients will only support projects that serve their own needs and interests. China explicitly acknowledges this, emphasizing that the BRI should develop through bilateral dialogue, so as to ‘integrate’ Chinese business interests into the ‘development strategies’ of recipient countries (NDRC, MFA and MOFCOM, 2015: Preface). For this reason alone, the BRI simply cannot unfold according to a unilateral Chinese strategy. It can only develop gradually, through bilateral negotiations with over 130 partners; it is *co-created* through countless, fragmented interactions. If a secret blueprint existed, it would have to be revised constantly to reflect these negotiations. Accordingly, there is no blueprint, nor even an official map of the BRI; indeed, Beijing banned unofficial maps in 2017 (Narins and Agnew, 2019).

Other governments’ interest in participating in the BRI may be shaped by need, greed, or some combination thereof. Developing countries urgently require infrastructure development to generate economic growth and improve living standards, which, in turn, ruling elites often need to ensure in order to avoid social unrest and maintain domestic legitimacy. The World Bank estimates that \$97 trillion of infrastructure investment is needed worldwide by 2040, with a projected shortfall of \$18 trillion (Heathcote, 2017). China’s BRI therefore corresponds to a genuine need – one neglected by Western and multilateral development agencies for decades, in favour of ‘good governance’ programmes.

However, infrastructure projects also create opportunities to cultivate political support, feed patronage networks, and obtain financial inducements (kickbacks). Extensive research demonstrates that ruling elites frequently direct development spending and infrastructure projects towards their own ethnic or geographic base (see Burgess et al., 2012; Barthel et al., 2013; Do et al., 2016). Research on Chinese projects shows they are vulnerable to regional favouritism and can easily be exploited for political gain (Bräutigam, 2009; Mthembu-Salter, 2012; Dreher et al., 2014). Construction is a notoriously corrupt sector, with an estimated 10–30 per cent of project costs being misappropriated annually worldwide (Matthews, 2016). Ruling elites can insert their associates into megaprojects as subcontractors to maintain their loyalty and potentially extract kickbacks and bribes. Our case studies on Sri Lanka and Malaysia demonstrate both dynamics.

This need and greed, and associated political contestation, very often overwhelm rational development planning, generating projects of dubious economic viability with substantial negative political, social and environmental implications. Many developing countries have limited capacity to assess projects’ viability or ensure their appropriate governance, and bureaucratic niceties are often overridden by powerful interests. For example, Pakistani interest groups’ wrangling has repeatedly changed the route and scope of the CPEC, with many additional projects being added on, some of which appear commercially unviable (Rafiq, 2017: pp. 15–21). Plans for the development of facilities at the Pakistani port of Gwadar, for example, seem likely to generate surplus capacity, given stiff competition from the port at Karachi, also in Pakistan, and the Indian-backed Chabahar port in Iran (Rafiq, 2017: pp. 23–32).

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Thus, rather than debt-trap diplomacy, bumps on the Belt and Road are typically caused by the intersection between powerful interests and associated governance shortcomings on the Chinese and recipient sides. Chinese SOEs’ desperate need for contracts, and weak governance of development financing, coupled with poor planning or venal interests in recipient countries, are generating badly conceived projects that replicate China’s surplus capacity crisis. For example, the 12,000-km China–Europe railway is reported to have up to 45 per cent surplus capacity on the return journey, rendering it loss-making without Chinese government subsidies of \$1,000–\$7,000 per container (Hillman, 2018). A \$3.2 billion, Chinese-backed railway line in Kenya is also reportedly loss-making, while the \$4.5 billion Djibouti–Addis Ababa line has encountered so many financial and operational difficulties that Sinosure, which insures Chinese outbound investment, has written-off \$1 billion in related losses, its chief economist describing the due diligence process on the project as ‘downright inadequate’ (Pilling and Feng, 2018). The \$62 billion CPEC has also been widely described as a ‘corridor to nowhere’, with fewer than a third of projects having been completed to date. At Gwadar, for example, the port is reportedly barely used; construction of an airport (which would have been Pakistan’s largest) has still not begun after six years of delays; and an industrial park sits empty (Prasso, 2020). Understandably, some recipients of Chinese development financing are experiencing cold feet. Tanzania has cancelled a \$10 billion port project, Nepal, the construction of two hydropower dams, and Sierra Leone, a project to build a new airport at Mamamah, outside the capital Freetown; Kenya has suspended a \$2.6 billion highway; and Myanmar has downsized the Kyaukpyu port project from 10 berths to two, cutting the cost of construction from \$7.3 billion to \$1.3 billion.

Chinese elites increasingly recognize these problems. In August 2017, Beijing tightened restrictions on outbound investment because, as the governor of China’s central bank complained, some SOEs’ investments ‘do not meet our industrial policy requirements [...] they are not of great benefit to China and have led to complaints abroad’ (Feng, 2017). Real estate and entertainment investments, for example, had to be banned completely, amid fears that wealthy individuals were exploiting the BRI to facilitate offshore capital flight. In 2018, President Xi conceded that the BRI had operated only within loosely sketched guidelines and needed a tighter focus, better-quality projects, and a greater degree of party oversight (Zheng, 2018). Xi also established the China International Development Cooperation Agency (CIDCA) in March 2018, to improve inter-agency coordination. However, CIDCA’s ambit is limited to ‘aid’ projects, excluding the far wider development financing field. Moreover, it is only a coordinating body with around 100 personnel, led by an ex-NDRC official, suggesting a continued commercial orientation. Its impact is still unclear, with experts close to the process bemoaning a ‘half-done revolution’ (interviews, May 2018). Chinese officials have also intensified ‘soft power’ charm offensives to address increasing societal resistance to the BRI in partner countries (Rolland, 2019; Zou and Jones, 2019).

Having outlined the pathologies of Chinese development financing, which clearly vitiate the strategic use of economic statecraft and debt-trap diplomacy, we can now examine how these play out in two key BRI partner countries: Sri Lanka and Malaysia.

## 4. Sri Lanka and the BRI

The debt-trap diplomacy thesis arose directly from Sri Lanka’s experience, making it a crucial test case.<sup>2</sup> The conventional account is that China lent money to Sri Lanka to build a major port at Hambantota on Sri Lanka’s southern coast, knowing that Colombo would experience debt distress, and that this allowed Beijing to seize the port in exchange for debt relief, permitting its use by the Chinese navy (Chellaney, 2017). Indian commentators frequently argue that China is using the BRI to pursue ‘strategic ambitions’ in South Asia, in this case ‘creating a Chinese naval outpost’ as part of a ‘salami-slicing approach’, and arguing that ‘there is little doubt that China’s leadership would seek to leverage its possession for strategic gains’ (Singh, 2018). Hambantota is thus presented as ‘part of a larger modus operandi’, as US analyst Constantino Xavier has put it, ‘Beijing typically finds a local partner, makes [them] accept investment plans that are detrimental to their country in the long term, and then uses the debts to either acquire the project altogether or to acquire political leverage in that country’ (Stacey, 2017). Similar accounts abound throughout the media, and across a wide range of think-tank and academic literature.

As this section shows, there are many misconceptions in this conventional narrative. First, the Hambantota Port project was not proposed by China, but by the government of former Sri Lankan President (and current Prime Minister) Mahinda Rajapaksa, in cooperation with a profit-seeking Chinese SOE. Second, it was a commercial, not a geostrategic, venture, but one which created vast surplus capacity due to governance problems in Sri Lanka. The port was one of several ‘white elephant’ projects promoted by Mahinda Rajapaksa as part of a corrupt and unsustainable developmental programme. Third, Sri Lanka’s debt distress was unconnected to Chinese lending, arising instead from excessive borrowing on Western-dominated capital markets and from structural problems within the Sri Lankan economy. Fourth, there was no debt-for-asset swap. Rather, after bargaining hard for commercial reasons, a Chinese SOE leased the port in exchange for \$1.1 billion, which Sri Lanka used to pay down other debts and boost foreign reserves. Fifth, Chinese navy vessels cannot use the port, which will instead become the new base of Sri Lanka’s own southern naval command. All these problems arose not from a carefully crafted top-down strategy, but rather as a result of the dynamics described in chapters 2 and 3 of this paper.

### The origins of Hambantota Port

The Hambantota Port project originated not in the minds of Chinese strategists, but rather in those of Sri Lankan developmentalists. The idea of building a deepwater harbour there originated in the 1970s, conceived by local parliamentarian D. A. Rajapaksa (SLPA, 2010). In 2001, one of his sons, Mahinda, then minister with responsibility for ports, gazetted the port and commissioned a feasibility study, but this judged the location to be unsuitable (SLPA, 2010; Wijenayake, 2017). Nonetheless, it was included in the government’s 2002 ‘Regaining Sri Lanka’ development strategy (Government of Sri Lanka, 2002). After becoming prime minister in April 2004, Mahinda Rajapaksa commissioned another feasibility study, but was deterred by projected costs. However, in 2006, another feasibility study, by Danish firm Rambøll, found that a first phase would be commercially



viable (Rithmire and Li, 2019: p. 8). This persuaded the Sri Lankan Ports Authority (SLPA) to champion the project, which was finally green-lighted in 2007 (SLPA, 2010). The government then began seeking international backers.

The Hambantota Port project, together with other infrastructure projects, reflected both need and greed. Sri Lanka has a serious infrastructure gap – estimated at \$36 billion in 2014 – and post-2006 pledged Chinese investment eventually covered one-third of this (Wignaraja et al., 2020: p. 8). However, these plans also reflected Mahinda Rajapaksa’s wish to direct resources to his home district, and the wider region, where his Sri Lanka Freedom Party faced a mounting opposition challenge (US Embassy, 2007a). Alongside the port development came ambitious plans for road and railway links, a new airport (the largest in South Asia), and a new airline. As early as 2006, US diplomats observed that political motives were overriding rational development planning:

Rajapaksa [...] has chosen large projects that will attract a lot of attention and praise for him and his party. Unfortunately, little thought has been put into what Hambantota District actually needs, what types of projects would provide jobs that locals can fill, and what would raise standards of living. There is no strategic approach to developing the region and no coordination between the agencies responsible for the different projects. There also seems to be a lack of understanding, even within the business community, that a certain level of demand and investor interest is necessary for some of these projects to be successful. An empty port, an empty airport, and an empty vast convention center would not generate the benefits that Hambantota needs [...] (US Embassy, 2006).

These projects also serviced a corrupt and increasingly authoritarian network centred on the president’s family. The government assigned infrastructure projects to regime-linked cronies, while cramming key agencies with loyalists to mute bureaucratic objections and facilitate off-balance-sheet borrowing by state-owned companies and private banks (Kelegama, 2017: pp. 441, 446–7). The company responsible for building Hambantota Port also allegedly funnelled at least \$7.6 million to affiliates of Mahinda Rajapaksa, to assist his 2015 bid for re-election to the presidency (Abi-Habib, 2018).

Reflecting the recipient-driven nature of Chinese development financing, Chinese involvement in Hambantota was initiated by Colombo, not Beijing. In 2007, Sri Lanka made an ‘open request for funding’, apparently also directly approaching India, but only China responded favourably (SLPA, 2010). As Rajapaksa stated in 2009, ‘I asked for it. [...] It was not a Chinese proposal. The proposal was from us; they gave money. If India said, “Yes, we’ll give you a port”, I will gladly accept. If America says, “We will give a fully equipped airport” – yes, why not? Unfortunately, they are not offering to us’ (Thotham, 2009). Similarly, Sri Lanka’s ambassador to China subsequently insisted:

[...] Sri Lanka asked for this project loan on our own. We were not forced to get this loan. [...] It is very unfair to blame China or [EXIM Bank] or the firms that constructed the Hambantota port. [...] It is a decision taken by the government of Sri Lanka [...] if something was wrong in the decision, we are responsible (Global Times, 2018).

However, reflecting the dynamics described in Chapter 2 of this paper, China’s engagement was also shaped by profit-seeking SOEs. Colombo’s application for Chinese funding was strongly encouraged by China Harbour Engineering Group (CHEG), which had been implementing Chinese-funded reconstruction projects in Sri Lanka in the aftermath of the December 2004 Indian Ocean earthquake and tsunami. Seeking more lucrative opportunities, CHEG lobbied the Rajapaksa government to transform an initially modest plan to expand Hambantota’s fishing harbour into a megaproject, offering free feasibility studies and exaggerating the likely economic benefits (Zhu, 2015: pp. 7–8). The contract was also shaped by SOE competition, which manifested within the Sri Lankan regime itself. Although CHEG was well placed, given its early involvement, the Chinese hydropower

construction company Sinohydro also pursued the contract. In 2007, the country’s former minister of ports and aviation reportedly stated that both companies recruited brothers of the president to separately press their different cases, resulting in the contract being shared between them (US Embassy, 2007b). Such rivalry between SOEs again suggests little strategic coordination on the Chinese side, but rather implies profit-seeking behaviour.

As with many other Chinese-backed projects,<sup>3</sup> Hambantota Port turned out not to be commercially viable, generating massive surplus capacity and losses for the SLPA. The first phase was built between 2008 and 2010, followed by a second stage designed to make the port South Asia’s largest by 2014. In reality, the port was barely operational, with usage actually declining year-on-year (see Table 2). In 2016, it took just \$11.8 million in revenue, versus operating expenses of \$10 million (Grey, 2018). Sri Lanka’s finance ministry reportedly estimated the port’s total losses at \$230 million for 2011–16 (Aneez, 2017). Local experts place the blame squarely on the government’s ‘incompetence and disregard of any commercial sense’ (Kulamannage, 2018). They cite its premature opening of the port to celebrate Rajapaksa’s birthday in 2010, despite the fact that a large rock still blocked entry to the harbour, and the government’s failure to secure investors able to provide ‘the services needed to operate a non-containerised port’; in short, ‘everything was bungled’ (ibid.). Moreover, Colombo’s response was to seek even more Chinese investment. In September 2014, CHEC and China Merchants Port Holdings (CMPort) agreed to jointly develop and run a new container terminal under a supply-operate-transfer model. The SOEs would take a 65 per cent equity stake, supply the necessary equipment, and operate the terminal for 35 years, during which 35 per cent of the revenue would be used to repay EXIM Bank, before Hambantota was returned to the SLPA (Rithmire and Li, 2019: p. 9).<sup>4</sup>

**Table 2: Usage of Hambantota Port 2014–18**

	2014	2015	2016	2017	2018
Number of ships	335	295	281	230	270
Cargo ('000 tonnes)	474	293	355	213	494

Source: Department of Census and Statistics (2017: p. 65; 2019: p. 65).

## Sri Lanka’s debt crisis

By 2014, Rajapaksa’s debt-fuelled programme of economic stimulus was collapsing amid unsustainable debts. The regime’s mismanagement, authoritarianism and corruption were major electoral issues in 2015, resulting in Rajapaksa losing the presidential election to Maithripala Sirisena. The new president turned to the IMF for assistance, agreeing a \$1.5 billion stabilization package in June 2016.

Sri Lanka’s debt crisis was made, not in China, but in Colombo, and in the international (i.e. Western-dominated) financial markets. By 2016, 61 per cent of the government’s sustained budget deficit was financed by foreign borrowing (Central Bank of Sri Lanka, 2016: p. 69), with total government debt increasing by 52 per cent between 2009 and 2016, to Rs. 9.4 trillion (\$64.5 billion). Of this, 34.2 per cent (\$22 billion) comprised external borrowing, while debt servicing absorbed 44 per cent of government revenues (Central Bank of Sri Lanka, 2016: p. iv).

<sup>3</sup> The Mattala Rajapaksa International Airport at Hambantota, and the nearby international cricket stadium, also proved highly unprofitable.

<sup>4</sup> Sri Lanka cancelled this agreement in December 2016.

Rajapaksa’s borrowing-and-spending spree was facilitated by low global interest rates caused by the policy of quantitative easing favoured by many Western central banks. Three-quarters of external government debt was owed to private financial institutions, not to foreign governments (IMF, 2017: p. 35). But this borrowing was unsustainable given Sri Lanka’s persistent current account deficit, reflecting a widening trade deficit, low competitiveness and weak inward investment. However, despite ample warnings, foreign creditors kept lending, while the government refused to change course for political reasons (Kelegama, 2017: pp. 437–9).

The debt crisis was precipitated by the winding-down of quantitative easing in the US from 2013, which sharply increased Sri Lanka’s borrowing costs. From 2011–16, interest rates on Sri Lanka’s short-term borrowing doubled, to around 10 per cent, while long-term rates increased from 7–8 per cent to 11–13 per cent; meanwhile, the rupee fell 36 per cent against the dollar, further increasing repayment costs (Central Bank of Sri Lanka, 2016: p. 32; IMF, 2017: p. 19). Failed efforts to defend the currency shrank Sri Lanka’s foreign reserves to just \$6 billion by 2016, below the demands on foreign currency in 2017 (IMF, 2017: p. 5). With over 58 per cent of Sri Lanka’s government debt being denominated in dollars, Colombo faced being unable to repay or ‘roll over’ (extend) its loans, with \$17 billion being required from 2019–23 (Central Bank of Sri Lanka, 2016: p. 14; IMF, 2017: p. 6; Wheeler, 2020).

**Table 3: Ownership of Sri Lankan government external debt 2007–16 (\$ billion, at current exchange rates)**

	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016	% share of total (2016)
<b>Multilateral</b>	<b>5,531</b>	<b>5,706</b>	<b>5,786</b>	<b>5,969</b>	<b>6,529</b>	<b>6,617</b>	<b>7,000</b>	<b>6,801</b>	<b>7,320</b>	<b>7,395</b>	<b>27</b>
Asian Development Bank	2,782	2,933	2,998	3,174	3,468	3,514	3,710	3,613	3,929	3,913	14
International Development Association (World Bank)	2,464	2,469	2,471	2,487	2,734	2,743	2,891	2,781	2,879	2,869	10
<b>Bilateral</b>	<b>5,376</b>	<b>6,153</b>	<b>5,957</b>	<b>6,538</b>	<b>7,623</b>	<b>8,118</b>	<b>6,378</b>	<b>6,075</b>	<b>6,543</b>	<b>6,496</b>	<b>23</b>
Japan	3,121	3,941	3,713	4,236	4,785	4,291	3,629	3,189	3,367	3,340	12
India	141	141	156	153	379	614	797	919	1,011	977	4
China*	216	274	406	499	538	528	520	672	863	904	3
<b>Financial markets</b>	<b>1,726</b>	<b>1,514</b>	<b>3,573</b>	<b>5,399</b>	<b>6,915</b>	<b>6,952</b>	<b>9,558</b>	<b>10,967</b>	<b>12,223</b>	<b>13,899</b>	<b>50</b>
China EXIM	–	–	–	–	–	–	–	1,120	684	1,665	6
Other	1,445	1,366	3,535	5,366	6,884	6,925	9,534	9,825	10,782	12,218	44
International sovereign bonds	518	522	995	1,963	3,091	3,488	3,546	5,018	7,052	8,386	30
<b>Total</b>	<b>12,633</b>	<b>13,373</b>	<b>15,316</b>	<b>17,906</b>	<b>21,067</b>	<b>21,687</b>	<b>22,937</b>	<b>23,843</b>	<b>26,086</b>	<b>27,791</b>	<b>100</b>

Source: Calculated from Central Bank of Sri Lanka (2016: p. 63).

Note: \*Excludes loans to SOEs.

Although data irregularities make it hard to establish China’s share of Sri Lankan debt, it was relatively small. Excluding borrowing by Sri Lankan SOEs, Chinese loans comprised just 9 per cent of Sri Lankan government debt by 2016 (see Table 3). Moreover, with maturities of 15–20 years and interest rates averaging 2.5 per cent, these were far less pressing than other foreign loans (Weerakoon and Jayasuriya, 2019). Wheeler (2020) estimates that instalments due to EXIM Bank comprised just 5 per cent of the government’s annual debt-servicing payments. The Chinese loans for Hambantota Port specifically totalled \$1.3 billion (see Table 4), i.e. just 4.8 per cent of the government’s total

external debt (excluding SOEs). According to one source, in 2016 repayment costs for Hambantota Port were \$67.5 million (see Table 5), i.e. just 3.3 per cent of the total cost (\$2.03 billion) of foreign debt servicing in that year (Central Bank of Sri Lanka, 2016: pp. 16–8). According to slightly higher figures announced in January 2017 by Ravi Karunanayake, Sri Lanka’s Minister of Finance, from 2011 to 2016 the government ‘lost’ a total of Rs. 31.4 billion (\$215.6 million) through ‘loan instalments and interests’ for the port project, with Rs. 10.6 billion (\$73.2 million) being ‘needed to service this debt in 2018’ (Mudalige, 2017). Even using these higher values, it is clearly absurd to claim that Hambantota Port, or even Chinese lending in general, caused Sri Lanka’s debt crisis. The government’s desire to offload the port – and other loss-making ventures, like the Hambantota airport – seems instead to reflect the terms of Sri Lanka’s IMF ‘bailout’, which demanded reducing the losses of five SOEs, including the SLPA (see IMF, 2017: p. 12).

**Table 4: Loans from China EXIM Bank for Hambantota Port, 2005–13**

Year	Amount (\$ million)	Type	Interest rate (%)	Maturity (years)	Grace period (years)	Grant element (%)*
2005	307	Loan	6.3	15	4	21.6
2009	77	Loan	n/a	15	3	n/a
2012	600	Export credits	2	13	6	54.6
2012	158.35	Loan	2 + 1% fees	19	6	54.6
2012	51	Buyer’s credit loan	4.69 (LIBOR 06 + 4%) + 1.6% fees	15	4	31
2013	147	Loan	6.3	20	5	25
<b>Total</b>	<b>1,340.35</b>					

Source: Based on data from Dreher et al. (2017).

Note: n/a = not available. \* The grant element percentage measures the concessionality level of a flow, using OECD methodology or, where data are insufficient, taking into account the discount rate, annual repayments and type of repayment.

**Table 5: Hambantota Port loan repayments 2010–17 (\$ million)**

Year	Interest	Principal
2010	7.5	0
2011	18.3	0
2012	21.7	0
2013	25.4	0
2014	31.3	30.8
2015	34.7	33.8
2016	33.7	33.8
2017 (Jan.–Jun.)	16.2	16.9

Source: Sautman and Yan (2019a: p. 3).

## The Chinese ‘bailout’

The usual account of subsequent events has been that, given Sri Lanka’s inability to repay China’s EXIM Bank, Colombo was forced into a ‘debt-equity swap’, ceding ownership of Hambantota Port to China in exchange for debt relief. Both parts of this story are simply untrue. Ownership was not transferred, and no debt was forgiven. A Chinese SOE paid Sri Lanka to lease the port, providing Colombo with liquidity so that it could repay Western creditors; the debt to China remained in place. Claims that China ‘seized’ the port to extend its naval reach are likewise false.

In 2016, to raise urgently needed US dollars, the Sri Lankan government asked Japanese and Indian firms (unsuccessfully) to lease Hambantota Port, and also ‘lobbied hard’ in China (Sautman and Yan, 2019b). Sri Lanka’s ambassador to Beijing said that the ‘Chinese government never asked [us] to hand over the port [...] this proposal came from Sri Lanka, asking [for] partnership from China’ (CGTN, 2018). According to Minister of Ports and Shipping Mahinda Samarasinghe, Sri Lankan Prime Minister Ranil Wickremesinghe asked President Xi to provide financial aid or to take a majority equity stake in the port; Xi refused, but promised to help find an investor (Rithmire and Li, 2019: p. 10). This led to a lease agreement between the Sri Lankan government and CMPort in July 2017. Samarasinghe stated, ‘We thank China for arranging this investor to save us from the debt trap’ (Sirilal and Aneez, 2017).

The agreement’s terms are partially revealed through CMPort’s statutory disclosures to the Hong Kong Stock Exchange (CMPort, 2017b; 2017c). The SLPA agreed to create two subsidiaries: Hambantota International Port Group (HIPG), which would develop and operate the port under a 99-year lease from SLPA (which remained the port’s legal owner), and Hambantota International Port Services (HIPS), which would run common user facilities. The SLPA agreed to sell 85 per cent of HIPG’s shares to CMPort for \$973.7 million; HIPG would in turn purchase 58 per cent of HIPS’s shares. CMPort also agreed to invest an additional \$146.3 million, the exact use of which would be decided jointly with the government of Sri Lanka within one year.

Although Xi may have helped to ‘arrange’ this investment to support bilateral ties, CMPort clearly prioritized its commercial interests. As Wickremesinghe stated in a speech in June 2018, CMPort would not ‘[take] over the Port as charity. It had to be made a viable business model’ (Imtiaz, 2018). Sri Lankan government officials are reported to have claimed that CMPort disputed the port’s valuation and demanded an additional 15,000-acre site for an adjacent industrial zone in exchange for its investment (Abi-Habib, 2018). This was necessary for CMPort’s longstanding ‘port-park-city’ business model, whereby industrial parks and real estate are developed alongside ports to generate cargo throughput. After pursuing this model to the point of oversaturation in China, CMPort had externalized this approach, as part of a commercially driven international expansion seeking new resources, expertise, markets and distribution networks (Huo, Zhang and Chen, 2018: p. 72). CMPort had acquired a 49 per cent stake in a French port operator in 2013, followed by investments in Brazil, Djibouti and Australia, including a 99-year lease on the Australian port of Newcastle (Bloomberg, 2018; CMPort, 2019b; Bräutigam, 2020: p. 9).<sup>5</sup> Thus, far from being a one-off transaction as part of a plot to ‘grab’ a particular port, CMPort’s investment was part of a wider corporate strategy of overseas expansion, exploiting the ‘development opportunities arising from the “Belt and Road” initiative’ for its own purposes – as expressed in company documents published well in advance of the Hambantota deal (CMPort, 2017a: pp. 22–3). By 2018, overseas ports already accounted

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<sup>5</sup> Lengthy leases are normal in the port sector, where a large-scale investment can take two decades to yield a return. For example, Australia has leased one port (Melbourne) for 50 years and five for 98–99 years, with another 99-year lease proposed (Sautman and Yan 2019a, p. 3).

for 18.9 per cent of the group’s total container throughput (CMPort, 2019b). CMPort faces formidable challenges in making Hambantota profitable, but is courting investors and managed to increase bulk cargo throughput from 81,000 to 455,000 tonnes in the first half of 2019, while wheeled volume increased 57.6 per cent year-on-year (CMPort, 2019a).

CMPort thus only leased the port, not taking formal ownership, and Sri Lanka did not receive debt relief as part of the agreement. CMPort’s investment was used to stabilize foreign reserves and service non-Chinese debt. The central bank’s deputy governor reportedly stated, ‘from 2019 onwards, several international and domestic sovereign bonds are set to mature and this is a problem’. The deputy governor noted that ‘[t]he additional Chinese money [...] will help us manage our short-term liabilities [and] help the Central Bank manage its foreign reserves’ (Imtiaz, 2017). Based on interviews with Sri Lankan policymakers, including the Central Bank governor and his predecessor, Sautman and Yan (2019b) conclude that the CMPort investment was ‘not used to repay port-related debt, but to pay off more expensive loans, generally to Western entities’. Moreover, the ‘loans obtained [from China] to construct [Hambantota] port were not written off and the government is still committed to loan repayments as per the original agreements’ (Moramudali, 2019).<sup>6</sup> In July 2018, Minister of Ports and Shipping Samarasinghe confirmed that the debt obligation still existed, but had been shifted from the SLPA to the Treasury, enabling the SLPA to report higher profits (Nafeel and Ables, 2018) – as required by the IMF bailout.

Finally, the claim that China could use Hambantota as a naval base is clearly erroneous. Sri Lankan politicians and diplomats have repeatedly insisted that this never featured in their discussions with Beijing. As Sri Lanka’s ambassador to China has stated flatly, ‘China never asks us. We never offered it’ (CGTN, 2018). The SLPA–CMPort agreement assigned responsibility for port security to an oversight committee comprising the Sri Lankan navy and police, the SLPA, and the secretary to the minister of development strategies and international trade, with HIPG only being responsible for internal port security (Carrai, 2019: p. 1097). Several hundred Sri Lankan naval personnel are stationed at Hambantota and in 2018 it was decided to relocate the navy’s southern command to the port. There is no evidence of any Chinese military activity at or near Hambantota since CMPort’s lease began; conversely, there have been port visits by US and Indian naval vessels, and Hambantota port is subject to US Coastguard inspections under the International Port Security scheme (Wignaraja et al., 2020: pp. 25–6).

## Conclusion

This chapter has disproven the debt-trap diplomacy claims surrounding Hambantota Port. China did not propose the port; the project was overwhelmingly driven by Sri Lankan actors for their own domestic purposes, with some input from a Chinese SOE acting for commercial reasons. Sri Lanka’s debt trap was thus primarily created as a result of domestic policy decisions and was facilitated by Western lending and monetary policy, and not by the policies of the Chinese government. China’s aid to Sri Lanka involved facilitating investment, not a debt-for-asset swap. The story of Hambantota Port is, in reality, a narrative of political and economic incompetence, facilitated by lax governance and inadequate risk management on both sides.



## 5. Malaysia and the BRI

Malaysia’s United Malays National Organization (UMNO), the country’s main ruling party from 1957 to 2018, warmly embraced the BRI, signing a memorandum of understanding in 2015 and agreeing many controversial megaprojects. As with Sri Lanka, analysts branded this bilateral cooperation as debt-trap diplomacy: China was widely believed to be seeking military and strategic influence in the Straits of Malacca (Melaka), through which pass some 80 per cent of Chinese oil imports (Hutchinson, 2019), and angling for a railway ‘land bridge’ to circumvent the Straits altogether (Lim, 2018: p. 87). As with Hambantota, Chinese-funded port projects were reported to be linked to China’s ‘string of pearls’ strategy (Beech, 2018). The debt-trap narrative was further fuelled by claims that Beijing had inflated loans for the East Coast Rail Link (ECRL) and two gas pipeline projects in order to bail out the troubled sovereign wealth fund 1Malaysia Development Berhad (1MDB) (Wright and Hope, 2019).

The Pakatan Harapan (PH) coalition – which ousted the UMNO-dominated Barisan Nasional (BN) coalition in 2018 – accused China of ensnaring Malaysia in a debt trap in order to seize strategically significant assets (Hernandez, 2019: p. 75). In August 2018, Lim Guan Eng, the new minister of finance in the PH coalition, stated, ‘We don’t want a situation like Sri Lanka where they couldn’t pay and the Chinese ended up taking over the project’ (quoted in Beech, 2018). PH Prime Minister Mahathir Mohamad agreed, ‘They know that when they lend big sums of money to a poor country, in the end they may have to take the project for themselves’ (ibid.). Malaysia under the PH was thus seen to emblemize a growing ‘pushback’ against China’s expansionist plans, as the government suspended a number of key projects (Beech, 2018; Pomfret, 2018).

**The real issue here is not one of geopolitics, but rather – as in Sri Lanka – the recipient government’s efforts to harness Chinese investment and development financing to advance domestic political agendas, reflecting both need and greed.**

Yet, as in Sri Lanka, both the debt-trap and pushback narratives are flawed. Evidence for Chinese strategic direction and coordination of projects is scant; the initiatives were clearly driven primarily by commercial, economic and political imperatives in Malaysia. Evidence of a debt trap is even weaker, as the IMF (2018: pp. 41–2) judged Malaysia’s public debt to be ‘manageable’ in late 2017 and predicted it would decline steadily relative to GDP in the period to 2022. Malaysia’s supposed pushback was also rather modest. Only four BRI projects were suspended; others proceeded or were even revived from suspension. Even the ECRL eventually went ahead, albeit at reduced cost. The PH coalition also reasserted its support for the BRI and continued Malaysia’s economic engagement with China (Ngeow, 2019b: pp. 36–41).

The real issue here is not one of geopolitics, but rather – as in Sri Lanka – the recipient government’s efforts to harness Chinese investment and development financing to advance domestic political agendas, reflecting both need and greed. Malaysia’s economy has long depended on foreign investment and, as traditional sources dried up, the former government courted Chinese businesses to sustain both economic growth and UMNO’s performance legitimacy. However, UMNO also saw China’s BRI as an excellent opportunity to feed the politically important construction sector.

Dominated by large, government-linked companies (GLCs), the sector constituted the backbone of the patronage machine sustaining elite cohesion and UMNO’s electoral support among ethnic Malays (Lim, 2015, pp. 5–8). These GLCs received lucrative contracts, including through joint ventures with foreign companies, while project costs were systematically inflated, apparently to enable kickbacks and ‘donations’ for electoral purposes (Gomez et al., 2018).

Nonetheless, this construction spree did not precipitate a debt crisis. The only serious debt problem related to 1MDB, which borrowed vast sums of money through questionable deals, funnelling much of it back to Malaysia for political operations, with some RM 30 billion (\$7 billion) missing or misappropriated (Rewcastle Brown, 2018: Ch. 20). When this news broke in 2016, it imperilled the BN government’s survival. Prime Minister Najib Razak, of UMNO, and his business executive Low Taek Jho (Jho Low), therefore sought Chinese assistance, negotiating vastly inflated loans for the construction of the ECRL and two gas pipelines, a proportion of which would be siphoned off in order to bail out the heavily indebted 1MDB. While senior Chinese officials helped to broker this deal, it was instigated by Najib, not by the Chinese government, and Chinese lenders insisted on both commercial terms and sovereign guarantees to protect their interests. Their origins in Najib’s corruption explains why the PH government’s supposed pushback against the BRI was confined to these projects, and did not amount to a wider rejection of Chinese development financing.

## Explaining Malaysia’s thirst for Chinese projects

The claim has been frequently asserted that China foisted infrastructure projects on Malaysia for geostrategic purposes, laying a debt trap so that it could seize strategic assets at a later date. In reality, Chinese-backed projects in Malaysia were overwhelmingly non-strategic investments in the sectors of real estate, entertainment and industry, while port and railway projects were developed commercially by subnational actors on both sides.

Table 6 summarizes the most prominent Chinese-backed projects in Malaysia. It is impossible to establish precisely which of these constitute part of the BRI. In 2018, the Malaysian government itself asked China to identify which projects it considered BRI and non-BRI, but according to a PH minister interviewed by Malgeri (2019: p. 23) Beijing could not. This reflects the BRI’s non-strategic and poorly coordinated nature, and indicates a casual rebranding of many unrelated and long-standing projects as ‘BRI’ by opportunistic actors seeking political or monetary advantage.

The information contained in Table 6 debunks several of the myths that have been propagated around Malaysia’s BRI involvement. First, many projects predate the BRI, some by decades, and cannot therefore be seen as part of a strategy conceived in Beijing in 2013. Second, most projects are non-strategic, involving speculative real-estate investment, which Beijing banned in 2017. Third, the diversity of Chinese companies involved indicates commercially-driven relationships, based on mutual interest and expertise – not strategic direction from Beijing. Fourth, all the projects were initiated by Malaysian, not Chinese, actors, predominantly by private-sector and subnational governments. Fifth, only the pipelines and the ECRL were financed by loans from Chinese banks to the Malaysian government. Coupled with the Malaysian initiation of these schemes (discussed further below), this disproves claims that China sought to lure Malaysia into a debt trap in order to seize strategic assets.

## Debunking the Myth of ‘Debt-trap Diplomacy’: How Recipient Countries Shape China’s Belt and Road Initiative

**Table 6: Major Chinese-backed projects in Malaysia**

Project	Value/financing	Partners	Origins/instigators
<b>Bandar Malaysia:</b> underground city project containing financial, commercial and tourist facilities	RM 200 billion (\$47 billion)  Private commercial financing – Bank of China, Industrial and Commercial Bank of China (ICBC), CIMB Bank, Maybank, RHB  No sovereign debt	Malaysia: Iskandar Waterfront Holdings – joint venture between Credence Resources (private) and Johor state government’s investment arm  China: China Railway Engineering Company (national SOE)	Entirely private project, led by Malaysian partners
<b>Malacca Gateway:</b> three artificial islands, port, cruise terminal, industrial park, hotel	RM 41 billion (\$9.7 billion)  No sovereign debt	Malaysia: KAJ Development (private company); Malacca state government’s investment arm  China: Shenzhen Yantian Port Group (provincial SOE, added 2015); PowerChina International (national SOE, added 2016); Rizhao Port Group (provincial SOE, added 2017)	Spearheaded by KAJ Development and Malacca state government from 2009
<b>Forest City:</b> artificial island and housing for 700,000 people, aimed at Chinese market	RM 247 billion (\$58 billion)  No sovereign debt	Malaysia (40%): Esplanade Danga 88 Pty Ltd, owned 64.4% by Sultan of Johor, 20% by Johor state government investment arm  China (60%): Country Garden (private)	Private project
<b>Malaysia-China Kuantan Industrial Park and port:</b> upgrade to attract Chinese industrial investment	RM 6.5 billion (\$1.53 billion)  No sovereign debt	Malaysia (51%): Kuantan Pahang Holding (co-owned by Pahang state government; private firms S. P. Setia and Rimbunan Hijau, replaced by Sime Darby in 2014; and IJM, Kuantan port operator)  China (49%): Guangxi Beibu Gulf ASEAN Investment (subnational SOE consortium)	Pahang state government and Guangxi Zhuang Autonomous Region, with co-oversight from MOFCOM and Malaysia’s Ministry of International Trade and Industry
<b>Gemas-Johor Baru double-tracking rail project:</b> 197-km railway upgrade	RM 8.9 billion (\$2.1 billion)  Directly funded by Malaysian government	Malaysia (30%): SIPP, company linked to Sultan of Johor  China (70%): SOE consortium – China Railway Construction Company (40%), China Railway Engineering Company (30%), China Communications Construction Company (CCCC) (30%)	Malaysian government initiated 2002; scrapped 2003; revived 2007; final consortium approved 2016
<b>Trans-Sabah Gas Pipeline/Multi-Product Pipeline:</b> domestic gas and petrochemical pipelines	RM 4.53 billion and RM 4.06 billion (total \$2.02 billion)  85% EXIM Bank loan at 3.25% over 20 years, with sovereign guarantee; 15% by CIMB at 4.2% over 18 months	China (100%): China Petroleum Pipeline Bureau (subsidiary of national SOE)	Malaysian government initiated mid-2016
<b>East Coast Rail Link (ECRL):</b> 600-km railway connecting Pahang’s east-coast Kuantan Port to west-coast Port Klang	RM 55 billion (\$13 billion)  85% EXIM Bank loan at 3.25% over 20 years, with sovereign guarantee	Malaysia (30%): unspecified Malaysian partners  China (70%): CCCC (national SOE)	Malaysian government initiated 2016; first mooted in 1980s when Najib was chief minister of Pahang. Included in Malaysian development planning since 2007
<b>Kuala Lumpur–Singapore High Speed Railway (KLSHSR)</b>	Estimated RM 60 billion (\$14.2 billion) but never put to tender	Chinese companies among expected bidders, but project abandoned in 2018	Private-sector proposal in 2006, pursued by Najib government from late 2010

Sources: Ngeow (2019a); Bernama (2019); Liu and Lim (2019); Lampton, Ho and Kuik (2020: Ch. 4).

Rather than debt-trap diplomacy, this plethora of megaprojects is better explained by two domestic imperatives. First, the UMNO-dominated regime’s legitimacy rested for a long time on its capacity to deliver rapid economic growth, which in turn depended on high levels of foreign investment. Its engagement with China was simply an extension of this (Liu and Lim, 2019: p. 220). Secondly, megaprojects served the interests of powerful domestic constituencies. UMNO’s electoral success relied partly on gerrymandering, media controls and other authoritarian measures, but also on garnering support from the ethnic Malay community through targeted economic patronage. In practice, this involved cultivating a Malay business class entwined with UMNO (Gomez and Jomo, 1999). After the Asian financial crisis of 1997–98, patronage once dispensed through UMNO was increasingly centralized through federal government-linked investment companies (GLICs) under the Ministry of Finance – which has historically been under the prime minister’s control – enabling development spending to ‘serve political goals’ (Gomez et al., 2018: p. 226). Through GLIC investment and bailouts, most leading construction firms became government-linked companies (GLCs) – as did all private banks, which were then directed to support construction companies and other GLCs (Lim, 2015: pp. 8–10; Gomez et al., 2018: pp. 108–10). The construction sector thereby became a key component of the patronage system sustaining UMNO rule. The government dispensed lucrative, often inflated contracts, as well as cut-price land and permits; construction firms funnelled resources into UMNO ‘war chests’. The UMNO government thus welcomed Chinese investment as a means of sustaining this network, especially amid dwindling popular support in the 2008 and 2013 elections. As Table 6 shows, most BRI projects involved joint ventures between Chinese investors and Malaysian GLCs (Liu and Lim, 2019: p. 221).

## The wheels come off: 1MDB and the BRI

This mutually beneficial arrangement was disrupted, not by a generalized debt crisis, but rather by the 1MDB scandal. Established in 2009, ostensibly to finance domestic development, 1MDB was a staggeringly corrupt UMNO ‘slush fund’, which unravelled in 2014–16. Newspaper reports that China helped to bail out 1MDB in late 2016 through a corrupt, \$34 billion deal to build two pipelines and the ECRL (Wright and Hope, 2019) were later confirmed in testimony at the trial of ex-Prime Minister Najib (Amhari, 2019). This fuelled debt-trap diplomacy accounts, because the ECRL was depicted as a strategic Chinese move to circumvent the Straits of Malacca (Lim, 2018: p. 87). However, the available evidence suggests that, as in Sri Lanka, Chinese involvement was again solicited by corrupt Malaysian elites, rather than reflecting a deliberate Chinese strategy. Malaysia’s debt distress was also self-inflicted, well before China became involved.

With extensive support from Western consultants, auditors and banks, 1MDB borrowed heavily on domestic and global markets, then used shell companies to funnel money to Malaysia – including to Najib’s private bank account – for personal and political use (Rewcastle Brown, 2018; Amhari, 2019). By 2014, 1MDB was effectively bankrupt, owing \$12.7 billion, with urgent debt repayments due (Rewcastle Brown, 2018: Ch. 11). In February 2015, 1MDB announced it was to wind down its operations. Official investigations followed which, despite Najib’s efforts at sabotage, revealed that around RM 30 billion (\$7 billion) had been misappropriated. This prompted widespread uproar, not only from opposition parties but also within UMNO, led by former Prime Minister Mahathir (Rewcastle Brown, 2018: Ch. 20).

Najib sought Chinese help to cover up the scandal. Effectively, he offered vastly inflated contracts to Chinese SOEs, financed with sovereign debt, in exchange for which the same SOEs were either to directly assume 1MDB’s debts, or to funnel part of their income to repay 1MDB’s loans. On 28 June 2016, Najib’s special officer Amhari Efendi Nazaruddin and Jho Low (Najib’s principal co-conspirator in the 1MDB scandal) met senior Chinese officials in Beijing, including SASAC Chairman Xiao Yaqing, to seek ‘investment to help repay 1MDB’s debts’ (Amhari, 2019; Wright and Hope, 2019). According to minutes leaked to the *Wall Street Journal*, Jho proposed awarding the ECRL project to CCCC in exchange for the SOE assuming \$4.78 billion of 1MDB debt. A Chinese official worried this would be ‘very noticeable’, though Xiao reportedly claimed that President Xi and Premier Li Keqiang had ‘approved’ the deal in principle (Wright and Hope, 2019). If true, this would reflect the manner in which senior Chinese leaders make broad decisions about helping diplomatic partners, but leave it to others to plan the implementation of such decisions in detail.

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Amhari (2019) states that Jho ‘finalised an agreement’ with SASAC and ‘China’s SOE’ (i.e. CCCC) the next day. Jho then appointed former 1MDB finance director Terence Geh Cho Heng to develop a ‘China-Malaysia Economic Programme’, which packaged together the ECRL and two pipelines (ibid.). On 18 July, the two sides agreed that CCCC would make surreptitious payments that ‘would be indirectly used to repay 1MDB debt’ (Amhari, 2019; Wright and Hope, 2019). On 22 September, Amhari and Jho met the SASAC vice-chairman and EXIM Bank vice-president to finalize arrangements. The minutes of this meeting recorded their agreement to proceed ‘even though “[the projects] may not have strong project financials.” Participants need not “waste time studying the actual project financials to see if they can sustain the debt, etc.,” because Malaysia’s government backed the deal for strategic reasons’ (Wright and Hope, 2019).

Other evidence supports this account. In late July 2016, a cabinet paper leaked to the Sarawak Report blog indicated that the contract ‘price tag’ of the ECRL was being deliberately inflated from RM 30 billion (\$7 billion) to RM 60 billion (\$14 billion), making it 120–140 per cent costlier than comparable projects (Malaysiakini, 2016). The paper documented CCCC’s profits and its agreement to funnel money through shell companies to help repay 1MDB’s debts, and to assume \$4.78 billion of 1MDB debts between 2016–22 in exchange for largely fake ‘assets’ valued at \$5.63 billion (Rewcastle Brown, 2018: Ch. 37). It also recorded CCCC’s agreement to bail out two front companies owned by Jho Low. The details broadly map onto Amhari’s (2019) account of the deal, and the final project cost was indeed vastly inflated, at RM 55 billion (\$13 billion).

Najib authorized massive, highly irregular upfront payments to CCCC to facilitate the 1MDB bailout. By 2018, RM 29.5 billion (\$6.95 billion) of the RM 65.4 billion (\$15.4 billion) total cost of ECRL and the pipelines had already been dispensed, despite very limited progress; as Gunasegaram (2018) observes, ‘These deals were structured in this way to help 1MDB cover the holes caused by theft of [...] around RM 30 billion’. In August 2017, a Cayman Islands-registered, China-based company, Silk Road Southeast Asia Real Estate, made one of the payments described in the leaked cabinet paper, just days before a major 1MDB debt repayment was due (Amarthalingam, 2018;

Malaysiakini, 2018a). Later, Malaysia’s Anti-Corruption Commission confirmed that in August 2017 RM 1.2 billion (\$280 million), paid up front to Chinese contractors for the ECRL and pipelines, was secretly funnelled back to Malaysia to repay 1MDB loans (Hariz, 2018).

These events, while undoubtedly distasteful, do not fit the debt-trap diplomacy narrative. China did not ensnare Malaysia in unsustainable debt in order to build, then capture, strategic infrastructure in that country. Rather, the UMNO-led regime caught itself in a debt trap – facilitated, as in Sri Lanka, by Western financial intermediaries – then sought Chinese help. Beijing did not promote projects of strategic utility for China: the Malaysian government proposed the projects involved, and the main infrastructure project – the ECRL – had been part of Malaysian development planning for almost a decade prior to its initiation in 2016. Nor did the deal involve unsustainable debt. Malaysia’s debt-to-GDP ratio had risen sharply in 2009–18, from 54.5 per cent to 64.7 per cent, prompting concern from the IMF and ratings agencies (Bank Negara Malaysia, 2019: pp. 47–48). However, the IMF states that this was caused not by discretionary borrowing but rather – and similarly to Sri Lanka – by the use of cheap credit, fuelled by quantitative easing, to cover fiscal deficits, followed by rising interest rates and falling oil prices. Moreover, government borrowing had peaked in 2016; its debt-to-GDP ratio was predicted by the IMF to fall to 54 per cent by 2022; and government debt would ‘remain manageable under a variety of shocks’ (IMF, 2018: pp. 41, 43, 50–51). The Malaysian government never fell into debt distress and there has been no prospect of any asset seizures. Indeed, the attraction of the ECRL and pipeline deal to Chinese SOEs, the SASAC and EXIM Bank was presumably that Chinese entities would *not* be involved beyond providing lucrative turnkey projects, with all the operational and financial risks being shouldered by the Malaysian government. If President Xi and Premier Li really did approve the deal, it was likely to further cement ties with a friendly (and apparently secure) regime; an opportunistic, reactive move, not the implementation of a strategy to build and then seize assets useful to China.

## Pakatan Harapan’s limited pushback

The foregoing account explains why the PH government’s pushback against the BRI has been far more limited than conventional narratives suggest (Ngeow, 2019b). Notwithstanding heated campaign rhetoric about Najib ‘selling’ Malaysia to China, and Prime Minister Mahathir’s subsequent criticism of Chinese ‘imperialism’, the PH coalition overwhelmingly blamed the Najib regime for these events, and its pushback focused on the 1MDB-linked deals, not the BRI itself.

After the 2018 election, PH politicians clearly placed the blame for controversial projects with their UMNO predecessors, not with China, while quickly reaffirming Malaysia’s general support for the BRI. Mahathir, for example, argued, ‘This is our own people’s stupidity. We can’t blame the Chinese for that’ (Malaysiakini, 2018b). He also changed his tune on the BRI, expressing an understanding remarkably similar to that conveyed in this report:

At the beginning, we thought that the BRI was for China to dominate in ASEAN and Asia because the BRI is the passageway for trade through the Straits of Malacca and South China Sea, and we had believed China wanted to gain control [... Now we realize this] initiative is not being dominated by China. The suggestions are not only from China, but also views from other countries. This will be a creation by all involved nations... I have more understanding and this makes it easier for us to support [it.] (Wong, 2019.)



The PH government’s pushback was limited to 1MDB-linked projects as it sought to unravel Najib’s patronage network, putting the former prime minister on trial in October 2018 on six counts of criminal breach of trust over 1MDB.<sup>7</sup> In July 2020, Najib was found guilty of all charges and sentenced to 12 years in prison and a RM 250 million (\$50 million) fine. Work on the pipelines and the ECRL was immediately suspended, but other projects were unaffected. Daim Zainuddin, a Mahathir confidante and former UMNO finance minister, was sent to Beijing for talks, apparently initially seeking to cancel the suspended projects. However, the Chinese apparently ‘bargained hard’, with CCCC reportedly seeking to resolve the dispute as a commercial, business-to-business matter, while the Malaysians sought a government-to-government resolution (Malgeri, 2019: p. 31). In addition to the RM 29.5 billion (\$6.95 billion) already disbursed, cancelling the ECRL would also have entailed a huge termination penalty of RM 21.78 billion (\$5.1 billion) (Gunasegaram, 2018; Malgeri, 2019: p. 30). Although the pipeline projects remained suspended, the PH focused on reducing costs and increasing local participation in the ECRL (Malgeri, 2019: p. 30; Lampton, Ho and Kuik, 2020). Chinese officials eventually pressured CCCC to compromise to counter emerging debt-trap diplomacy narratives ahead of the Second Belt and Road Forum for International Cooperation, held in Beijing in April 2019 (Malgeri, 2019: p. 33). A revised agreement emerged in that month, cutting the cost to RM 44 billion (\$10.3 billion) and increasing local partners’ share from 30 per cent to 40 per cent. Perhaps most importantly, CCCC agreed to form a joint venture to operate and maintain the railway, thereby sharing the risks of commercial failure (Malaysiakini, 2019). This is significant insofar as most analysts see the ECRL as a ‘white elephant’, creating vast surplus passenger and cargo-carrying capacity (Jomo, 2017; Lim, 2018: p. 92).

Chinese officials eventually pressured CCCC to compromise to counter emerging debt-trap diplomacy narratives ahead of the Second Belt and Road Forum for International Cooperation, held in Beijing in April 2019.

The PH government’s reluctance to cancel other megaprojects reflects the entrenched power of the politico-business interests involved in Malaysia’s political economy, which the 2018 election did little to dislodge. *Ancien regime* forces fiercely opposed cancelling the ECRL and pipeline projects (Malaysiakini, 2018c; Wee, 2019). PH coalition partners also rejected Mahathir’s criticism of other projects where their interests were involved (Ngeow, 2019b: pp. 32–3). Moreover, Mahathir’s own ex-UMNO faction retained close ties to many vested interests. The ECRL relaunch primarily benefited construction GLCs, shares in which surged by 11–45 per cent in a single day on 22 April 2019 (Ho, 2019). The company experiencing the largest rise in share value, Ekovest, had received lucrative patronage under Mahathir’s previous UMNO government, and had purchased Mahathir’s failed bakery chain shortly before the announcement (Singh, 2019). Daim Zainuddin had also facilitated the rise of many of these GLCs during his tenure as minister of finance in 1984–91, becoming deeply networked with the Malay business community (Gomez et al., 2018).

These vested interests constrained PH Finance Minister Lim Guan Eng to renegotiate rather than scrap many inflated projects, including those with no Chinese involvement. According to Lim, the government negotiated down the cost of 121 smaller infrastructure projects, costing RM 13.9 billion (\$3.2 billion), by nearly RM 810 million (\$190 million), while the price tags for two major public transportation projects, Light Rail Transit 3 (LRT3) and Mass Rapid Transit 2 (MRT2), were

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<sup>7</sup> The planned KLSHSR was also postponed, but since it had not yet been put to tender, no Chinese parties were yet involved.

reduced by RM 23.8 billion (\$5.6 billion) (Izmir, 2019). Lim stated in July 2018 that LRT3, awarded to the construction GLC George Kent, known to be close to Najib, had been padded with ‘unnecessary’ stations and tunnelling, and almost double the amount of rolling stock actually required (Bernama, 2018). This project – with no Chinese involvement – illustrates that UMNO’s padding of construction contracts for patronage purposes was an entirely indigenous practice.

## Conclusion

Malaysia has been portrayed as both a victim of China’s debt-trap diplomacy and as leading a backlash against the BRI. Neither narrative is accurate. Malaysia’s engagement with the BRI actually demonstrates how recipients seek to harness Chinese economic expansion to serve their own domestic agendas – in this case, maintaining economic growth and fuelling the patronage networks sustaining the UMNO regime’s political power. Moreover, Malaysia’s pushback against the BRI was also limited by domestic factors – the continued imperative of sustaining growth and the vested interests that have emerged within Malaysia’s political economy through decades of crony capitalism. The PH coalition’s unwillingness – or inability – to dismantle the deeper power structures within Malaysia’s political economy ultimately brought about the doom of the coalition government, as Mahathir’s ex-UMNO faction left the PH in February 2020 and formed a new ruling coalition with UMNO. This marks the victory of *ancien regime* forces in Malaysia, making a return to ambitious megaprojects with Chinese involvement appear highly likely.

## 6. Conclusion and Policy Recommendations

Mainstream accounts depict China’s BRI as a predatory form of economic statecraft, seeking to ensnare poor countries for geopolitical ends. This paper has demonstrated that the BRI is, in fact, motivated largely by economic factors. It has also shown that China’s fragmented and poorly coordinated international development financing system is not geared towards advancing coherent geopolitical aims. In addition, recipient countries (such as Sri Lanka and Malaysia) are not hapless victims, but actively shape outcomes within China’s development financing system. Accordingly, the BRI does not follow a top-down plan, but emerges piecemeal, through diverse bilateral interactions, with outcomes being shaped by interests, agendas and governance problems on both sides. What does this imply for policymakers and civil society actors interested in the BRI?

### **Chinese policymakers should improve project governance and SOE regulation**

China’s loosely coordinated and weakly regulated development financing system often yields poor results at high cost, generating blowback against China, as the Sri Lankan and Malaysian cases show. Chinese policymakers increasingly recognize this and have tried to improve governance arrangements and cultivate stronger relations with non-government groups in partner countries (Rolland, 2019; Zou and Jones, 2019). However, they must go further. Rather than a multi-agency bargaining system, a coherent, integrated decision-making process is required, backed with sufficient risk assessment capacities and operating according to strict, clear and enforceable rules, rather than vague guidelines. This will involve tackling vested interests within China, particularly among commercially oriented agencies and in the SOE sector.

### **Recipient-state policymakers should improve their capacity to evaluate, negotiate and regulate BRI projects**

Recipient governments cannot expect China to carry out due diligence on their behalf. Since Chinese development financing is recipient-led, these governments must take greater responsibility for ensuring that projects are viable and financially sustainable. They must also bargain harder and more judiciously with Chinese partners, who are primarily driven to make profits, and must take the lead in ensuring developmental benefits for local people. In addition, tendering should be open to minimize corruption. Since Chinese regulations continue to rely on host-country governance, recipients must bolster their domestic regulations, and their inspection and enforcement capacities, to ensure that projects do not inflict social and environmental harms. International donors can support the changes through capacity-building projects, but this is ultimately a political, not technical, task, given the powerful domestic interests at stake in many countries.

## **Policymakers in other states: Adopt a more realistic understanding of, and appropriate responses to, the BRI**

### **Do not respond to the BRI as a geopolitical strategy**

If policymakers in other countries continue to assume that the fragmented activities comprising the BRI are directed from the top down as part of a coordinated grand strategy, they will formulate unnecessarily hostile and counterproductive responses. A geostrategic reading of the BRI entails balancing strategies like the ‘free and open Indo-Pacific’, seeking to curb a Chinese ‘offensive’ that the BRI does not really constitute. This is seen by Beijing as evidence of relentless Western hostility, fuelling a conflict spiral and increasing the risk of great-power confrontation. It also alienates developing countries keen to develop their infrastructure but receiving no Western assistance.

### **Provide alternative development financing**

Rather than attacking the BRI, wealthy countries should provide better alternatives. Traditional donors’ abandonment of infrastructure development in favour of dubious ‘good governance’ programmes created the space for China’s unique offer to developing countries. Clearly, China offers what many traditional donors should not: the debt-financed implementation of sometimes apparently senseless projects, often coupled with kickbacks. Nonetheless, China also offers a less risk-averse, materialist approach to development, with tangible benefits. Other states should follow suit and could even partner with China on specific projects to strengthen governance standards – as seen with the establishment of the AIIB (Hameiri and Jones, 2018).

In a positive development, traditional donors have begun returning to infrastructure financing. In 2018, the US agreed with Australia and Japan to co-finance Asia-Pacific infrastructure, and in December 2019 the US established the International Development Finance Corporation (DFC), as the main focal point for its international infrastructure financing. In 2019, the EU and Japan agreed to finance Europe–Asia connectivity, and Australia launched its Infrastructure Financing Facility for the Pacific. However, these initiatives need additional funding to truly compete with the BRI. Competition is in some cases appropriate, for example, where Chinese-financed projects are of poor quality or are socially and environmentally harmful. Elsewhere, it may be more appropriate to partner with China. As the BRI is so fragmented, there is no one-size-fits-all approach. Other finance providers must tailor their actions to the particular context of recipient states and the nature of Chinese engagements there.

### **Engage recipients and China to improve BRI governance**

Donors should support recipient countries to strengthen their development governance systems, and engage China in dialogue to bring Chinese development financing closer to international standards. The AIIB could represent a potential entry point. Although a marginal player within China’s development financing system, it is the only platform where Chinese and other donor states’ officials interact regularly.

### Help improve the transparency of megaprojects

Vested interests will resist governance improvements where they benefit from existing arrangements. Donors should therefore support transparency initiatives, including whistleblowing, investigative journalism and civil society campaigning, to shed light on projects, as well as academic research like the AidData project, which painstakingly pieces together open-source data. Transparency alone will not transform governance, but it will provide opposition groups with the requisite ammunition to pursue greater accountability and policymaking in the public interest.

### Civil society and political opposition: Recalibrate campaigning

Chinese and recipient governments alike are not neutral actors, disinterestedly pursuing ‘win-win co-operation’ and broad-based development. As this paper shows, they are often serving powerful political and business interests seeking to exploit the BRI for gain. Civil society and political opposition groups therefore have crucial roles to play. Like states, these groups need to avoid a conspiratorial view of the BRI or blaming ‘China’ exclusively for problems. The BRI is not a well-crafted Chinese plan, and recipient governments are equally or even more to blame for poorly conceived development projects. Externalizing blame only allows domestic elites to evade accountability. It can also border on racist nationalism. Civil society and opposition groups would be better advised to demand a transparent and participatory approach to project design and management. They should also exploit the Chinese party-state’s fragmentation to seek multiple entry-points for lobbying campaigns. Viewed as a monolithic entity pursuing a unilateral strategy, China appears impervious to pressure. But, in reality, as Inclusive Development International’s (2019) comprehensive handbook shows, there are many pressure points, including diverse regulatory agencies, some of which are genuinely interested in preventing malfeasance, upstream financiers, and downstream users of products and services arising from Chinese projects.

## About the Authors

**Dr Lee Jones** is reader in international politics at Queen Mary University of London. His research concerns political economy, social conflict, state power and security, particularly in the Asia-Pacific. He is author of *ASEAN, Sovereignty and Intervention in Southeast Asia* (2012), *Societies Under Siege: Exploring How International Economic Sanctions (Do Not) Work* (2015) and, with Shahar Hameiri, *Governing Borderless Threats: Non-Traditional Security and the Politics of State Transformation* (2015), and co-editor, with Toby Carroll and Shahar Hameiri, of *The Political Economy of Southeast Asia: Politics and Uneven Development under Hyperglobalisation* (2020). His website is [www.leejones.tk](http://www.leejones.tk) and he tweets @DrLeeJones.

**Dr Shahar Hameiri** is associate professor of international politics at the School of Political Science and International Studies, University of Queensland, specializing in the politics of development and security in Asia. His latest books are *The Political Economy of Southeast Asia*, 4th ed., (2020) co-edited with Toby Carroll and Lee Jones, and *International Intervention and Local Politics* (2017), co-authored with Caroline Hughes and Fabio Scarpello. His work has also appeared in leading scholarly journals, including *International Studies Quarterly*, *European Journal of International Relations* and *International Affairs*. He tweets @ShaharHameiri.



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Cover image: Officials visit the tunnel of the East Coast Rail Link project in Dungun, Malaysia on 25 July 2019.

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The Royal Institute of International Affairs  
Chatham House  
10 St James's Square, London SW1Y 4LE  
T +44 (0)20 7957 5700 F +44 (0)20 7957 5710  
[contact@chathamhouse.org](mailto:contact@chathamhouse.org) [www.chathamhouse.org](http://www.chathamhouse.org)

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