Belt & Road block

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Chinese President Xi Jinping's $4 trillion Belt & Road initiative, launched in 2013, had already been coming under increasing criticism as "debt book diplomacy". In April, International Monetary Fund managing director Christine Lagarde warned in a speech in Beijing that Belt & Road initiatives could lead to a "problematic" increase in debt for the recipient country.

Then main opposition party Pakatan Harapan (PH), led by former Prime Minister Mahathir Mohamad, won a surprise victory in Malaysia's general election in May this year (2018). Support for PH was in part provoked by resentment over Chinese infrastructure investments. In 2017, Malaysia was the fourth largest recipient of Chinese investment, with Belt & Road financial commitments estimated at around $34 billion.

Keeping to his campaign promises, Mahathir pledged to review all infrastructure deals negotiated by his predecessor Najib Razak in an effort to cut the country's debt burden. "I've been informed that our debt is actually $250 billion, but today we were able to study and look for ways to reduce this debt," Mahathir said shortly after taking office in late May.

By early July, Mahathir had canned all the major infrastructure projects in the pipeline, including the Belt & Road ones.

First to be shelved, at least for the foreseeable future, were the Kuala Lumpur–Singapore high speed railway and the MRT3 line in Kuala Lumpur.

Mahathir also ordered construction to be suspended on the $8 billion East Coast Rail Link (ECRL), as well as two gas pipelines worth over $2 billion. The value of the two gas pipeline contracts were also almost entirely paid in advance before any work was completed, raising further questions about the nature of the agreements.

The regime change risk

The contract for ECRL, part of a wider Belt & Road venture to link Port Klang on the west coast to a deep sea port being developed in Kuantan on the east coast, had been controversial since the outset.

Shortly after the contract and soft loan with China were announced, whistleblower site Sarawak Report published the term sheet of the deal, alleging construction costs had been doubled.

In addition, China's state-owned CCCC, which had won the contract without a tender being held, had allegedly agreed to assume nearly $5 billion of the debts of scandal-plagued state infrastructure investment fund 1Malaysia Development (1MDB). Questions were also raised about the unusually high interest rate for the soft loan.

The 1MDB scandal, which is credited with fuelling the opposition's surprise victory despite chronic gerrymandering, has quickly become undone. Former Prime Minister Najib Razak has now been arrested and the new government has

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claimed it has almost completed its investigation in Malaysia. Najib has pled not guilty.

Mahathir has been openly critical of the “unfair” terms of contracts. “There are several issues to be brought up, among which is the unfairness of the terms of the contracts and also of the loans,” he told reporters in Kuala Lumpur in early July.

Mahathir is set to visit Beijing in August, but other Belt & Road initiatives in Malaysia appear certain to be cancelled regardless of the Chinese government’s position, including the nearly $11 billion Malacca Gateway port development, awarded to Malaysia’s KAJ Development and PowerChina to build four new terminals off the coast of Malacca.

All of which would leave the Malaysian leg of Belt & Road, one of the pillars of China’s strategy to reduce its dependence of its trade through Singapore’s port in the Malacca Straits, back at the drawing board.

“The Chinese government will also take concrete measures to safeguard the interests and rights of Chinese enterprises,” China’s *Global Times*, a state-owned tabloid which is widely considered to be advocating the government’s position, said in a comment published on the Malaysia issue in June.

Ceylon blues

Meanwhile, another controversial Belt & Road initiative has come under new scrutiny.

The Port of Hambantota on the south eastern coast of Sri Lanka was built with Chinese soft loans despite feasibility studies showing no demand for cargo, even though the site is on the main shipping route from Asia to Europe.

Former Prime Minister Mahinda Rajapaksa, who had become increasingly dependent on China for financial and military support in the last years of the civil war, agreed terms with Chinese entities on the port in 2008.

Sri Lanka in 2008 took on a $300 million loan from Exim Bank of China and gave the contract to build the deep sea port, without a tender, to state-owned China Harbor. In 2012, Rajapaksa agreed to take on another loan, of nearly $800 million, at an annual interest rate of 6.3%. Since then, the debt burden on the development has ballooned to $1.3 billion.

Rajapaksa lost power to Ranil Wickremesinghe in 2015 but Sri Lanka has continued to be held to the terms of the debt. Wickremesinghe has sought to move closer to India and Japan, but China has turned out to be an unforgiving lender.

Unable to meet the payments on Hambantota port, Wickremesinghe’s government agreed to a contentious restructuring which ceded control of the Port of Hambantota on a 99-year lease to the operator of the port, China Merchants Port.

Under the agreement, China Merchants Port will pay the government $1.1 billion for an 85% share in the asset. In return, China Merchants Port will have full control of the development of the port, along with managing all of its operations.

The deal, signed in July 2017, provoked widespread street protests for ceding sovereign control over the island’s territory.

The agreement has drawn renewed scrutiny after a *New York Times* investigation published in late June 2018 alleged the Chinese government had demanded that Sri Lanka cede control of the port to either China Harbor or China Merchants Port in return for writing down some of the debt.

China Merchants Port also demanded, and was granted, rights to 15,000 acres of land around the port, according to the report.

Beijing for its part has dismissed the allegations. “According to the needs of Sri Lanka, Chinese financial institutions have provided support to Sri Lanka in solving the financing gap. Later, the Chinese side made efforts to adjust relevant asset allocation according to the wishes of the Sri Lankan side,” Foreign Ministry spokesperson Lu Kang said in response to the *New York Times* report.

The Sri Lankan government is struggling to extricate itself from other China-backed projects. Colombo is reportedly in

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talks with India to sell 70% of the 40-year concession to operate Mattala airport for $300 million.

The Mattala airport, 30km inland from Hambonata port and often dubbed “the world’s emptiest international airport”, currently has no scheduled daily flights after FlyDubai cancelled its last service in early June 2018.

More election risk

One country where Belt & Road does not appear to be exposed to election risk is Pakistan, which will go to the polls in late July 2018. The China-Pakistan Economic Corridor (CPEC) is China’s largest Belt & Road commitment to date.

CPEC is a collection of infrastructure projects being developed across Pakistan, with the backing of investment by Chinese entities. Originally valued at $46 billion, the collective value of CPEC has now swelled to over $62 billion.

CPEC’s long-term plan through to 2030, published in December 2017, remains rather vague, citing “a growth axis and a development belt”, with “the comprehensive transportation corridor and industrial cooperation between Pakistan and China as the main axis”.

The terms of most of the CPEC projects have been kept secret. One exception has been Gwadar Port, which was officially leased in 2015 to China Overseas Port for 43 years, until 2059. China Overseas Port has also been awarded $1 billion worth of expansion contracts.

In November 2017, then federal minister for ports and fisheries Hasil Bizenjo revealed in a briefing to the Senate that China would receive 91% of the port-generated revenues for the duration of the concession, while the federal government-controlled Gwadar Port Authority would receive the remaining 9%.

Questions have been raised about the economic viability of Gwadar Port, which includes the development of a 290,000-acre free trade zone, but the government remains bullish. “CPEC is turning into a reality today which will change the fate of the region,” Pakistani Prime Minister Shahid Khaqan Abbasi said at the opening ceremony for the first phase of the free trade zone in January 2018.

All three of Pakistan’s major political parties, the Pakistan Muslim League, the Pakistan People’s Party and former cricket player Imran Khan’s PTI, have remained broadly supportive of CPEC despite criticism, mostly from western countries over the rising debt levels and lack of transparency.

“While it is too early to assess if CPEC can deliver the economic gains Islamabad promises, the project risks inflaming longstanding tensions between the centre and smaller federal units and within provinces over inequitable economic development and resource distribution,” International Crisis Group warned in a recent report.

While the political class may be supportive, with a record external account deficit of up to $18 billion and central bank reserves of less than $10 billion, Pakistan may be facing another International Monetary Fund bailout after the July elections.

“Further and considerable policy efforts would be required to stabilise the external position, and a new government has limited time to act after the 25 July elections as external debt obligations will pick up more rapidly in 2019,” Fitch Ratings warned in a report.

China has already provided loans of $5 billion to Pakistan in the past year and has also provided it a trade facility of $1.5 billion. But analysts don’t expect Beijing to stabilise Pakistan.

The IMF is certain to require disclosure of Pakistan’s debt obligations, including for Belt & Road, and Pakistani officials are reportedly already worried that projects will cancelled.

With the future of Belt & Road in two of its largest flagship countries now under a cloud, some analysts have begun to question whether Beijing needs to change tactics, perhaps by embracing a more multilateral approach. Whether it can remains to be seen.

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"Will Belt & Road bend to the will of existing multilateral norms and standards?" concluded a recent Center for Global Development report on Belt & Road's debt sustainability.

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