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Is China's Belt and Road working? A progress report from eight countries

Beijing's infrastructure push clouded by project delays and mounting debt

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A Chinese construction worker at the site of a Chinese-backed hotel complex in Colombo in October 2015

GWADAR, Pakistan -- The idea of transforming the ancient fishing village of Gwadar into a bustling port city has been around since at least 1954, when Pakistan commissioned the U.S. Geological Survey to examine its coastline. Their conclusion: Gwadar, which sits on the Arabian Sea, would be an ideal location for a deep-water port.

Gwadar's potential went unrealized for decades, but it is now at the heart of a hugely ambitious plan known as the China-Pakistan Economic Corridor, or CPEC. China has pledged to spend $63 billion to bolster Pakistan's power plants, ports, airports, expressways and other infrastructure under the initiative, which Beijing positions as one of the pillars of its $1 trillion global Belt and Road Initiative championed by Chinese President Xi Jinping.

The investment is clearly visible at Gwadar. More than 1,000 people, about half of whom are Chinese, work at a recently completed 660-meter container terminal. Nearby is a hospital built using Chinese funds. Pearl Continental Hotel, a luxury hotel owned by a local company, stands on a hill overlooking the port. The pier is dotted with Pakistani naval and coast guard ships. Armed boats and pickup trucks patrol the area, while wooden fishing boats float in the distance.

The gains for China in all of this development are perhaps less visible, but potentially far more significant. A major goal for China is to link its landlocked western region to the port at Gwadar. This would allow ships carrying oil and other goods from the Persian Gulf to avoid the "choke point" of the Strait of Malacca, shaving thousands of kilometers off existing routes frequently patrolled by foreign navies.

China has high hopes for the deep-water port being developed in Gwadar, Pakistan. © Reuters

For all this grand ambition, some analysts have doubts. Pakistan's trade deficit with China has been rising, and there are concerns about what happens if it is unable to repay its debt. As with other countries that have benefited recently from Beijing's largesse, some in Pakistan worry that the price of such investment could be a huge debt burden.

The China-Pakistan corridor "will no doubt be a game changer for Pakistan, but we need to be careful," said Ehsan Malik, the CEO of Pakistan Business Council, a business policy advocacy forum. "Ten years' tax concessions, 90-year leases for Chinese companies and cheap imports will impact the competitiveness of existing domestic industries."

Pakistan symbolizes both the promise and the potential peril for countries participating in China's BRI undertaking -- arguably the largest investment drive ever launched by a single country -- and its related projects.

For countries needing infrastructure, the BRI holds the promise of investment in new railways, roads, ports and other projects. But as the Nikkei Asian Review and The Banker magazine discovered in producing this special report, participating countries also have worries, ranging from a lack of participation by local workers and banks to unmanageable debt hangovers.

The Nikkei Asian Review and The Banker examined how BRI projects are unfolding in eight countries: Indonesia, Sri Lanka, Kazakhstan, Bangladesh, India, Poland, Laos and Pakistan. We also collaborated with the Center for Strategic and International Studies' Reconnecting Asia Project to aggregate key BRI infrastructure projects worldwide.

Key findings include:

Project delays After initial fanfare, projects sometimes experience serious delays. In Indonesia, construction on a $6 billion rail line is behind schedule and costs are escalating. Similar problems have plagued projects in Kazakhstan and Bangladesh.
Ballooning deficits Besides Pakistan, concerns about owing unmanageable debts to Beijing have been raised in Sri Lanka, the Maldives and Laos.
Sovereignty concerns In Sri Lanka, China's takeover of a troubled port has raised questions about a loss of sovereignty. And neighboring India openly rejects the BRI, saying China's projects with neighboring Pakistan infringe on its sovereignty.

Mushtaq Khan, an economist and former chief economic adviser at the State Bank of Pakistan, acknowledges that the country's debt to China is rising. But he says Beijing "cannot afford" to bankrupt Pakistan -- in part because of the country's importance as a counterweight to India, a regional rival of China's.

"China's primary interest in Pakistan is geopolitical rather than strictly economic, and therefore, for China, repayment of the debt burden will be secondary to maintaining a good political and economic relationship with Pakistan," he said.

Key Belt and Road projects in Pakistan

Name	Status	Cost *(in billions of dollars)*
Gwadar Port construction of breakwaters	Completed	0.12
Kohala hydropower project	Announced/under negotiation	2.40
Peshawar-Karachi motorway *(Multan-Sukkur section)*	Under construction	2.84

Gwadar, with a population of 110,000, is 90 minutes west by propeller plane from the mercantile city of Karachi in southern Pakistan and just 70km from the border with Iran. China refers to neighboring Pakistan as its "all-weather friend," but the country is not known for having a healthy business climate. Pakistan ranked 147th out of 190 countries and regions in the World Bank's Ease of Doing Business 2018.

The deeper ties with China come amid strains between Pakistan and the U.S. In January, the U.S. State Department announced that it would suspend security assistance to Pakistan over what it called a failure to clamp down on terror groups.

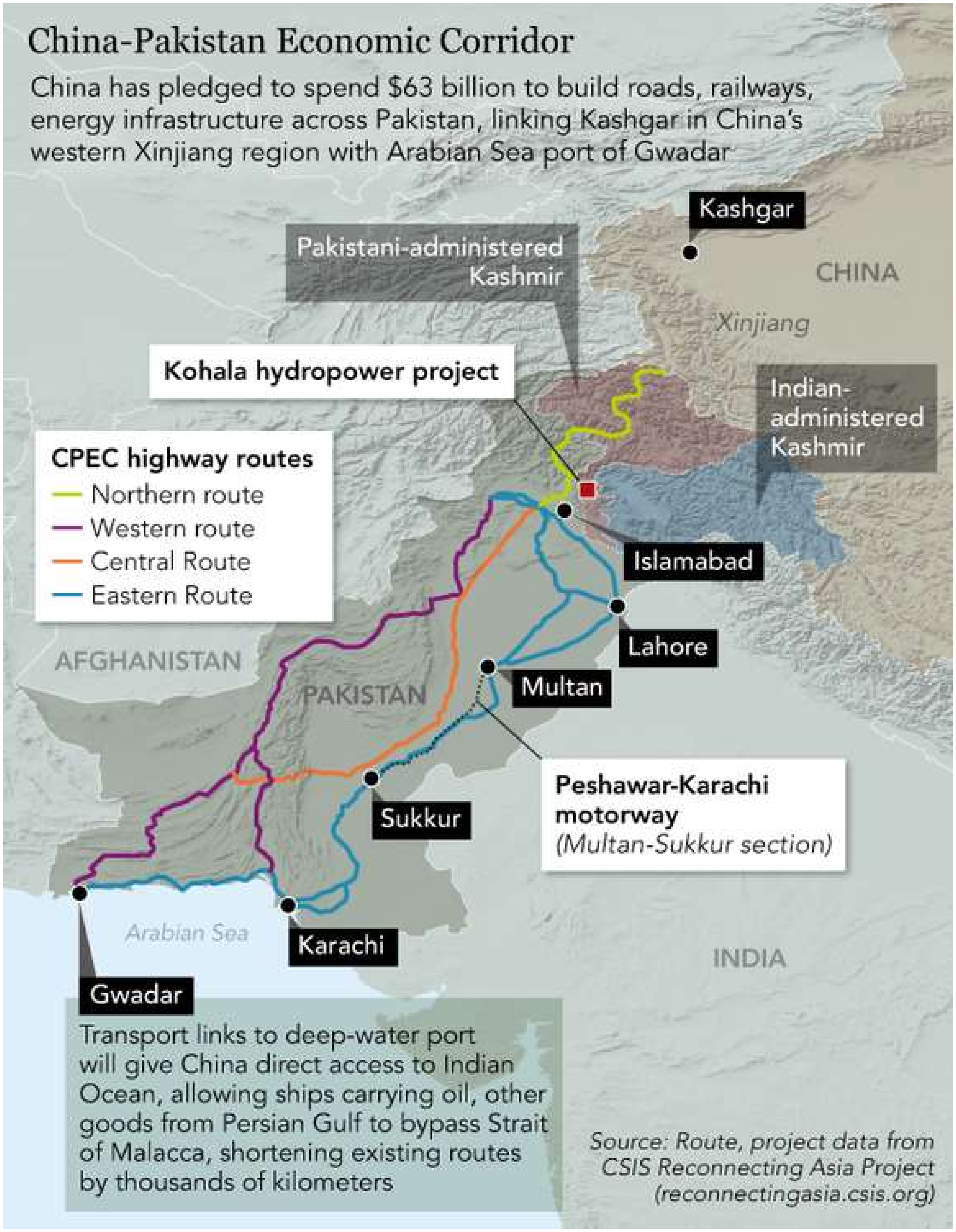
The country's economy has been battered over the years by terrorism, fuel shortages and tattered governance, but it grew 5.4% in the year through June 2017, the fastest pace in

10 years. The State Bank of Pakistan forecasts growth to approach 6% in the year ending June 2018.

The projects are underway with the belief that the troubled nation can join the vibrant club of emerging Asian economies. The government of Pakistan plans to transform Gwadar into one of the world's largest port cities by 2055, housing steel mills, terminals for liquefied natural gas, oil refineries and other facilities. Under the plan, trade and industrial zones will be concentrated on the city's east side, while the western side of the peninsula will serve as residential and tourism areas.

"Gwadar port will be a hub to link Afghanistan and Central Asia, but it is not just a trade and logistics center," said Dostain Khan Jamaldini, chairman of Gwadar Port Authority. "We will set up an industrial estate with export manufacturing zones, and invite the motorcycle and electronics industries."

"Gwadar port is not given to China only," Jamaldini said, stressing the authority's willingness to welcome U.S., European and Asian companies.



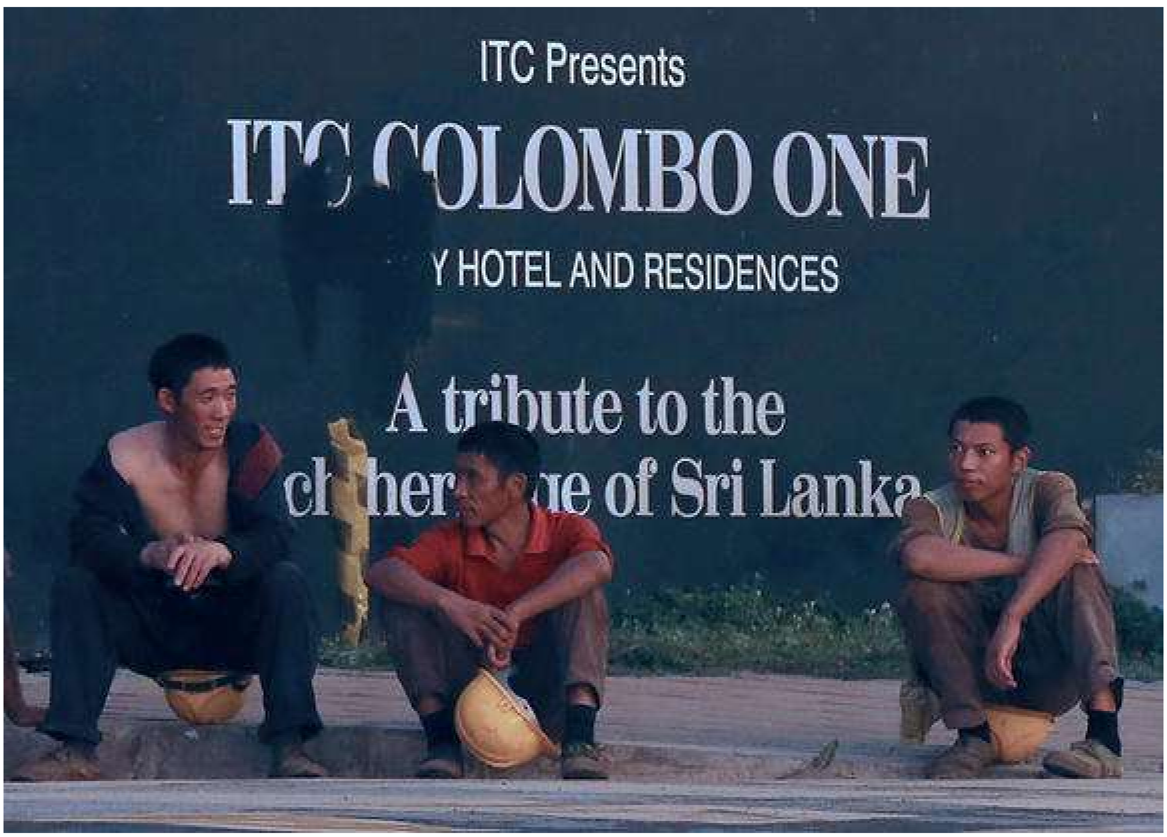
The chairman denied speculation that China could try to make Gwadar a military port in the future. "Gwadar is 100% commercial. If China [has military] needs, we have Ormara naval base near here," he said. "We have nothing to hide."

Such developments have unnerved neighboring India, which has rejected the BRI program because China is financing projects on land that is claimed by both India and Pakistan. Arun Jaitley, India's finance minister, says the BRI violates India's sovereignty. "We are not a part of the project, and the proposed [BRI] road passes through what we regard as Indian territory," Jaitley said, referring to a project in the Gilgit-Baltistan area of Kashmir. Both India and Pakistan claim the Kashmir region.

"We had to get out of this debt trap"

When Sri Lanka handed over its southern port of Hambantota to China in December 2017, many saw it as a cautionary tale for other nations that are eagerly accepting Chinese help to build grand infrastructure projects.

The country granted a 99-year lease on the port to China Merchants Port Holdings in hopes of cutting its debt, which is among the highest of the emerging economies. For its part, China gained an important beachhead for its attempt to expand its military influence in the Indian Ocean.



Chinese construction workers take a break in the Sri Lankan capital of Colombo in October 2015. © Getty Images

Construction of the $1.5 billion Hambantota Port started in 2008 under former President Mahinda Rajapaksa. The first phase of the project, which ended in 2010, cost $361 million. While details of the second phase are unknown, Export-Import Bank of China financed 85% of the first phase of work.

But as the port's losses began to mount, the government in Colombo found itself unable to repay its debts. The country had an external debt of $48.3 billion at the end of 2017, and its annual external financing needs are $11 billion -- roughly the same as its annual tax revenue. Sri Lanka's debt to China totals $8 billion and is said to carry an interest rate of 6%.

"We had to take a decision to get out of this debt trap," said Mahinda Samarasinghe, Sri Lanka's ports and shipping minister, of the reasoning behind the 99-year lease.

Government critics have said Sri Lanka's sovereignty has been compromised by the port episode, which came only two months before the former president of neighboring Maldives warned that its debts to Beijing could force the country to cede territory to China as early as next year.

Sri Lanka is located at a strategic point for the BRI. The port of Hambantota is indispensable for China's energy security because the country imports two-thirds of its oil through shipping lanes south of the port.

Jonathan Hillman, director of the Reconnecting Asia Project at the CSIS, says India has been watching China's activity in Sri Lanka with concern. "The docking of a Chinese submarine at the port of Colombo in 2014 is one reason why the handover of a port at Hambantota in December 2017 raised alarms in Delhi. The nature of the Hambantota transaction, a debt-for-equity deal, also raised concerns," he said.

Key Belt and Road projects in **Sri Lanka**

Name	Status	Cost *(in billions of dollars)*
Hambantota deep sea port *(Phase I)*	Completed	0.50
Hambantota deep sea port *(Phase II)*	Completed	0.80
Matara–Kataragama railway extension project *(Phase I)* Matara-Beliatta section	Under construction	Unknown

In 2009, President Rajapaksa put an end to Sri Lanka's civil war with the Liberation Tigers of Tamil Eelam and shifted government policy from fighting toward improving infrastructure ahead of the presidential election in 2010. The development of Hambantota Port, located within his constituency, was a typical project.

Rajapaksa kicked off the construction of Sri Lanka's second international airport in Mattala, an inland town 20km from the port, in 2009. Of the $209 million construction cost, Exim Bank of China put up $190 million with a concessionary loan. Mattala

Rajapaksa International Airport is now called "the world's emptiest international airport" because it has only four regular flights arriving and departing per week. The Sri Lankan government plans to sell the airport, too.

India is afraid that if the airport is purchased by China, it will become a Chinese air force base. A delegation from India visited the airport last year to discuss taking it over, but an airport official said, "I heard that it was not going well due to a mismatch in conditions from both sides."

China is also involved in a $15 billion project to build "Port City Colombo" on reclaimed land in the capital. The $1.4 billion first phase of the project is being undertaken by a subsidiary of China Communications & Construction Co., which is shouldering the total cost of reclaiming 269 hectares of land.

Sri Lanka's debt equals 81.6% of its gross domestic product, which the International Monetary Fund says is the third-highest ratio among emerging economies.

Yet even after the debt problems at Hambantota were clear, China last year proposed to Sri Lanka two joint construction projects around the port: a $3 billion oil refinery and a $125 million cement factory.

To the Sri Lankan government, "there is no country or institution with ready cash other than China," a senior economic official said.

Rail lines in Southeast Asia

In the middle of a tea plantation outside Bandung, Indonesia's third-largest city, sits the future site of one of the four stations on the country's first high-speed railway.

A Chinese high-speed train exhibition in Jakarta in August 2015: Progress on a Chinese-backed railway project in Indonesia has been slow. © Reuters

The railway is one of two ongoing projects under the BRI in Indonesia. Launched in January 2016, the planned 142km railway that will connect Jakarta and Bandung was supposed to illustrate China's expanding economic power and influence. But as of late February, local officials said only 10% of the work had been completed, making it impossible for operations to start next year as scheduled. A funding crunch is also starting to raise concerns over the financial health of Indonesian companies involved.

"After the project launch, there was almost no activity besides the land being cleared," said local villager Asep as he looked over the construction site at the Walini tea plantation. "No rail tracks. Nothing. Work only restarted around three months ago, for the underground tunnel."

Paperwork and permit problems halted the project in its first several months, after which land acquisition proved to be a major headache. Only half of total land needed has been secured. Rising land prices during the delays is partially responsible for the project's growing price tag -- from $5.5 billion when it was announced to $6 billion.

Sluggish land acquisition has had other consequences: China Development Bank, which agreed to cover 75% of the cost with loans, has repeatedly delayed disbursement, further hampering progress.

Key Belt and Road projects in Indonesia

Name	Status	Cost (in billions of dollars)
Jakarta-Bandung high-speed rail	Preparatory phase	6.00
Manado-Bitung toll road	Under construction	0.37
Sumsel-5 power plant	Completed	0.31

"The CDB will [start] loan disbursement this month," Chief Maritime Minister Luhut Panjaitan, whose office oversees joint Belt and Road projects with China, said on March 9. But since the bank signed the loan agreement during the BRI forum in Beijing last May, deadlines for distributing the money have been pushed back time and again.

Analysts say it is unlikely China will cancel its funding given Indonesia's strategic importance as Southeast Asia's largest economy. But some think China has other, more pressing, priorities.

"[High-speed railway] in Java island is an investment that could wait, as China has more immediate incentives to strengthen its trade routes in its neighboring countries first that are not separated by seas," brokerage Reliance Sekuritas Indonesia said in a note.

The second active BRI project in Indonesia is the Morowali Industrial Park on Sulawesi island. The island already hosts Chinese nickel smelters and a stainless steel factory. A $1.6 billion deal was signed in Beijing last year that includes the construction of a carbon steel factory and a power plant. Additionally, Indonesia's Investment Coordinating Board has designated three provinces -- North Sulawesi, North Kalimantan and North Sumatra -- for BRI investment. Future plans include the development of new industrial parks, ports, airports and tourism.

Despite the delayed railway construction, Indonesia continues to have high hopes that BRI will help cover the funding gap in President Joko Widodo's $355 billion infrastructure drive.

Bangladesh's experience has been similar. Its BRI projects were given a huge boost by Chinese President Xi's momentous 2016 state visit -- the first by a Chinese head of state in 30 years.


Schoolchildren cross a road in Dhaka in March. Bangladesh's huge infrastructure needs make it a promising partner for China. © Reuters

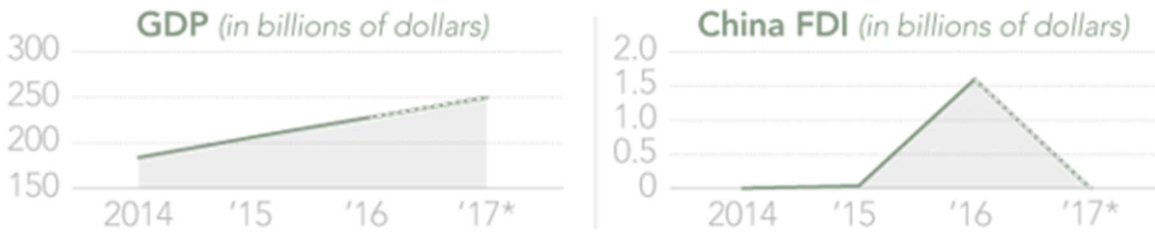
But after an initial spike in activity, construction has slowed. "It started off pretty well, but while it's a bilateral initiative, it's not really just bilateral. There are other geopolitical issues which can play a part in actual execution. We see a bit of a slowdown," said Naser Ezaz Bijoy, CEO at Standard Chartered Bangladesh.

The CSIS Reconnecting Asia Project has identified three key BRI projects in Bangladesh: the Dhaka-Jessore rail line, the Payra power plant and the Karnaphuli Tunnel -- the country's first-ever underwater tunnel. Chinese development banks dominate the projects' financing, while Chinese contractors often take over the construction process.

Construction has already started for the $1.65 billion coal-fired power plant by the port of Payra. The plant is a joint venture involving Chinese power company CMC and Bangladesh's state-owned North-West Power Generation Co. While the equity will be split in half, the project's financing is fully provided by China. The plant is scheduled to be operational by December 2019.

Key Belt and Road projects in Bangladesh

Name	Status	Cost *(in billions of dollars)*
Dhaka-Jessore rail line	Preparatory phase	4.40
Payra power plant	Under construction	1.65
Karnaphuli Tunnel	Preparatory phase	Unknown



The $4.4 billion Dhaka-Jessore rail line is still in its preparatory phase. Announced in 2016, the line is expected to launch in 2022. State-owned China Railway Construction is the project's contractor.

The construction stage for the Karnaphuli Tunnel is less clear. State-owned China Communications Construction Co. signed a $705 million contract with the Bangladesh Bridge Authority back in 2015. But in November 2017, Bangladeshi newspaper Financial Express reported that construction work had not started because the BBA was waiting for the Exim Bank of China to release funds for the project.

Whatever the delay, Bijoy notes that the two countries are a good fit. "China has overcapacity onshore and it's not growing as fast as it did in the past, so it would require external demand to support its production. Countries like Bangladesh growing at 7% will have that demand."

A BRI rail project in Laos is further along. Construction of a 414km railway linking Vientiane, the capital, to the China-Laos border is scheduled to be completed in December 2021.

A hydropower project in Phongsaly Province, Laos: China is investing big in energy infrastructure in its southern neighbor. © Getty Images

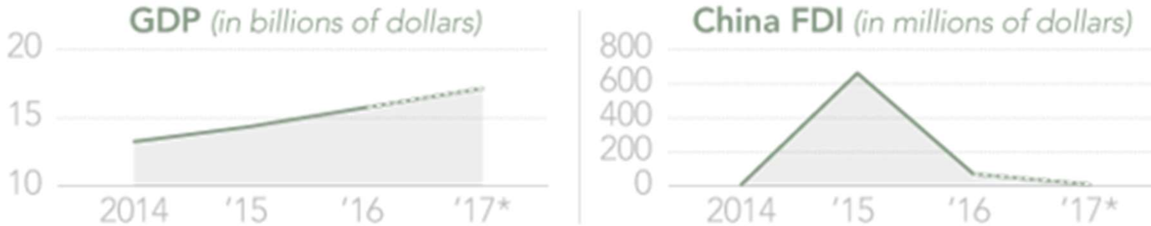
Talks on a possible rail project began in 2001, long before Xi introduced the idea of building a "new Silk Road." The two countries did not sign a memorandum of understanding until April 2010, however. After a number of further delays, a ceremony marking the official start of construction was held in December 2016 at Luang Prabang, Laos' ancient royal capital, which will be one of the main stations on the new rail line.

"When it comes to Laos, China has for many years had a strategy to use its railway system to drive into Southeast Asia to bind these countries to China," said James Stent, who served for 13 years on the boards of China Minsheng Bank and China Everbright Bank in Beijing.

There are complaints among Laotians that the labor on the rail line is predominantly Chinese, detracting from any knock-on benefits to the economy. Development banks worry that the $6 billion rail project will exacerbate Laos' already precarious debt levels, which reached 68% of GDP in 2016, increasing the debt distress level from "moderate" to "high" in the recent World Bank/IMF Debt Sustainability Analysis. Laos' budget deficit in 2017 was 4.8% of GDP, compared with 4.6% in 2016.

Key Belt and Road projects in Laos

Name	Status	Cost (in billions of dollars)
China-Laos railway	Under construction	5.80
Nam Ou hydro project 1, 3, 4, 7 *(Phase II)*	Under construction	2.80
Phongsaly-Yunnan road	Unknown	0.91



"There was some impact from the rail project because the government has to contribute $250 million to the project over the next five years, or $50 million a year from domestic revenues," said one development bank economist. "This money will mainly pay for the compensation to affected people along the railway line."

China and Laos have set up a 70/30 joint venture to finance the railway project. Each side needs to contribute 40% of their investment commitment in cash, which means that Laos, with 30% of the joint venture, needs to contribute $715 million over the five-year construction period. Of this, $250 million will come from the national budget. The remaining $465 million will be borrowed from the Exim Bank of China at a 2.3% interest with a five-year grace period and a 35-year maturity.

A worry hanging over the joint venture is: Who will pick up the tab if the railway does not make money? That may be more of a concern for Laos than for China. "It probably is not a commercially viable project in the time frame of a Western bank," Stent said. "But once you add in what China's objectives are, it makes sense for China."

Nikkei staff writers Yuji Kuronuma and Erwida Maulia, and The Banker contributing writer Peter Janssen contributed to this report.