

CHAPTER I

INTRODUCTION

1.1 Background

Debt-trap diplomacy comes from the core understanding of debt trap. Debt trap is a situation where a certain amount of debt is difficult or even impossible to repay.¹ The usage of the word Debt-trap diplomacy was promoted by Brahma Chellaney in describing China's predatory lending practices to developing countries that would be overwhelmed with unsustainable loans and forced to serve China's interest.² This took form in that the creditor country intentionally extends excessive credit to the debtor country with the intention of extracting economic or political concessions from the debtor country when the debtor country becomes unable to meet its debt repayment obligations.³

In dismay, this occurrence has several examples in the history of the International realm. During the Asian Financial crisis in the 1990s, the crisis that started from Thailand spread across East and Southeast Asia. Countries such as Indonesia ran to IMF believing for a reliable bailout and did receive a package of 43 billion USD under the demand to close 16 privately owned banks and advised

¹ Collins Dictionary, s.v. "Debt trap," *Collins Dictionary Online*. English. Available from <https://www.collinsdictionary.com/submission/7098/Debt+trap>; accessed 14 June 2021.

² Brahma Chellaney. China's Debt-Trap Diplomacy. January 23, 2017. <https://www.project-syndicate.org/commentary/china-one-belt-one-road-loans-debt-by-brahma-chellaney-2017-01> (accessed June 14, 2021).

³ Peter Fabricus. Is COVID-19 enabling debt-trap diplomacy?: Will Mombasa and Port Sudan be ceded to foreign powers to repay debt?. April 30, 2020. <https://issafrica.org/iss-today/is-covid-19-enabling-debt-trap-diplomacy> (accessed June 7, 2021).

Indonesia Central Bank to raise interest rates.⁴ This domestic policy reform pushed by the IMF however did not go well and triggered a run on in other banks. panic rushing causes billions of rupiah to be extracted from saving accounts forcing the Central Bank to provide large credits towards the remaining banks to save it from banking crises. However, the rupiah could not stay hold and lost half of its value within just 5 days in January 1998.⁵ Similar case also happened between the IMF and Argentina. Where Argentina had pleaded for loans around every four and a half years to the IMF due to inflation since the 1990s. With no small amount of loans in the 1990s Argentina has pocketed enormous debt towards the IMF. So much that in early 2002, due to a series of inflations and immense net outflow of currency, defaulted on most of its debt. Causing loss of confidence and outrush of escaping locals and foreign investors. Leaving Argentina's currency massively devalued, a 25% unemployment, and half a population degrading below the poverty line.⁶

For the past decades China has seen a steep rise in its economy. Currently placed second in the World's GDP just behind the United States at the grand total of 14.723 trillion USD.⁷ China is widely considered as a great power. However this does not come in one night. Prior to 1979 China was under the leadership of Mao

⁴International Monetary Fund. "Indonesia-Memorandum of Economic and Financial Policies," International Monetary Fund. Publications. January 15, 1998. Available from <https://www.imf.org/external/np/loi/011598.htm>; Internet; accessed 14 June 2021.

⁵ The Investopedia Team. "Asian Financial Crisis," *Investopedia*. International Markets. April 18, 2021. Reviewed by Gordon Scot. Available from <https://www.investopedia.com/terms/a/asian-financial-crisis.asp>; Internet; accessed 14 June 2021.

⁶ Christina Daseking, Atish R. Ghosh, Timothy D. Lane, and Alun H. Thomas, 2005. "VII Conclusions". In *Lessons from the Crisis in Argentina*. USA: International Monetary Fund, p.42-45.

⁷ The World Bank. "GDP (current US\$) - China," World Bank national accounts data and OECD National Accounts data files. China. Available from <https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN>; Internet Accessed 14 June 2021.

Zedong that maintained a centrally planned economy.⁸ Only after the death of Mao Zedong, China led by Deng Xiaoping, reformed China's economy leading to its modern day success. Deng Xiaoping embraced policies of "reform and opening" that contributed to unleashing China's buried potentials.⁹

With China reaping its long term benefit from Deng Xiaoping's reforms, China launched The Belt and Road Initiatives (BRI) in 2013 to further increase their scope internationally.¹⁰ BRI is China's most ambitious foreign policy and economic initiatives. BRI consists primarily of the Silk Road Economic Belt that links China to Central and South and Europe. While the New Maritime Silk Road links China to Southeast Asia, Gulf Countries, North Africa, and Europe. Spanning 138 countries wide.

Estimated to be a total of over \$8 trillion USD project, China has heralded the project to be a golden opportunity to revitalize the region. While Chinese loans through BRI projects have provided vital infrastructure funding to developing countries, it has dragged many towards unsustainable debt issues.

While Chinese loans through BRI projects do provide vital infrastructure funding to developing countries, it also leaves many countries with unsustainable debt. Around 8 BRI recipient countries are at high risk of debt due to BRI project

⁸ Dwight H. Perkins. 2014. *The Centrally Planned Command Economy (1949–84)*. UK: Routledge Handbook of the Chinese Economy Routledge, P. 41-42.

⁹ Shigeo Kobayashi, Jia Baobo, and Junya Sano. "MThe "Three Reforms" in China: Progress and Outlook," *Japan Research Institute* 45 (1999). [e-journal] <https://www.jri.co.jp/english/periodical/rim/1999/RIMe199904threereforms/> (accessed 20 June 2021).

¹⁰ Peter Cai. "Understanding China's Belt and Road Initiative." *Lowy Institute for International Policy* (March 2017). [e-journal] <http://www.jstor.org/stable/resrep10136> (accessed 6 September 2021), p.2.

loans.¹¹ These countries are called to be at high risk due to facing debt-to-GDP ratios that are beyond 50 percent with at least 40 percent of their external debt owned by China.¹² Both Sri Lanka and Pakistan are along with countries that have high risk of debt due to the BRI project. The Hambantota port and Gwadar port have been a living testament of the debt case where both countries leased its infrastructure to China respectively for 198 years and 43 years due to inability to repay loans given by China. This has created the strong impression of the commercial nature of BRI.

1.2 Research Question

As debate on this matter heated up and several countries are clearly at stake from debt default caused by aggressive BRI loans, the issue becomes crucial enough to be discussed. Questions will be used for this Thesis. Including:

1. What are the factors that contributed to China being able to conduct debt-trap diplomacy in Sri Lanka and Pakistan through its BRI project?
2. What are China's national interests through its BRI project nationally and in Sri Lanka and Pakistan?
3. What is China's debt-trap diplomacy pattern through its BRI project?

¹¹ Dylan Gerstel. "IT'S A (DEBT) TRAP! MANAGING CHINA-IMF COOPERATION ACROSS THE BELT AND ROAD," *CSIS Website*. Available from https://csis-website-prod.s3.amazonaws.com/s3fs-public/181017_DebtTrap.pdf?MKq76lYIBpiOgyPZ9EyK2VUD7on_2rIV; Internet; accessed 14 June 2021, p.12.

¹² Gerstel. "IT'S A (DEBT) TRAP! MANAGING CHINA-IMF COOPERATION ACROSS THE BELT AND ROAD," p.12.

1.3 Research Objective

In accordance with the research question and the making of this thesis, the objective of this research is:

1. To understand factors that contributed to China being able to conduct debt-trap diplomacy in Sri Lanka and Pakistan through its BRI project.
2. To understand what are China's national interests through its BRI project nationally and in Sri Lanka and Pakistan.
3. To understand China's debt-trap diplomacy pattern through its BRI project.

The outcome of this thesis will broadly explain the relations between the variables that will be discussed. Particularly on factors that contributed to China being able to conduct debt-trap diplomacy in Sri Lanka and Pakistan as well as its national interests to do so. Ultimately discovering China's debt-trap diplomacy pattern through its BRI project.

1.4 Significance of Research

The purpose of this thesis is to analyze factors that contributed to China being able to conduct debt-trap diplomacy through its BRI project in Sri Lanka and Pakistan to achieve Its national interests. Findings in both Sri Lanka's Hambantota Port and Pakistan's Gwadar Port will then be used as a prototype to identify China's debt-trap diplomacy pattern. This thesis will also use the same pattern on Djibouti's ongoing case and show the consistency of several factors that contributed to China's ability to perform debt-trap diplomacy to these countries. I hope that the findings

from this research can shed light on factors that precede China's ability to conduct debt-trap diplomacy as well as its pattern through the BRI project. This is so that there will be a better understanding on the position of several high risk debt default countries such as Djibouti in the future. Hopefully this research will become a source of knowledge for a wide audience, especially scholars, political economists, and economic practitioners who are interested to further analyze China BRI projects nature in the future, its conduct in Africa until it is proven to be complete, as well as the possibility of high risk countries' sustainable debt. Last but not least, this thesis will be useful for anyone who needs any sources, readings, and secondary data that is in connection to the topic area that is discussed.

1.5 Structure of Writing

The first chapter, which is an introduction, talks about the background of the thesis topic, research questions that the research will address, the purpose of the research, and the significance of the research.

The second chapter, theoretical frameworks, talks about the literature review, the International Relations Theory and concepts that were used as framework to analyze China's debt-trap diplomacy through its BRI project in Sri Lanka's Hambantota Port and Pakistan's Gwadar port as well as historical background effect towards present policies. This section compiles several studies on the concept of Structural Realism theory, economic power, and zero sum game that is much needed in understanding this research.

The third chapter, Methodology, explains the research approach, research method, data collection technique, and data analysis technique used in gathering data and information for the research.

The fourth chapter, Analysis, is the peak of the thesis and analysis. This chapter analyses and presents all the data gathered regarding factors that made China able to conduct debt-trap diplomacy through its BRI project in Sri Lanka and Pakistan, Its national interest within China and globally, China's debt-trap diplomacy pattern in both countries, and a small assessment on Djibouti.

The fifth chapter, Conclusion and recommendations, summarizes the previous analysis chapter. The chapter will briefly explain the analysis approach of the thesis as well as answer the three research questions asked in the first chapter. Before proceeding to point out recommendations for future studies and comparison to investigate Djibouti and many other African countries' debt-trap diplomacy cases until it proves that the issue is finished. On the other hand, ways and possibilities to counter unsustainable debt of these countries could also be assessed. It may focus on assessing choices countries could make instead of leasing the infrastructure and weighted the consequences of each possible action.