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ISSUE BRIEF

GWADAR AND HAMBANTOTA UNDER BRI

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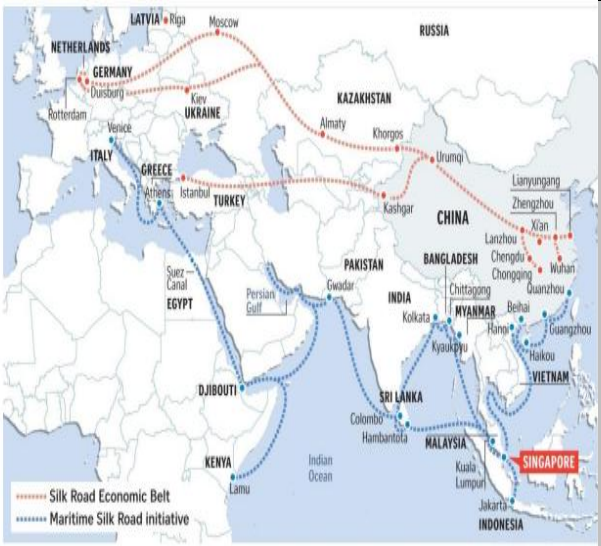
August 27, 2019

(Views expressed in the brief are those of the author, and do not represent those of ISSI)



The economic and strategic investment by China under its Belt and Road Initiative (BRI) is credited as the country's greatest international economic ambition catering to 64 % of the world population and 30 % of world GDP.[1] Launched in 2013 by Chinese paramount leader Xi Jinping, the initiative includes six land and one maritime route encompassing 60 countries in an attempt to create cultural integration and fast-moving economic trade corridors. A key component of this project is the reconfiguration of the maritime silk route spurring investment from both state owned enterprises and directly from the Chinese government to key ports along the route. This brief aims to assess two ports namely, Hambantota and Gwadar, that received Chinese investment and how the economic and political climate has been orchestrated to work towards achieving the previously mentioned ambition.

The belt and road initiative aims to develop trade superiority for China using land and maritime routes. To secure the maritime route, China has followed an investment scheme into major ports along the trade circuit hailing sizeable economic financing and the prospect of designated special economic zones to spur development. The investment has been welcomed by most countries that find it difficult to obtain debt financing on relaxed terms such as those offered by Beijing, due to

1 Huang Yiping, "Understanding China's Belt & Road Initiative: Motivation, framework and assessment", *China Economic Review*, July 25, 2016. https://doi.org/10.1016/j.chieco.2016.07.007

economic and/or political instability. This has been evident by the infrastructure investment in Africa with an approach that downplays political issues (e.g. unstable governments) while creating investment inflow opportunities.[2] China has strategically placed the aforementioned investment to fit the BRI route to ensure development of necessary infrastructure required for the eventual trade boom projecting, according to the World Bank, a 12% reduction in travel times along the corridor, an increase in trade between 2.7% and 9.7%, and the alleviation of 7.6 million people from extreme poverty.[3]

Hambantota, the first of the two ports under review, lies on the southern coast of Sri Lanka. Due to the location of Sri Lanka's major port, Colombo, being on the west coast, Hambantota offers cargo ships to avoid extra travel costs and time in contrast to Colombo. The port is credited as the second largest in the country and after its three-phase completion, will be marked as the largest port to be constructed this century. To supplement the exponential growth, there is also a plan to construct a 15000-acre special economic zone within the region estimated to generate 100,000 jobs. However, this progress in the under-developed district has not come without substantial costs to the government. The country has been one of the major beneficiaries of Chinese lending with estimates putting up to eight billion dollars obtained as of the end of 2018. Much of this funding has been received by the port, placing the Sri Lankan government under fiscal pressure.

The port, during phase one of its three-phase construction program, recorded a revenue of US$11.81 million for the year 2016, while direct and administrative costs amounted to US$10 million. This put the operating profit for 2016 at US $1.81 million. In strict contrast, the loan repayment amount for the year 2017 was closed at US$79 million.[4] The inability to repay this debt resulted in the lease agreement of Hambantota port, at a 70% stake to China Merchants Port Holdings in a joint venture with the state-run Sri Lanka ports authority. The lease has been set at US$1.12 billion,[5] and will help in the repayment of the existing Chinese loans on the country. The settlement spans for 99 years, a move that has been heavily criticized by the Sri Lankan media.

Statistics of this nature have led to critics labelling Sri Lanka as a prime example of China's "debt diplomacy" influencing political decisions based on economic superiority. However, Sri Lankan government officials have denied any existing evidence of debt diplomacy with Dr. Karunasena

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[2] Adisu Kinfu, Sharkey Thomas, Okoroafo C. Sam, "The Impact of Chinese Investment in Africa", *International Journal of Business and Management*, September, 2010. DOI: 10.5539/ijbm.v5n9p3

[3] https://www.worldbank.org/en/topic/regional-integration/brief/belt-and-road-initiative

[4] Sakalasooriya Indika, "Hambantota Port Sale in Perspective", *Daily Mirror,* August 3, 2019. http://www.dailymirror.lk/article/Hambantota-Port-sale-in-perspective-122278.html

[5] Sirilal Ranga, "Chinese Firm Pays $584 million in Sri Lanka Port Debt-to-Equity Deal", *Thomson Rueters,* June 20, 2018. https://www.reuters.com/article/us-sri-lanka-china-ports/chinese-firm-pays-584-million-in-sri-lanka-port-debt-to-equity-deal-idUSKBN1JG2Z6

Kodituwakku, the country's ambassador to Beijing since 2015, acknowledging the current debt crises but strictly maintaining that the debt repayments are on schedule, and that there is no fear of political or economic instability. Amidst the continuing allegations, the Bank of China, one of the country's biggest lenders, has offered a US$300 million loan to Sri Lanka with an extension clause to make it US$1 billion while increasing political instability has lowered the credit rating of the country.[6]

The second port under consideration lies in the province of Baluchistan on the southern coast of Pakistan. Gwadar has long been a prospect for development as the largest deep sea port in the world. It also commands immense strategic importance allowing the passage of Middle East oil through the Persian Gulf. Furthermore, the city represents the southern end of China's titanic investment in Pakistan under CPEC (China Pakistan Economic Corridor), a sub-project of the BRI initiative. The plan includes a 2463 km highway stretching from Gwadar to the Chinese border at Khunjerab Pass[7] to encourage trade between the countries.

Commissioned under then president, General Pervez Musharraf, the port was supposed to supplement the transformation of a small fishing village into a commercial metropolis rivaling the bustling port city of Dubai. Construction started in 2002 and completed in late 2007. The port was estimated to cost US $248 million, with 75% of the expenditure being borne by China.[8] However, development of the necessary surrounding infrastructure including rail and road networks were amiss leading to the project never taking off in the expected fashion. The speculative property bubble burst in late 2012 with investors incurring sizeable losses and the port deemed to be a dead enterprise.

In April 2015, the governments of Pakistan and China signed a US$46 billion agreement for the development of the China-Pakistan Economic Corridor (CPEC) which was extended to US $62 billion by mid-2017.[9] Under this investment program, Gwadar was once again speculated to become a commercial hub in the not so distant future. Expansion schemes amounting to US$1.02 billion were

[6] https://www.aljazeera.com/news/2019/01/bank-china-offers-300m-loan-sri-lanka-190116064011066.html

[7] "CPEC Western, Central and Eastern Routes Construction Status Overview", *Times of Islamabad,* May 25, 2017. https://timesofislamabad.com/25-May-2017/cpec-western-central-and-eastern-routes-construction-status-overview

[8] Walsh Declan, "Chinese Company Will RunStrategic Pakistani Port", *The New York Times,* January 31, 2013. https://www.nytimes.com/2013/02/01/world/asia/chinese-firm-will-run-strategic-pakistani-port-at-gwadar.html?_r=0

[9] Siddique Salman, "CPEC Investment Pushed From $55b to $62b", *The Express Tribune,* April 12, 2017. https://tribune.com.pk/story/1381733/cpec-investment-pushed-55b-62b/

laid out including new multipurpose berths and cargo terminals for the port.[10] Energy projects, rail and road infrastructure, a desalination plant for potable water and a free trade zone spanning 2281 acres were announced.[11]

Beijing outlined interest free loans to aid surrounding projects such as the East Bay Expressway that aims to develop road links connecting the port to the Makran Coastal Highway.[12] Other zero interest projects include the installation of breakwaters, a coal power plant, and a 300-bed hospital in the city. This infrastructure development policy undertaken by the Chinese government has similar traces to those discussed in the case of Hambantota port. However, Pakistan has enjoyed relatively relaxed terms of agreements with Ambassador Yao Jing stressing over the fact that China does not view CPEC as a solely economic initiative but promotes the China-Pakistan relationship as that of “Iron Brothers”.

Another key contrast between the countries is illustrated by the fact that the port of Gwadar was secured by China in a 2000-acre leasing deal for a period of 43 years in mid-2015. Consequently, critics of the Chinese infrastructure development program in Gwadar have described the relaxed loan terms not as a sign of friendship between the countries, but rather as a way of catalyzing development to make the 43 year lease a profitable enterprise for China. Nonetheless, it remains difficult to argue that the investment will not spur considerable economic development within the region.

In the grand scheme of things, China has secured two key ports that fall on the maritime route that the country wishes to reconfigure. Following an economic version of the policies adopted by the British for Hong Kong, the country hopes to develop the ports into key locations in President Xi Jinping’s BRI initiative. Although the exact ramifications of the lease agreements remain open to interpretation due to the lack of economic data; the next 5 years will be vital in determining the long-term consequences of the arrangement.

Pakistan unquestionably holds a central role in the BRI initiative. CPEC has long been hailed as the flagship project of the initiative by Beijing promoting not only economic prosperity, but holding high the value of friendship between the countries. However, it remains an obligation on the governing

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10 Xin Zheng, “Zhuhai Port Scores Big with Deal in Pakistan”, *China Daily USA,* October 30, 2015. http://usa.chinadaily.com.cn/epaper/2015-10/30/content_22326165.htm

11 Yan Li, “Groundwork Laid for China-Pakistan FTZ”, *English China News Service,* November 17, 2015

12 CT Report, “China Provides Interest-Free Loans For Gwadar Expressway East Bay”, *Customs Today,* January 1, 2019. http://www.customstoday.com.pk/china-provides-interest-free-loans-for-gwadar-expressway-east-bay/

body to safe-guard the interests of the country. It is imperative to quantify the possible ramifications of all agreements henceforth to be able to take informed economic and socio-political decisions.

Consequently, Pakistan must strengthen its institutions to promote the expertise required for informed decision making. Little importance is accorded to research-based institutions resulting in a distinct lack of presentable data. There is also a need to introduce transparency within the system to avoid conflict of interest between short-term and long-term development goals. A restructuring of the country-wide institutions under a relatively transparent model remains to date, one of the greatest hurdles to development in Pakistan. Such a restructuring must become the foundational step towards prosperity as the country embarks on the greatest infrastructure development project in its 72-year history.