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**China's foreign economic policy resilience: Sri Lanka and Ethiopia, two countries set to test the model**

# *China's foreign economic policy resilience: Sri Lanka and Ethiopia, two countries set to test the model*

## *Abstract:*

*The PRC has been following a country-plan that has driven its policy for the last decades. Seeking to respond to the new needs of the country, Xi Jinping, secretary general of the Communist Party of China (CPC) since 2012, has shifted China's foreign policy towards a more proactive and assertive line of action, demanding the position of a global leading power. Within this context, the narrative of 'Chinese renaissance', the 'Chinese dream' and the concept of 'The Belt and Road Initiative' are gaining momentum. Will China succeed at building an alternative international economic model? Has it so far been resilient?*

## *Keywords:*

*China, Ethiopia, Sri Lanka, Belt and Road Initiative, alternative economic international system.*

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## Introduction

Many renowned historical figures have suggested throughout centuries that humanity had reached the ultimate form of system of governance, the last of these assertions being made by Francis Fukuyama in 1992. Yet, the 21st Century is once more, defying the concept of 'The End of History' since, the model of liberal democracy and free market economy which seemed to be indisputable, is today, being put into question.

The world is indeed experiencing a change in its balance of power. The emerging demographic, economic and political forces are reshaping the geopolitical and economic global scenario, challenging the unipolar hegemony of the United States of America (USA) in force during the past thirty years. This new direction, which aims to lay the foundations for a multipolar system, has as its main exponent the People's Republic of China (PRC). The Beijing regime is unique so far in history and at present, President Xi Jinping's leadership and orientation of the PRC is at the centre of the debate.

Yet, China's rise to success and whether it becomes a real alternative does not depend only on its internal policies. All global powers need of their external environment to survive, and China is no exception to these historical rules. The PRC's ascendancy to the position of a global power will therefore depend largely on its foreign policy, how its system interrelates with that of other countries against what it calls the Western status quo, and, on its ability to make these players join them on their long-term project.

Within this context, the study "The People's Republic of China and its interrelation with emerging countries: Is the International Economic Model that China seeks to establish a resilient alternative?" published in Ocronos and carried out under the supervision of Miguel Otero-Iglesias, addresses the PRC's political-economic model's interaction with the Democratic Socialist Republic of Sri Lanka and the Federal Democratic Republic of Ethiopia. This article seeks to summarize these two-country case-studies, selected for three main reasons. Firstly, China is itself an emerging power and it is primarily surrounded in geographic terms by other emerging states. Secondly, the PRC is building the basis for an alternative economic international system more favourable to their interests. The success of the Chinese model will therefore rely on the support to their system by relevant emerging economies, whose interests are those that could be most aligned with the PRC. Thirdly, both countries perform a crucial role in Beijing's new course of action: the Belt and Road Initiative (BRI). With it, China is trying to reactivate its GDP, diversify its supply routes, access foreign markets, and internationalize its currency, in order to keep its economy growing steadily at the minimum rate that allows the CPC to maintain its tacit social contract —those trades liberties for economic well-being and progress— with its population. Its realization requires of building infrastructure all throughout Asia, Eurasia and Africa and calling for countries to join them and cooperate on security and economic matters.

**The People's Republic of China and the Democratic Socialist Republic of Sri Lanka**

In recent years, Sri Lanka has been object of desire of the PRC as a cornerstone of the 21st Century Maritime Silk Road since, for the maritime trade with the Middle East, Africa and the Gulf of Bengal, it has a privileged position. Furthermore, China has also seen the opportunity to establish itself in an enclave immediately close to India, its main geostrategic competitor in South-East Asia and in the Indian Ocean.

The PRC increased exponentially its participation in Sri Lanka with the Government of Mahinda Rajapaksa (2005-2015). Ever since, projects from all sectors have become object of Chinese interest and financing, although the industry in which China has invested in the strongest is the Maritime Transport Infrastructure, a strategic industry that responds to the country's national interests —evidencing how the Government guides the business policies.

For instance, the Colombo International Financial Centre (2016), awarded to China Harbour Engineering Company (CHEC)[1] without public competition. Additionally, the Chinese company was also awarded 0.5 $km^2$ of land attached to this new terminal, and over which Sri Lanka does not have sovereignty. The initial known investment has been of $1.5 billion, but the second phase is expected to reach $13 billion. This project is also based on the previous expansion of the Colombo Port that started back in 2008, where China Merchant Port Holdings executed the building of the Colombo South Container Terminal. According to the Asian Development Bank (ADB) Completion Report (2015)[2],

[1] Subsidiary of China Communications Construction Company (CCCC).
[2] "Sri Lanka: Colombo Port Expansion Project, Asian Development Bank", *Banco Asiático de Desarrollo*, Completion Report, 39431-013, 2015.

total costs reached $921 million[3].

Secondly, the Hambantota Port Development Project (2008), also called the 'Port to Nowhere', personal project of the then President of Sri Lanka, Mahinda Rajapaksa. The construction was also awarded to CHEC. The cost amounts to 1.4 billion $, where the Exim Bank of China has financed 85% as shows by AID DATA (2017)[4]. The failure of this project has been resounding. Despite being in one of the busiest maritime routes in the world, it only attracts a few dozen ships a year. Given the economic non-viability of the project and the inability of the Government of Sri Lanka to repay its debt, an agreement was reached where the port and 60 $km^2$ would be leased to China Merchant Port Holdings for 99-years.

The third project is the construction of the Mattala Rajapaksa International Airport (2008), where the CHEC also took over its construction and the Exim Bank of China financed approximately $200 million. However, the airport lacked the necessary air traffic to be sustained and therefore, has been shifted away from commercial purposes.

Lastly, the Southern Expressway Project (2011) and its posterior extension, which connects cities all the way from Colombo to Mattala and Hambantota. According to AID DATA (2017), the highway was executed by CHEC and partially financed by the Exim Bank of China, which provided $278.2 million.

While all projects have had green light from the Chinese Government, not all serve the same purpose. Some of them clearly respond to China's strategic interests, but others seek to satisfy the wishes of the ruling Sri Lankan Government or improve China's image with the local population.

In general terms, the Chinese financing process of these projects has been as follows. According to the White Papers (2014)[5], which classifies this type of investment as 'Developing Foreign Assistance', the flow of funds is channelled through: grants, interest-free loans, and concessional loans. Their origin, varies. Funds may come directly from the Chinese Government, from bank entities – usually the Exim Bank of China, the China

[3] ADB financed $300 million of the Colombo Port Expansion Project
[4] "AidData's Global Chinese Official Finance Dataset", *AIDDATA*, 2000-2014 Version 1.0, Research Lab, William & Mary's Global Research Institute, Global China Data, 2017.
[5] "White Papers: China's Foreign Aid", *Information Office of the State Council*, The People's Republic of China, 2014.

Development Bank (CDB) and the Industrial and Commercial Bank of China (ICBC) – dependent on the Central Financial and Economic Affairs Commission and ultimately on the Secretary General of the CPC or from a completely unknown origin, as shown by the AID DATA database (2017). In most cases, the projects are implemented by Chinese companies, through Public-Private Partnerships or Joint ventures with local companies or agencies. In this way, the CPC guarantees the financing and work to its own national companies.

Furthermore, Sri Lanka has long been responding positively to the initiatives launched by the PRC, adhering to the Sino-Lanka Joint Commission for Economic and Trade Cooperation (1991), the Sri Lankan-China Business Cooperation Council (1994), the BRI (2015) and the Asian Infrastructure Investment Bank (AIIB) in 2016. They also both share membership in the Asian Development Bank (ADB) and are currently in talks for a China-Sri Lanka Free Trade Agreement.

The great concern of the Western block and India is, that China uses the ports and lands under concession not only for commercial purposes, but for military activities and intelligence work.

## *The PRC's impact on Sri Lanka's over the last decade: Balance of Trade, Foreign Direct Investment, Foreign Loans and National Debt*

### *Balance of Trade*

To examine the impact of the PRC in Sri Lanka, information was gathered from the World Bank[6], China Statistical Yearbook[7], and the Central Bank of Sri Lanka[8]. For the past decade, Sri Lanka's Trade Balance has been negative, remaining approximately an 11% of the GDP. Data also shows that the PRC has indeed grown in relevance as a commercial partner for Sri Lanka, representing 40% of Sri Lanka's balance of trade in 2017 and 36% back in 2007.

[6] "Imports, Exports and Trade Balance By country and by region", *Banco Mundial*, World Integrated Trade Solution (WITS), 2020.
[7] "China Statistical Yearbook", *National Bureau of Statistics of China*, Annual Data, Statistical Database, Government of the People's Republic of China, 2020.
[8] "Annual Report", *Banco Central de Sri Lanka*, Economic and Financial Reports, Publications, 2020.

When measuring the export/import coverage ratio, Sri Lanka-World (excluding China) holds a coverage ratio of 67%, which has remained fixed over the period 2007-2017 while Sri Lanka-China was 4% back in 2007 and 8% in 2017. This indicates the existence of a strong imbalance in Sri Lanka's trade balance with the PRC maintained overtime.

*Foreign Direct Investment*

From the UN Conference on Trade and Development (UNCTAD) and from the Statistical Bulletin of China's Outward FDI, total FDI and Chinese FDI accumulated in Sri Lanka was obtained, respectively.

Over the last decade, Sri Lanka has successfully managed to attract FDI, multiplying the total figure by 5 times, with Chinese direct investment increasing in this respect from a merely symbolic position of 0.4% over the total in 2008 to 16% in 2018.

*Foreign Loans*

According to the Central Bank of Sri Lanka, Total Foreign Loans provided to the Government of Sri Lanka have increased by 6,5 times over the last decade reaching a value of $24 billion in 2018. China has also substantially improved its position in this dimension, going from representing a 7% in 2008 to 17% in 2018.

*National Debt*

Over the last decade, Sri Lanka has increased its Total Foreign Debt by almost 3 times as indicated by the Central Bank of Sri Lanka, reaching $32.6 billion in 2018 and representing 41.2% of its GDP when back in 2008 it was 32.8%. During that same period, China has multiplied its presence by 11 times, increasing its weight on the external debt from 2.0% to a 9.1%. However, Sri Lanka's Total National Debt[9] has remained roughly the same for these 10 years, above 80% of its GDP.

This information underlines two facts. First, Sri Lanka has increased its dependency on external debt. Secondly, these accounts reveal that Sri Lanka is mired in a debt crisis,

[9] Total National Debt includes Internal Debt and External Debt.

which is not exclusive to its relationship with the PRC, although it has accentuated with it.

*Conclusions*

From all the macroeconomics dimensions analysed so far, it can be concluded that China has grown in importance for Sri Lanka as an investor, creditor, and trading partner. Hence, Sri Lanka's economic dependency on the PRC has increased. This, together with the state of Sri Lanka's national accounts, leads us to think that indeed, Sri Lanka has fallen into a debt-trap, not necessarily because of what the PRC represents over its debt, but due to the nature of some of the projects executed, which have turned out to not be economically viable for now.

Xi Jinping claimed that their new foreign policy formula would be mutually beneficial, but it is not evident that the mutual benefit has materialized in the case of Sri Lanka.

**The People's Republic of China and the Federal Democratic Republic of Ethiopia**

Contrary to Sri Lanka, the F. D. R. of Ethiopia should not theoretically be part of the BRI. Notwithstanding, it is a crucial country for Beijing's plans for many reasons.

In the first place, Ethiopia is fundamental for protecting the interests of China in its neighbouring country Djibouti, which, is indeed part of the Silk Road route, and of absolutely priority for the defence of free maritime circulation through the Red Sea —entrance to the Suez Canal— and where China has built its first overseas military base.

Secondly, Ethiopia is a strategic country for the penetration and control of Northeast and Central Africa. Its privileged location comes with the fact that it is the second most populous country in Africa, hosts the headquarters of the African Union and boasts a history of independence and Africanity.

Thirdly, Ethiopia experienced in its recent past (1978-1991) the Red Terror Marxist Leninist regime under the sphere of influence of the USSR, whose fall, immediately after the dissolution of the Soviet Union, was replaced with the PRC. Since the Chinese period of influence began, Ethiopia's political regime formally adopted a parliamentary democracy, although de facto it remained to be that of a single party under the governance of the Ethiopian's People Democratic Front (ERPDF), formed from a union of the different ethnicities present in the territory. The new political regime, under the leadership of Meles Zenawi, followed the same ideological patterns of the previous system, however, with characteristics that aligned it to Beijing's political regime. For instance, during the 1990s, a period of economic reforms began which led to the abandonment of the Soviet-type state-led economy to a quasi-free market economy, with the State reserving strategic sectors for itself and other essential sectors for its citizens.

Ethiopia plays a fourth role for China. The PRC considers Ethiopia to be of commercial strategic interest, being key for its penetration into the African market. China sees in Ethiopia a new factory of cheap products to satisfy the African demand. Consequently, the PRC is trying to outsource to Ethiopia those factories that are no longer competitive to maintain in Chinese territory and whose supply is in demand in Africa.

Lastly Ethiopia, as the potential regional power, plays a pivotal role for China's resource extraction policy[10]. The PRC views this emerging economy as a platform from which to easily access Sudan's oil and the immense mineral wealth of Central Africa, especially that of the Democratic Republic of Congo.

For all these reasons, in recent years, the PRC has participated in countless projects in Ethiopian territory, following the same rules and financing process outlined in the previous case-study.

These projects have varied largely from one to another as China got involved in multiple sectors, yet, for the specific case of Ethiopia, it is the Ground Transportation Infrastructure industry the one that has received the most funding and attention.

For instance, the Addis Ababa-Djibouti Railway Project, which is possibly the Chinese project in Ethiopia that has attracted the most attention by the international community. This railway has as its basic purpose the transport of goods and has become a crucial element for the development of the country for it allows Ethiopia to gain an indirect access to the sea, key for its commerce. According to AID DATA (2017), the project has been executed by China Railway Group (CREC), the China Civil Engineering Construction Corporation (CRCC) and the Ethiopian Railway Corporation (ERC), and financed by the

[10] In 2010, mineral products constituted a 79% of Chinese imports from Africa according to Africa Research Institute, "Between Extremes: China and Africa", Publications, 2012.

Exim Bank of China with $2.4 billion and by the ICBC and CDB for the remaining $0.4 billion.

The Addis Ababa Light Rail Project (2011) has also caused admiration within the local population for its usefulness. The Exim Bank of China and the ICBC have financed $403 million according to AID DATA (2017).

Third, China has been greatly involved in power station projects, the most prominent being the Grand Ethiopian Renaissance Dam (2011). This dam, which once finished will be the biggest hydroelectric complex in Africa, has been built in the Blue Nile River and has raised numerous concerns among its neighbouring African countries. First, because the Nile River course will suffer during the time that it takes the dam to be filled, for which it has been proposed to fill it very gradually. This problem is further aggravated by the fact that the water will also experience a higher evaporation rate. Finally, Egypt sees its agriculture being threatened if Ethiopia uses the water to irrigate its own lands. The total costs of the project amount to $4.8 billion, where the Exim Bank of China has covered $1.8 billion.

Lastly, the FDR of Ethiopia has long shown an affirmative response to the initiatives announced by the PRC to strengthen ties. Besides, the adherence to initiatives has worked both ways with the African Continent. Examples are China's adherence to the African Development Bank (1985), the Forum on China-Africa Cooperation (FOCAC) in 2000 where the second Ministerial Conference took place in Addis Ababa, highlighting the value of Ethiopia in China's plans, the China-Africa Cooperative Partnership for Peace and Security (2012), Ethiopia joining the BRI (2015) and the AIIB (2017).

### ***The PRC's impact on the Federal Democratic Republic of Ethiopia over the last decade: Balance of Trade, Foreign Direct Investment, Foreign Loans and National Debt***

#### *Balance of Trade*

To examine the impact of the PRC in Ethiopia, information was gathered from the World

Bank, China Statistical Yearbook, and the National Bank of Ethiopia[11]. For the past decade, the country has maintained a trade deficit yet experienced a slight improvement, representing 27% of its GDP in 2006 and 23% in 2016. These figures are not necessarily alarming per se for a country that is still developing, although it does reveal that it is an extremely unbalanced balance of trade.

Data also shows that the PRC has indeed grown in relevance as a commercial partner for Ethiopia, representing 16% of Ethiopia's balance of trade in 2016 and 7% back in 2006.

When measuring the export/import coverage ratio, Ethiopia-World (excluding China) holds a coverage ratio of 8% in 2016 and 19% back in 2006, while Ethiopia-China was 13% in 2016 and 31% back in 2006. This indicates that Ethiopia has more uneven commercial relations with the PRC than with the average of the rest of its partners.

### *Foreign Direct Investment (FDI)*

Information on the Total and Chinese FDI accumulated in Ethiopia was retrieved from the UNCTAD, the Statistical Bulletin of China's Outward FDI and the China Africa Research Initiative (SAIS-CARI)[12], John Hopkins University School of Advanced International Studies.

Over the last decade, Ethiopia has attracted $20.2 billion dollars, multiplying by 12 the amount of 2008. During this same period, Chinese FDI reached $2.6 billion, having increased the amount of 2008 by 21 times. Consequently, the PRC has gone from accounting a 7% of the FDI to a 13% in 2018.

### *Foreign Loans*

According to the National Bank of Ethiopia and to the SAIS-CARI, Total Foreign Loans received by the Ethiopian Government have increased by 11 times over the last decade reaching a value of $24.6 billion in 2017. For that same period, China also increased the

[11] "Annual Report", *National Bank of Ethiopia Addis Ababa*, Publications, 2020.
[12] John Hopkins University School of Advanced International Studies, "The SAIS China Africa Research Initiative" (SAIS-CARI), Washington D.C., 2014.

loans granted, reaching $13.8 billion.

It is worth noticing that, although in absolute numbers China has indeed increased its contribution, its relative weight over the total of Foreign Loans has in fact decreased, from 77% to 56%. Yet it continues to be a relevant lender for Ethiopia, being responsible for more than half of the total loans received.

*National Debt*

According to the National Bank of Ethiopia, the country's National debt-to-GDP increased from 42% in 2007 to 59% in 2017. During the last decade, Total Foreign Debt-to-GDP has also increased to 30% accounting for half of the Total National Debt, while back in 2007 it only represented one fourth. This can be translated into a significant increase of external dependency.

Regarding the Ethiopian debt owed to the PRC, it must be noticed that in 2007 China held almost 9% of the total debt-to-GDP, meaning that almost 75% of the external debt belonged to China. In 2017, this total debt-to GDP figure increased to roughly 17%, although the PRC's weight over the external debt decreased to 56%.

*Conclusions*

Three facts can be concluded from this information. First, resembling the case of Sri Lanka, Ethiopia has considerably increased its dependency on external debt. Second, China's role in the Ethiopian National Debt is alarming. Even if its relative weight has decreased, such a high percentual representation deepens the economic dependency of Ethiopia on the PRC. This could also result in a risky bet from the Chinese perspective, since, in case of difficulties on the repayment of the debt, the Chinese economy would also suffer. Third, even if the growth of the Ethiopian GDP over the last decade has been remarkable, which has caused Ethiopia to be called the 'China of Africa', its debt has increased faster, which could immerse the country into a debt crisis.

**Final conclusions**

The PRC's participation in international trade has gone from a share of 7.6% in 2008 to

11.6% in 2018, as stipulated by the World Bank and Chinese official statistics, all with a commercial surplus of $350.9 billion. This success has also led to internal economic progress, for China's GDP per capita has increased by 280% in the last decade, from $3,468 in 2008 to $9,770 in 2018. The

resilience of the Chinese international economic model can be further reinforced by the looking at Chinese FDI – which has gone from representing a 0.10% of the world's GDP in 2008 to 0.25% in 2018, reaching a figure of $214.8 billion —and Chinese direct loans— increasing from 0.50% to 0.75% for these same dates, amounting $644.3 billion.

These variables support the Chinese foreign economic policy model in the medium and long run, since overseas investments usually imply long-term returns and the link between creditor and debtor, consciously or unconsciously, entails multiannual ties. In no case are they usually easily reversible in the short term. Evidence of this are the cases of Sri Lanka and Ethiopia. The magnitudes analysed indicate that the nature of their relationships is such that it is difficult to replace, while showing how they have strengthened throughout time.

Albeit, the implementation of China's international economic model has not been exempted from errors and criticism, during the last Silk Road conference held in Beijing in 2019 —main political event of China's new strategy for the world— some of these mistakes were recognized and changes were announced to amend these and improve the overall performance of the BRI: greater rigor in the economic analysis of projects, certification by international organizations, co-investment with third parties… The PRC follows a system of trial and error. We can therefore see the pragmatism of Chinese politics, both in its domestic and foreign policy.

As the Chinese international economic model has been expanding and encompassing more countries, the question that arises is whether the success achieved so far is maintainable over the future decades. As the Sinologist Holslag (2019)[13] stated, "the flag follows the trade, this is a typical pattern for emerging trading nations and China is no exception". The increasingly assertive and even intimidating policy in China's foreign relations, recently termed 'Wolf Warrior diplomacy', seems to point at an ambitious plan

[13] HOLSLAG, Jonathan, "The Silk Road Trap: How China's trade ambitions challenge Europe", *Polity Press*, 2019.

to make China the central global power and its political model, the reference. This course of action is perceived as a threat to the Western model and its global influence, contrary to Chinese intellectuals, who claim to only be taking back the position in the international order that historically corresponds to them. In this way, the narrative of China's Renaissance, that uses historical periods with a rhetorical language, has become an instrument to justify their interpretation.

### *Future Implications*

The COVID-19 pandemic will hardly give rise to a radical change in the world, although it will indeed mark a turning point in contemporary history, accelerating global trends that have been incubating in recent years.

Globalisation, as we have known it, will change. Both global companies and governments will relocate strategic sectors and activities in their territory. They will also ensure that they do not depend exclusively on foreign logistics, since, for instance, it has been found that China operates under rules of absolute mercantilism, even with basic health goods. This process of 'deglobalization' will have an important impact on the PRC, which will have to modify its economic growth model - where its future engine must be that of internal consumption and innovation.

The economic effects are going to be intense throughout the world, and consequently, international trade will be strongly affected. But it is expected that countries with fragile economies will be the main victims. China, as the main investor and creditor of these, will have to confront a more than probable restructuring of their debt.

The world is going to be increasingly demanding in terms of governance and transparency policies. The PRC, seeking to become a global leading power must, therefore, overcome its deficit in this sense as its handling of the pandemic has jeopardized its international reputation.

As McGregor (2010)[14] claims, China has a growing international presence, but its internal problems continue to be the main priority of its leaders. The strengths inherent in the system itself are, in turn, its greatest weaknesses, especially when the regime seeks a

[14] MCGREGOR, Richard. *The Party: The Secret World of China's Communist Rulers*, Penguin Books, 2010.

relevant international projection in a world where it no longer has the control of the society.

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