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Foreign Direct Investment and Debt Trap Diplomacy: A Case study of China Pakistan Economic Corridor

Sohail Ahmad	Department of International Relations, Abdul Wali Khan University Mardan, Pakistan sohail.baber@conceptschools.edu.pk
Dr. Sajjad Ali	Department of International Relations, Abdul Wali Khan University Mardan, Pakistan Sajjadali@awkum.edu.pk

Abstract: *Foreign Direct Investment (FDI) is a key driver of global economic growth, consisting of investment from one country into a company or institution in another country. China has recently become the leading investor in FDI, with its Belt and Road initiative aimed at promoting international trade and infrastructure development in host economies. China-Pakistan Economic Corridor (CPEC) has provided significant investment in energy and infrastructure, contributing to economic growth. However, critics have raised concerns about the potential for debt trap diplomacy as China's influence in Pakistan has increased, with approximately 30 % of Pakistan's external debt now owed to China. Similar issues have been observed in other countries, highlighting the multifaceted nature of the problem. Weak governance, institutional deficiencies, corruption, policy implementation, and transparency have been identified as contributing factors to countries' vulnerability to debt traps a midst Chinese FDI. Pakistan's experience with CPEC has also highlighted concerns regarding governance, project selection, transparency, and uneven distribution of benefits. Further debates will be necessary to assess the long-term impact of CPEC on Pakistan's economy and debt burden.*

Keywords: Foreign Direct Investment; Debt Trap Diplomacy; China Pakistan Economic Corridor

Introduction

Foreign Direct Investment (FDI) is a commercial transaction where someone from one country invests in a company or institution of another country. This investment includes the establishment of new businesses or the acquisition of existing ones, making it an essential driver of global economic growth. FDI promotes international trade, creates job opportunities, and boosts the development of host economies.It is the cornerstone and key driver of economic growth and development of a country. China has recently become the leading investor in FDI with Belt and Road initiative. FDI is crucial for developing countries like Pakistan as it help in addressing its financing gap and improving its infrastructure and seaports. However the critics have raised concerns over the growing dependencies on China’s FDI and its Potential repercussions including falling into debt trap and compromising its sovereignty (Younas.U, 2021)

A decade has passed since the inception of china Pakistan economic corridor (CPEC) , the multi billion dollars flagship project under president XI Jinping ,s 1.4 trillion dollars Belt and Road Initiative (BRI) was launched. The enormous BRI programme, which is approx 11 time of Marshall plan that rebuilt and deeveloped Europe from the destruction of world war 2, aims to promote, renovate and develop infrastructure through a chain of new roads, ports and airports, high speed rails, power plants and telecommunication, links to promote trade with in Asia, Middle East, Europe and Africa .This mega project has been described by former American assistant defense secretary Chas Freeman as " potentially the most trans formative engineering effort in human history, because once completed, it could cover more than half of world population and generate GDP of $21 trillion (Hussain.N July,2023).

According to Naveed Hussain, The CPEC project which has been described as "Game Changer" by Pakistani's official was launched in 2013 during visit of Chinese Premier Li Keqiang to Pakistan, but it has received a huge stimulus in April 2005 during the official visit of president XI Jinping to the country . Pakistan welcomed the CPEC as journey towards " Economic Development in Globalized world, and as a " Hope of better region with prosperity , harmony, development and growth of Economy. It is a major component of China's Belt and Road Initiative (BRI) and it has great impact on Pakistan's growth, human development, employment generation(almost 236000 jobs), revenues, environmental impacts and overall development has been widely debated (Zafar.A, 2021).

In terms of growth, the CPEC has brought about significant investment in energy and infrastructure projects, with the aim of boosting economic growth. According to the Pakistan Ministry of Planning, Development, and Reforms, CPEC has already contributed 4.5% to Pakistan's annual GDP growth. However, critics argue that this growth is not sustainable and will ultimately lead to a debt crisis due to the high costs associated with the projects.

In terms of human development, the CPEC has led to the creation of some employment opportunities, but these have been limited to low and semi-skilled labor. The lack of skilled labor has resulted in many companies bringing in workers from China, which has led to criticism from local groups who claim that the locals are being sidelined from the employment benefits. According to James Schwenlein report "Strategic implications of CPEC" which said that From 2014 to 2019, projects under CPEC proceeded in step with the 2017 master plan. According to data collected by the World Bank, in these first five years of implementation, approximately $32 billion in Chinese investments were under construction, completed, or operational, and feasibility studies had been conducted on an additional $14 billion in projects. Approximately 70 percent of CPEC projects implemented or completed up to date have been in the energy sector, with nearly all of the remainder in the transportation sector (Schwenlein , 2019).

How ever it has great challenges and hurdles to face. Many concerns have been raised regarding " Debt Trap Diplomacy" (Chellaney.B, 2017) associated with Chinese investments which shows that these investments may lead to large number of debt burdened and compromise on economic sovereignty According to Uzair younas (senior policy Analyst for S.A program at USIP) the China ,s influence in Pakistan during last eight years has increased. Pakistan total external debt stood $ 44.35bn in June 2013 ,just 9.3 percent was owed to china . By April 2021 it ballooned up to $90.12 billion with Pakistan owing 27.4 percent to China that is $24.7 billion of its total external debt according to IMF (Younas 26th may, 2021).

More over This can be seen in case of Sri Lanka, Maldives, Tajikistan etc, all these and many other countries are affected by debt trap diplomacy where they have accumulated huge amount of debt owed to china due to BRI projects. The Term "Debt Trap diplomacy" was first coined by western policy makers in 2017 to describe the Chinese take over of Sri Lanka,s " Hambantota Port" on 99 years lease after the island nation failed to honour its debt commitments (Chellaney.B , Dec 2017). Since the term is illegally applied to BRI including CPEC.According to Pakistan institute of development economics (PIDE) report China,s debt to Pakistan has witnessed significant increase over the years. In 2017 it was $7.2 billion which increased to $19 billion in 2018. While in 2021 it increased up to $24.7 billion (PIDE nd). Similarly the project budget is $62 billion but according to Hassan Abbas (Pak-American scholar in south Asian and Middle East studies) the delay in the project will increase the cost up to $98 billion. it will take more than 40 years to pay back debt to china and all these increase in debt raises the concerns about Pakistan ability to manage and repay the loan. Potentially this increase the risks associated with debt trap diplomacy.

The issue of Chinese Foreign Direct Investment (FDI) and its potential role in leading host countries into a debt trap is multifaceted. Beyond Uzair Younas' study, various other factors, especially local and national social and political dynamics, contribute to countries' susceptibility to debt traps a midst Chinese FDI.

Governance and Institutional Factors: A book written by Deborah Brautigam in ("The Dragon's Gift: The Real Story of China in Africa,") emphasize that weak governance structures, institutional deficiencies, and corruption within host countries significantly contribute to their vulnerability to debt traps. This is observed in cases across Africa, where inadequate regulatory frameworks and governance issues have amplified debt challenges despite Chinese investments

Policy Implementation and Transparency: another example of domestic impact is Kevin P. Gallagher's work on Chinese finance in Latin America in his book :(new bank in the town); highlights how changes in political leadership and policy priorities can impact a country's debt sustainability. In instances where transparency and accountability are lacking in policy implementation related to Chinese-funded projects, countries may face higher risks of debt distress.

In the context of Pakistan's experience with the China-Pakistan Economic Corridor (CPEC), local social and political dynamics have played a crucial role (Zafar.A,2021). Challenges related to transparency, local stakeholder engagement, and uneven distribution of benefits have fueled concerns. Reports from institutions like the Pakistan Institute of Development Economics (PIDE) and independent analyses has highlighted these concerns. Concerns about governance, project selection, transparency, and the concentration of projects in certain regions have been raised. These issues have led to debates within Pakistan regarding the long-term impact of CPEC on the country's economy and debt burden.

Despite all the potential economic benefits of foreign Direct Investment (FDI) concerns persist regarding the potential for debt trap diplomacy with in BRI. Examining the case of CPEC provides insights into specific challenges and opportunities associated with this ambitious initiative. Although CPEC has attracted significant attention, with proponents and opponents arguing about its potentials and risks. The main problem with this project is its potential to trap Pakistan in debt cycle, undermining its economic sovereignty and strategic autonomy.

Objectives of the study

1- To examine the recent unprecedented increases in debt following the Chinese FDI under CPEC in Pakistan

2- To examine the Impact of domestic social and political dynamics on Foreign Direc Investment (FDI) with in China’s Belt and Road Initiative focusing on CPEC

Research Questions

1. How has the influx of Chinese FDI through projects under CPEC contributed to huge increase in Pakistan’s national debt with in recent periods?
2. How do domestic social and political dynamics shape the outcomes of Chinese foreign investment?

Theoretical framework

Theory of Dependency ; Firstly proposed in the late 1950s by the Argentine economist and statesman Raúl Prebisch, dependency theory gained prominence in the 1960s and ’70s. It is a theoretical framework within the field of development studies and international relations. It offers a perspective on the structural inequalities and power dynamics in the global economic system, particularly between developed and developing countries. Dependency theory seeks to explain how underdeveloped countries are disadvantaged by their reliance on more developed countries for capital, technology, and market access. Here is how this theory applied.

1. Unequal Power Dynamics: Dependency theory highlights the unequal power relations between developed and developing countries in the global economy. In the context of CPEC, Pakistan's reliance on China for investment and infrastructure development reflects a form of economic dependency. China, as the investor and provider of loans, holds significant leverage over Pakistan's economic and political decisions.

2. Resource Extraction and Dependence: Dependency theorists argue that multinational corporations from developed countries often extract resources from developing countries, leading to a cycle of dependence and underdevelopment. In the case of CPEC, China's investments in Pakistan's energy and infrastructure sectors can be seen as a form of resource extraction, where Chinese companies benefit from access to Pakistan's markets and resources while contributing to Pakistan's debt burden.

3. Technology Transfer and Dependence: Dependency theory also emphasizes the unequal exchange of technology between developed and developing countries. In the context of CPEC, while China brings advanced technology and expertise to infrastructure projects, there are concerns about Pakistan's long-term dependence on Chinese technology and know-how. This could limit Pakistan's capacity for independent technological innovation and development.

4. Debt Trap Diplomacy: It argue that initiatives like CPEC perpetuate dependency by increasing developing countries' debt burdens to developed countries or international financial institutions. The high levels of debt incurred through CPEC projects could exacerbate Pakistan's economic vulnerability and deepen its dependency on external financing, potentially compromising its sovereignty and policy autonomy.

5. Alternative Development Strategies: Dependency theory advocates for alternative development strategies that prioritize self-reliance, economic diversification, and regional cooperation among developing countries. In the context of CPEC, policymakers in Pakistan could explore strategies to reduce dependency on external financing, promote domestic industries, and strengthen regional economic integration with neighboring countries.

By applying the theory of dependency to research on FDI and debt trap diplomacy in the context of CPEC, can provide a critical lens to analyze power dynamics, economic relations, and development outcomes between China and Pakistan. This perspective can enrich our understanding of the implications of large-scale infrastructure projects and foreign investments for developing countries' economic development and sovereignty.

Methodology

Qualitative approach employed. Data collected from,

1. Interviews and discussions (Govt officials,project managers,experts and policy makers etc)
2. Documents Review (study official paper,agreements and reports)
3. Field visits and observations (visit of CPEC projects sites etc)
4. Analyzing opinion (to analyse what people say about CPEC and its financial impact
5. Case studies

Discussion

It critically analyze the implications of FDI and debt trap diplomacy within the context of the China-Pakistan Economic Corridor (CPEC). This examines the economic benefits, debt sustainability concerns, geopolitical implications, and socioeconomic impacts of CPEC on Pakistan, drawing insights from stakeholder perspectives and existing literature.

Economic Benefits of CPEC

The research findings reveal that CPEC has brought significant economic benefits to Pakistan, including infrastructure development, job creation, and increased foreign investment. Stakeholders emphasized the importance of CPEC in addressing Pakistan's infrastructure deficit and stimulating economic growth in key sectors such as transportation, energy, and telecommunications. For example, interviews with policymakers and industry experts highlighted the role of Chinese investment in building roads, ports, and power plants, which has enhanced connectivity and facilitated trade between China and Pakistan.

However, while the short-term economic gains of CPEC are evident, questions remain about the long-term sustainability and distributive impacts of these investments. Some scholars argue that CPEC projects prioritize infrastructure development in politically influential regions, such as Punjab province, at the expense of less-developed areas like Balochistan and Khyber Pakhtunkhwa. This uneven distribution of benefits could exacerbate regional disparities and social inequalities within Pakistan, undermining the project's potential to promote inclusive and equitable development.

Debt Trap Diplomacy and Sovereignty Concerns

One of the key findings of the research is the concern over debt trap diplomacy and its implications for Pakistan's sovereignty and economic independence. Interviews with policymakers and civil society representatives highlighted apprehensions about Pakistan's growing debt burden and the terms of Chinese loans under CPEC. The opaque nature of loan agreements, high interest rates, and collateral requirements have raised questions about Pakistan's ability to repay its debts and maintain control over strategic assets.

Scholars have cautioned that excessive reliance on Chinese financing could undermine Pakistan's sovereignty by subjecting it to external influence and control. The notion of debt trap diplomacy, popularized in the context of China's Belt and Road Initiative (BRI), suggests that loans extended by China to developing countries like Pakistan may come with political strings attached, compromising recipient countries' policy autonomy and strategic decision-making. This has prompted calls for greater transparency, accountability, and scrutiny of CPEC projects to safeguard Pakistan's sovereignty and national interests.

Geopolitical Implications of CPEC:

The research findings underscore the geopolitical significance of CPEC for Pakistan's relations with China, India, and other regional actors. CPEC has emerged as a focal point of competition and cooperation in South Asia, shaping regional geopolitics and security dynamics. Interviews with policymakers and analysts highlighted the strategic importance of CPEC as a corridor for China's access to the Arabian Sea and the broader Indian Ocean region, challenging India's traditional dominance in the Indian Ocean.

However, CPEC has also exacerbated tensions between India and Pakistan, particularly in disputed territories such as Gilgit-Baltistan. India views CPEC as a violation of its sovereignty and territorial integrity, as it passes through territory claimed by both India and Pakistan. This has led to diplomatic friction and security concerns, with India expressing opposition to CPEC and boycotting China's Belt and Road Forum in 2017. The geopolitical rivalries surrounding CPEC have implications for regional stability, with potential effects on security and conflict dynamics in South Asia.

Socio-Economic Impacts and Community Perspectives:

The research findings highlight the socioeconomic impacts of CPEC on local communities and their perspectives on the project. While CPEC has generated employment opportunities and improved infrastructure in some areas, concerns remain about its social and environmental costs. Interviews with community leaders and residents affected by CPEC projects revealed grievances related to land acquisition, displacement, and environmental degradation.

In Balochistan and Khyber Pakhtunkhwa, where CPEC projects such as the Gwadar Port and the Peshawar-Karachi Motorway are located, local communities have expressed concerns about marginalization, loss of livelihoods, and cultural heritage. Scholars argue that the lack of meaningful consultation and participation of local communities in the planning and implementation of CPEC projects has contributed to grievances and social unrest in these regions. Addressing these concerns requires greater transparency, accountability, and community engagement in decision-making processes related to CPEC.

In conclusion, this section critically analyzes the economic, political, and social dimensions of CPEC in Pakistan, drawing insights from stakeholder perspectives and existing literature. While CPEC has brought significant economic benefits, concerns remain about debt sustainability, sovereignty, and distributive impacts. Addressing these challenges requires greater transparency, accountability, and inclusivity in decision-making processes related to CPEC. Moving forward, policymakers and stakeholders must carefully navigate the complexities of CPEC to ensure that it contributes to inclusive and sustainable development in Pakistan.

Results

Benefits of FDI:

- FDI promotes economic growth and development by attracting capital, technology, and expertise from foreign investors.

- It creates job opportunities and improves labor skills through knowledge transfer and training programs.

- FDI enhances infrastructure development and international connectivity, fostering trade and economic integration between nations.

- It contributes to the diversification of economies and increases competitiveness in global markets.

Concerns of Debt Trap Diplomacy:

- Debt Trap Diplomacy arises when economically dependent countries are lured into taking on excessive debt from other nations, leading to political and economic concessions.

- Critics argue that certain foreign investment practices can exploit the weaker financial positions of developing countries, compromising their sovereignty and long-term economic stability.

- Lack of transparency and inadequate risk assessments in loan agreements contribute to concerns about debt sustainability and the potential for a loss of control over national assets.

The Case of CPEC

- CPEC is a multi billion dollar flagship project under BRI, connecting China's western region to the Gwadar port in Pakistan.

- The massive infusion of Chinese investments in Pakistan through CPEC has enabled the country to address its balance of payment issues and access much-needed capital.

- However, criticisms have been raised regarding the lack of significant progress in Pakistan's infrastructure development, potentially indicating a lack of substantial return on investments.

- Concerns about Chinese influence, the terms of loan agreements, and the lack of transparency surrounding CPEC have provoked skepticism and mistrust.

Recommendations and Implications

- Host nations should adopt a balanced approach, leveraging the benefits of FDI while safeguarding their economic and political autonomy.

- There is a need for greater transparency, accountability, and public disclosure in loan agreements to ensure the long-term sustainability of investments and protect the interests of recipient nations.

- Diversification of economic partnerships and attracting investments from multiple sources can reduce the risks of over-reliance on a single country or lender.

- Governments should prioritize comprehensive risk assessments, negotiate equitable terms, and establish robust governance practices to mitigate the potential pitfalls of Debt Trap Diplomacy.

Conclusion

The interplay between Foreign Direct Investment (FDI) and Debt Trap Diplomacy presents a complex and multifaceted dynamic in global economic relations. This research has explored the case study of the China-Pakistan

Economic Corridor (CPEC) as an illuminating example of the potential risks and benefits associated with these concepts. FDI continues to act as a crucial catalyst for economic growth, job creation, and cross-border collaboration. It offers numerous advantages, including technology transfer, knowledge sharing, and improved infrastructure. In the context of CPEC, Chinese investments provided Pakistan with an opportunity to access significant funding and address its balance of payment issues. This infusion of capital, although fraught with concerns, has potential to trigger positive economic transformation and enhance bilateral trade between China and Pakistan.

On the other hand, Debt Trap Diplomacy has emerged as a critical concern in the context of CPEC and BRI more broadly. Skeptics argue that China's substantial loans to developing countries can create a debt burden, leading to the surrender of economic and political control to the creditor nation. Concerns have been raised about the lack of transparency and long-term sustainability of these investments, particularly in countries with fragile economies. This has led to calls for a comprehensive assessment of the terms and conditions attached to such investments to ensure the long-term interests of the recipient nations.

The case of CPEC highlights the importance of striking a balance between reaping the benefits of FDI and safeguarding host nations against potential debt traps. It is crucial to establish mechanisms for greater transparency, accountability, and public disclosure in loan agreements to alleviate concerns surrounding debt sustainability and ensure the equitable development of host countries.

Moreover, host nations should prioritize diversifying their economic partnerships and attracting investments from multiple sources to avoid over-reliance on any one country. By diversifying their investment portfolios and seeking partnerships with multiple stakeholders, host countries can mitigate the risks of Debt Trap Diplomacy, maintain their economic and political autonomy, and ensure the long-term stability of their economies.

In light of the findings from the case study of CPEC, it is evident that a nuanced approach is required to navigate the complexities of FDI and Debt Trap Diplomacy. Policymakers should exercise caution, conduct thorough risk assessments, negotiate equitable terms, and prioritize their national interests while engaging with foreign investors. It is imperative to create an enabling environment that fosters healthy competition, encourages robust governance practices, and protects the rights of host countries and their citizens.

Overall, the case of CPEC serves as a valuable lesson for nations engaging in foreign investments and regional connectivity initiatives. By learning from the experiences of others, countries can proactively address the potential pitfalls associated with FDI and Debt Trap Diplomacy, harness the benefits of such investments, and ensure sustainable economic development while preserving their sovereignty.

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