**Soviet Collapse Echoes in China’s Belt and Road**

David Fickling, *Bloomberg*, 12 août 2018

*Grand investment plans for unproductive regions have caused empires to founder before.*

What causes empires to fall? According to one influential view, it's ultimately a question of investment. Great powers are the nations that best harness their economic potential to build up military strength. When they become over-extended, the splurge of spending to sustain a strategic edge leaves more productive parts of the economy starved of capital, leading to inevitable decline.

That should be a worrying prospect for China, a would-be great power whose current phase of growth is associated with an increasingly aggressive military posture and a tsunami of capital spending in its strategic neighborhood.

**China's labor force is forecast to decline in 2018 for the first time in five decades**

Like the Soviet Union in the 1970s, China is coming to the end of a long labor-force boom, and hoping that an orgy of investment will keep the old magic going while stabilizing its fraying frontiers. The success or failure of its Belt and Road projects – and the still greater sums it’s spending domestically – will determine whether the nation achieves its dream of prosperity or succumbs to the same forces that doomed the U.S.S.R.

The conventional worry about the Belt and Road initiative – an open-ended framework for an estimated $1.5 trillion of infrastructure projects over the next decade across Southeast Asia, South Asia and Central Asia – is that it will doom the recipients of its largess to a future as indebted clients of Beijing.
Failed projects like Sri Lanka's Hambantota port may indeed be a way for China to quietly extend its strategic power around the world\(^1\). But defaults on investments cause problems for creditors as well as debtors. The risk for President Xi Jinping is that the toll of all that

\(^1\) Its lease was [handed to China for 99 years](#) to relieve the debt burden that the country's government took on from its builder, China Merchants Group.
misdirected spending gradually undermines the productivity growth on which China’s current might was built.

Consider some of the projects still on the drawing board. Think the $1.6 billion price tag Nomura Holdings Inc. has put on Hambantota looks excessive? Then check out Kyaukpyu in Myanmar, where Citic Group Corp. is leading the construction of a $9.6 billion deep-sea port and industrial zone to hook up with oil and gas pipelines built by China National Petroleum Corp.

There’s certainly a strategic logic here. China’s links to the western markets that consume its goods and the Middle Eastern countries it depends on for petroleum pass through a choke point in the straits of Singapore and Malacca, a worry for the country’s military planners. Building railways and pipelines to the Indian Ocean provides an alternative route west.

**Put That in Your Pipe**

Gas pipelines generally need to use at least half of their capacity to break even. The China-Myanmar pipeline has barely cracked one-third utilization since it opened in 2013

![Graph showing utilization of China-Myanmar pipeline](image)

Source: China Customs General Administration, Bloomberg, Bloomberg Opinion calculations

Note: Complete trailing 12-month data starts in 2014, a year after the pipeline opened.

On the economics, however, the idea falls down. The gas pipeline to Kyaukpyu has barely run at one-third of capacity since it was inaugurated in 2013, and the parallel oil tube sat dry for years before the first cargo was loaded up last year – not a great return on the $2.5 billion spent building them. A 260,000 barrels-a-day processing plant at the end of the pipe in Kunming that’s about the size of the U.K.’s biggest oil refinery will be similarly underutilized unless more crude deliveries arrive at Kyaukpyu.

Or take the web of touted rail projects through central Asia which form a centerpiece of most maps of Belt and Road projects. As we’ve argued before, such plans misunderstand both the long history and basic economics of east-west trade, which has almost always been far more dependent on maritime transport via Southeast Asia, India and the Arabian Peninsula than on overland Silk Roads through the Eurasian steppe.
Go West, Young Man
Belt and Road projects off the Asian mainland in Indonesia, the Philippines and Sri Lanka constitute only a small portion of the total

![Belt and Road Projects Pie Chart](image)

Source: Nomura Securities; AIIB; China-Pakistan Economic Corridor; Bloomberg Opinion calculations
Note: There's no definitive accounting of Belt and Road projects, or which of the development belts identified projects belong to. We've attributed projects at the country level although (for instance), Myanmar’s Kyaukpyu port could be considered part of the Maritime Silkroad rather than the China-Indochina belt.

The disadvantages of land transport are compounded these days by the existence of giant container ships capable of carrying almost $1 billion of cargo at a time, and the variety of different track gauges across Asia which require costly and time-consuming transfers.

The value of freight between Europe and Yiwu, a much-touted overland rail hub near Shanghai, came to 2.27 billion yuan ($330 million) in the first four months of this year, according to China Railway Express Co. That’s about one third of what you’d get on a single mega-container ship, and there are hundreds of somewhat smaller vessels plying east-west routes. China’s top four ports alone process about the same value of cargo every three hours.

I Must Go Down to the Sea
The overwhelming majority of China’s trade with Europe is by sea and air. Overland routes don’t cut it

![Trade Mode Distribution Chart](image)

Source: Center for Strategic and International Studies. Note: 2016 data.

It’s worth considering all this misdirected spending in the context of the Soviet Union’s decline. Around the middle decades of the 20th century, Moscow presided over a China-style economic miracle that caused many in the West to fear they would be overtaken. In the 1950s, the Soviet economy grew faster than that of any other major country barring Japan.
There are many reasons this development path started to falter in the 1970s, including the rigidities of a planned economy, a plateau in industrial workforce numbers, and the vast sums dedicated to Cold War-era military spending. Still, it’s hard to tell the story of declining Soviet productivity without also considering its own Belt and Road initiative, the development of Siberia.

From the 1960s, Siberia sucked up about a third of the Soviet Union’s heavy-construction equipment despite hosting just a fraction of the country’s population, as Moscow pumped in capital to develop gas fields, coal mines, aluminum plants, and a duplicate of the Trans-Siberian railway several hundred kilometers to the north.

**Hard Times**

Productivity declines in oil, coal and steel in the 1970s and 1980s dragged down the performance of the entire Soviet economy.

“Resource developments of Siberian natural resources was a vast sink for investment rubles,” as economist Robert C. Allen wrote in a 2001 paper, diverting spending from more attractive projects west of the Urals and eventually undermining the productivity of the economy as a whole. “The Soviet Union’s 'abundant' natural resources had become a curse,” he wrote. “Resource development swallowed up a large fraction of the investment budget for little increase in GDP.”

Could something similar happen in China? As with the U.S.S.R.’s strategic concerns about shoring up its eastern fringes, Beijing’s fears of separatism in its west have driven a surge in capital projects there in recent years, next to which Belt and Road projects look like merely the tip of the iceberg.
Crowding Out
The share of China's fixed capital formation going to its most-productive eastern regions has been in decline for a decade

Western China accounted for about 19.5 percent of the country’s fixed capital formation in 2016, compared to 15.4 percent in its dynamic Tier One cities and Guangdong province. Less developed parts of central, northern and western China have swallowed up the bulk of fixed capital ever since 2007, according to official data.

That’s matched the end of China’s productivity miracle, too. Unit labor costs have outpaced productivity growth since 2008, meaning the economy has been growing less and less competitive over time, according to a report last month by the Conference Board, a research group. About 90 percent of China’s advantage over the U.S. in terms of unit labor costs in 2016 was explained by currency effects alone, economist Siqi Zhou wrote.

China's anxiety about its western fringes has many troubling effects. Compared with the hundreds of thousands of Uighurs who've been sent to re-education camps and the millions more under constant surveillance in Xinjiang province, wasted capital on transport mega-projects may seem like a minor problem.

It’s not, though. In a country where reliable economic data is thin on the ground and the number of people in work is now in absolute decline, the toll of ill-conceived investments risks eating away at the foundations of growth.

China's rise this century was driven by its embrace of world trade and the coastal provinces most exposed to it. In this retreat inland, it’s sowing the seeds of decline.