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ANAKLIA PORT DEVELOPMENT: CHINA'S FINANCING AND ITS IMPLICATIONS FOR GEORGIA

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1. EXECUTIVE SUMMARY

China is the largest bilateral creditor to low- and middle-income countries (LMICs) presently. China's lending mainly targets infrastructure, transport, energy, and mining sectors in developing countries that are of strategic importance to the Chinese government. Sub-Saharan Africa and South Asia have observed the most substantial increases in borrowing. Chinese financing to LMICs is facilitated through state entities, offering concessional and non-concessional loans, with a significant portion of lending cloaked in confidentiality. These agreements often contain extensive default and cancellation clauses and are marked by collateralized transactions, which, while reducing lender risk, pose substantial challenges for borrowers, including increased risk of debt distress and complications in debt restructuring. Recent studies have highlighted the heightened risks and complexities associated with collateralized sovereign borrowing, emphasizing the need for transparency and proper disclosure to mitigate potential risks. Despite being one of the world's largest bilateral creditors, China is not a member of the Paris Club, an informal group of official creditors focused on finding coordinated solutions to debtor countries' payment difficulties; instead, China opts for direct, often less transparent, bilateral negotiations for debt restructuring and relief, incorporating strategies such as extended loan maturities, interest rate adjustments, debt-for-resource and debt-for-equity swaps, while more recently also endorsing the G20's Common Framework for coordinated debt treatments.

The policy paper provides an overview of various projects financed by China, categorizing them based on the modalities of goods for infrastructure and services for infrastructure, further explored in Annex 1 with comprehensive technical and operational details. It highlights the "Angola mode" or oil-for-infrastructure model, a goods-for-infrastructure transaction where infrastructure construction is compensated by goods exports in a subsequent period. This model, exemplified by the Sino-Angolan joint venture, has historically deemed being beneficial until recent debt treatments surfaced post-2020. On the services side, projects like the Laos-China Railway, the Addis Ababa–Djibouti Railway, and Sri Lanka Hambantota port showcase complex agreements where infrastructure services are expected to generate foreign exchange cash flow for debt repayments. These case studies reveal a pattern of collateralized transactions, often with offtake guarantees and asset pledges, facing debt distresses followed by debt treatments. The lessons drawn from case studies emphasize the importance of sound institutional and legal frameworks for risk management, highlighting problematic collateralization impacts and the necessity for borrower countries to enhance internal and external governance structures to ensure project success and financial integrity.

With the background above, the Anaklia Deep Sea Port project in Georgia, set to be developed through a Public-Private Partnership (PPP) with a Chinese-Singaporean consortium, faces numerous risks that could impact its execution and future operations. Nontransparent procurement, absence of competition, and uncertainties surrounding the contract's terms, coupled with the government's significant 51% stake, raise questions about fiscal responsibilities and the potential for contingent liabilities, such as state guarantees on cargo volumes, which could evolve into direct liabilities affecting the state budget. These concerns are compounded by the project's reliance on equity and debt financing for its US$600 million initial investment. Moreover, the decision to follow a Build-Own-Operate (BOO) model, rather than a more transparent Build-Operate-Transfer (BOT) model, further obscures the financial obligations and challenges the project's transparency.

Additionally, the geopolitical implications of sidelining Western involvement in favor of Chinese investment, the potential for increased Chinese influence, and control over critical Georgian infrastructure pose risks to Georgia's national security and economic independence. The project's profitability remains uncertain, given the speculative nature of projected trade flows with Europe and concerns over whether the Anaklia port can attract sufficient cargo volumes. The financing of the Georgian government's share, possibly through pension funds or loans from Chinese companies, introduces the risk of debt distress, reminiscent of Sri Lanka's Hambantota port. These challenges necessitate a careful evaluation of the project's strategic viability and financial sustainability, drawing from extensive unfavorable international experience in similar projects. drawing from extensive unfavorable international experience in similar projects. Will Georgia's objective of creating a major transit hub be undermined by the dangers of debt distress like in other countries, or can the country successfully manage these complexities to ensure a prosperous future for the Anaklia port? This analysis explores the potential risks that could be associated with Chinese investments in a critical infrastructural project, drawing on global lending practices discussed earlier.

For the Anaklia Deep Sea Port project in Georgia to achieve its full potential and ensure beneficial outcomes, a comprehensive approach to risk management and project governance is essential. The Georgian government and relevant stakeholders should prioritize sound institutional and legal frameworks. This includes conducting exhaustive reviews of contractual terms to ensure they align with domestic laws and international obligations, and closely aligning commercial agreements with legal requirements with a view of safeguarding country's critical assets.

To mitigate the risk of corruption and self-dealing practices, it is paramount to promote transparency and accountability throughout the entire process. Ensuring that every aspect of the project aligns with Georgia's broader debt strategy and macroeconomic policies will be crucial for its success. Additionally, enabling supervisory and back-office teams to have immediate and comprehensive access to review and contribute to negotiations as they happen, will ensure a more inclusive and informed decision-making process.

To support these structural and procedural reforms, the Georgian government must also focus on capacity building within key areas. Strengthening the expertise and resources available in legal, debt management, fiscal risk management, and public investment management is critical. This effort should aim at developing in-house capabilities that can provide the technical know-how required for the execution and ongoing management of the Anaklia port project. By implementing these recommendations, Georgia can better manage the complexities of the Anaklia Deep Sea Port project, ensuring it serves as a catalyst for economic growth while safeguarding national interests.

2. INTRODUCTION

Prompted by the Georgian Government's recent decision to select a Chinese company for the implementation of the Anaklia Deep Sea Port project, this paper is structured into three main sections. It begins by providing an overview of China's ascent as the foremost bilateral creditor, followed by an analysis of its lending practices and case studies. Building on this foundation, the paper then examines the risks associated with the Anaklia project and provides recommendations.

Section 3 summarizes China’s emergence as the largest bilateral creditor to low- and middle-income countries presently, overviews general characteristics of these lending instruments, and highlights special clauses such as confidentiality, default and cancellation, collateralization which while reducing lender risk, pose substantial challenges for borrowers, including increased risk of debt distress and complications in debt restructuring. It also discusses China’s approaches to debt treatment.

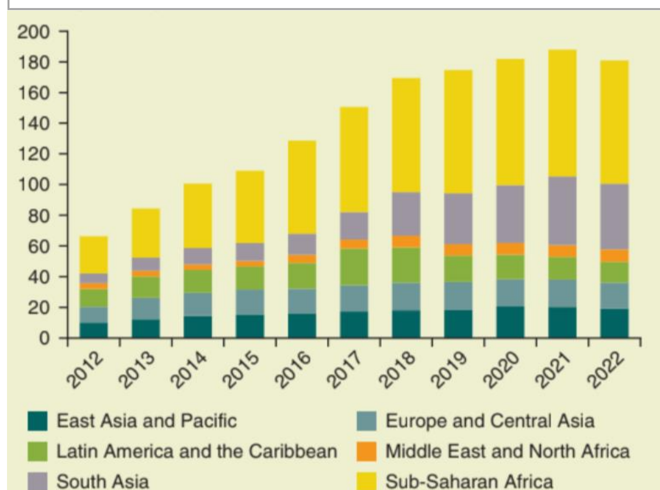
Section 4 presents an analysis of various projects financed by China, offering insights and recommendations through case studies. These studies are categorized into two types based on the financing modalities: goods for infrastructure and services for infrastructure. Additionally, Annex 1 delivers comprehensive technical descriptions of these lending approaches, detailing the development and operational phases of the projects, along with the corresponding financial transactions.

Section 5 discusses the implications of potential Chinese investment in Georgia's Anaklia Deep Sea Port project amid concerns of debt-trap diplomacy and geopolitical shifts. Historically significant, the Anaklia port aims to link Asia and Europe, enhancing Georgia's role as a transit hub. However, political hurdles and financial viability questions, particularly concerning Chinese involvement, have marred the project's progress. A 2024 international tender for the port's construction, favoring a Chinese-Singaporean consortium, raises transparency and ethical concerns due to the consortium's background. The project's execution as a Public-Private Partnership and its financing strategies, including the possible use of the pension fund, invite scrutiny over Georgia's fiscal risk, geopolitical alignment, potential corruption, and the economic impact of sidelining Western involvement. The complexities surrounding the Anaklia port underscore the need for careful consideration of the benefits and risks of foreign investments in critical infrastructure.

3. CHINA AS A GLOBAL CREDITOR: LENDING STRATEGIES

This section summarizes China's emergence as the largest bilateral creditor to low- and middle-income countries (LMICs) presently, overviews general characteristics of these lending instruments, and highlights special clauses such as confidentiality, default and cancellation, collateralization which while reducing lender risk, pose substantial challenges for borrowers, including increased risk of debt distress and complications in debt restructuring.

Figure 1. Low- and Middle-Income Countries' Debt to China, by Region, 2012-22. US$ (billion)



Source: Figure B1.7.1 from *International Debt Report 2023* (World Bank, 2023).

Over the past two decades, China has emerged as one of the world's most rapidly expanding economies. This growth has been significantly bolstered by China's "Going Global Strategy", which was launched in 1999 to encourage Chinese investments overseas and has significantly increased China's foreign investment and lending activities. This expansion strategy was further accelerated by a global infrastructure development strategy - the Belt and Road Initiative, adopted in 2013. Consequently, China has ascended to become the largest bilateral creditor to low- and middle-income countries (LMICs).[1] As of the end of 2022, LMICs collectively owed China US$180 billion in public and publicly guaranteed external debt. Significantly, Sub-Saharan Africa (SSA), led by Angola, has seen marked increases in its borrowing from China since 2012 and SSA represented 44 % of the total debt obligations of LMICs to China. Meanwhile, in South Asia, the debt to China witnessed a nearly sevenfold increase over an 11-year span, jumping from US$6.4 billion in 2012 to US$42.9 billion in 2022, with Pakistan accounting for two-thirds of this debt (Figure 1). [2]

The main initiatives funded through Chinese loans are in the sectors of infrastructure, transport, energy, and mining, while the main recipients are developing and emerging countries, which are of strategic interest to the Chinese government (Horn et al., 2019). China's lending over the past decade was mainly focused on oil-producing nations, countries neighboring China or along the Belt and Road corridor, and mineral-rich or significant nations in SSA. Initially, annual commitments surged, reaching a peak of US$52 billion in 2016, with 57% of this directed towards SSA countries. However, commitments have drastically decreased since then, hitting a record low of US$5.4 billion in 2022, 80% of which was allocated to China's neighboring countries and those in the South Asia region. This decline is attributed to shifts in China's economic landscape, a sharp reduction in its current account surplus, the failure of some international projects to yield

[1] The World Bank definition which includes countries with Gross National Income (GNI) per capita, calculated using the Atlas method, below $4,255 in 2022.
[2] Content is drawn from International Debt Report 2023 (worldbank.org), Box 1.7.

expected returns, and heightened debt vulnerabilities among borrowing nations, leading to some defaults to China.

LMIC countries have two broad categories of bilateral external financing modalities available to them. The first category is external financing issued to sovereign host governments which are direct liabilities of these governments. These include bilateral external loans and guarantees directly signed by these host governments and constitute official public and publicly guaranteed (PPG) external debt. These transactions are usually transparently reflected in various national and international PPG databases. The second category is indirect contingent liabilities[3] arising from the host government's ownerships in other borrowing entities (such as SOEs, PPPs, IPPs, and so on) and/or product/service off-take guarantees and collateral pledges. These indirect contingent liabilities – referred as hidden debt in recent literature (Horn et al., 2019) - are often excluded from PPG because these are obligations that only arise if a particular event occurs in the future (Chart 1).

Chart 1. China's Lending Modalities in LMICs.

Source: Authors' Chart.

Itself a middle-income country, China highlights that its engagements with LMICs are mutually beneficial exchanges in a context of respectful cooperation among peers. Its approach tends to be less bureaucratic, and its delivery generally faster, than that of other development partners. China is also said to be very responsive to the specific priorities of recipient countries and has been active in sectors with low priority for other official partners, such as infrastructure, extractive industries, and in countries that have difficulties accessing external financing.

[3] A contingent liability is a potential financial obligation that may arise in the future as a result of past events or transactions, but its existence and/or amount is uncertain until one or more future events occur or fail to occur, such as the government guarantees on SOEs', PPPs, IPPs loans and associated collateral pledges.

LMICs have access to different sources of funding from China. China's lending to LMICs is primarily facilitated by state entities like government agencies, policy banks, and state-owned enterprises (Horn et al., 2019), with the primary state lender being the Export-Import Bank of China (China Eximbank) or China Development Bank (CDB) (Gelpern et al., 2021). The World Bank (WB) categorizes Chinese lending to public and private sector entities in LMICs into four main types:

- **Concessional Loans**[4]: These are very low interest rate or interest-free loans funded from tax revenues, denominated in Yuan, and managed by the China International Development Cooperation Agency. They are aimed at development projects and are part of PPG
- **Export-Import Bank of China Loans**: This category includes concessional loans handled by the Preferential Loans Department. It consists of i) concessional loans denominated in Yuan and funded by the Chinese government. ii) "Preferential buyers" credits in US dollars, financed from the Export–Import Bank of China's own resources.
- **Policy Banks' Nonconcessional Loans**: These are dollar-denominated loans extended by policy banks such as the Export–Import Bank of China, China Development Bank, and Agricultural Development Bank of China. They are funded through bond issuance in both domestic and international capital markets, often insured by China's official export credit agency, SINOSURE.
- **Commercial Banks and Suppliers' Short-term Loans**: Chinese commercial banks and suppliers provide short- and medium-term loans, typically insured by SINOSURE. These are more commercially oriented and nonconcessional.

The body of research has identified some key legal characteristics of Chinese loan agreements which include confidentiality of contracts, extensive default and cancellation clauses, collateralized transactions, and subsequent debt treatments.

3.1 CONFIDENTIALITY OF CONTRACTS

One of the key concerns about the large contracts financed through Chinese lending is the confidentiality of the contracts between the Chinese state entities and the host country government (Horn et al., 2019). The analysis of a sample of 100 debt contracts between 2000 and 2020 showed that most of the contracts, and all contracts since 2014, contain clauses limiting the borrower from disclosing the terms of the contract, and in certain cases, even the existence of the contract. This is in contrast with the benchmark sample of contracts from international organizations that mainly impose confidentiality restrictions on the lender. This could give rise to several risks for the borrower state. These risks include limiting the transparency for a country's citizens and their unawareness of the full extent of the debts and obligations undertaken by the government. Given that the confidentiality from the public and international credit agencies also extends to debt restructuring agreements this can also skew the true financial standing of the country and hinder the design of crisis response approaches (Gelpern et al., 2021).

[4] The degree of concessionality of a loan or loans package is measured by its grant element, which is calculated as the difference between the loan's face value and the present value of the loan at the time of issuance, expressed as a percentage of the loan's face value. For a loan to be considered concessional, the grant element must be 35 percent or higher. See International Debt Report 2023 (worldbank.org).

3.2 DEFAULT AND CONTRACT CANCELLATION

Chinese contracts are also characterized by extensive clauses related to contract default and cancellation. Most notably, all analyzed CDB contracts contain clauses about terminating diplomatic relations between the borrower and China in case of default, while about 50% of the analyzed contracts broadly state that actions considered by the lender to be against the interest of “PCR entity” will trigger cross-default clauses. Additionally, in over 90% of the Chinese contracts there are clauses permitting the creditor to cancel the contract and require prompt repayment if substantial changes in laws or policies occur in either the debtor's or creditor's country. On the other hand, China also seems to use cross-cancellation clauses in individual contracts to insure the risks associated with its other investments in the borrower country. This was observed in Argentina, where CDB threatened to cancel a US$2 billion loan for the construction of a Belgrano Cargas Railway, when Argentina was considering the cancellation of the china-funded hydraulic dam construction project due to environmental concerns. All the cross-default and cross-cancellation clauses in combination can indicate China’s intentions to exert significant economic and political influence on the borrower country through its loan agreements (Gelpern et al., 2021).

3.3 COLLATERALIZED TRANSACTIONS

China uses collateralized debt instruments for its lending for high-risk high-reward projects in developing countries. Collateralized loans give creditors rights over a borrower's asset or revenue stream pledges. It can involve physical assets, financial assets, and present and future, related and unrelated revenue flows such as receivables. Recent studies (International Monetary Fund, & World Bank, 2020 and 2023) found that collateralized debt borrowing is associated with higher risk of debt distress and collateralized sovereign borrowing has increased the complexity of some recent debt restructurings. Many collateralized debt contracts with China became problematic, as mentioned in the IMF's recent report (International Monetary Fund & World Bank, 2023). Angola, Argentina, Chad, Ecuador, Ghana, Guinea, Malawi, Republic of Congo, Suriname, Zambia had high risk of overall debt distress and received debt treatments which include debt restructurings since 2020 (Table 2-3). There are other debt contracts which are also deemed problematic and undergoing debt treatments since then.

Table 2. Collateralized Borrowing and Risk of Debt Distress

Country	Last Reported in Debt Limits Policy	Risk of Overall Distress*	Debt Treatment**
Angola	Jan-22	N.A.	Yes
Argentina	Apr-23	High	Yes
Chad	Jan-23	High	Yes
Congo, Dem R.	Jul-23	Moderate	
Ghana	Mar-23	High	Yes
Guinea	Jan-23	Moderate	
Malawi	Nov-23	In distress	Yes
Rep of Congo	Jun-23	In distress	Yes
South Sudan	Mar-23	High	
Suriname	Mar-23	High	Yes
Zambia	Jul-23	In distress	Yes

Source: Table 1 from *Collateralized transactions: Recent developments and policy considerations* (International Monetary Fund & World Bank, 2023).
* The results are either from the IMF's Sovereign Risk and Debt Sustainability Framework or the Debt Sustainability Framework for Low-Income Countries
**Debt treatment includes debt restructuring that took place since 2020.

Table 3. Selected Loan Contracts with Special Accounts

Loan	Loan Amount
Ecuador - CDB, 2010	US$ 1bn
Ghana - Sinohydro, 2018	US$ 390 m
Guinea - ICBC, 2020	US$ 546 m
Rep Congo - China Exim, 2006	US$ 1,600 m
Suriname - China Exim, 2016	US$ 94 m

Source: Table 2 from *Collateralized transactions: Recent developments and policy considerations* (International Monetary Fund & World Bank,

The modalities of these collateralized instruments can be categorized based on their intended use into two groups: goods for infrastructure and services for infrastructure (See Section 4 for more details). Lack of transparency is a key impediment in monitoring collateralized transactions. For lenders, using collateral can reduce the risk of non-repayment and decrease monitoring costs. For borrowers, collateralized loans can be beneficial when future revenue streams are directly linked to repayment. However, risks are substantial: transparency problems due to complex collateralization structures and improper disclosures; altered debt seniority discourages lending by other creditors; complicated debt restructurings; inclusion of unrelated assets or revenue streams which increase the risk of a liquidity crisis; and use escrow accounts with minimum balance requirements which complicate cashflows. Chart 2 provides a comparative analysis of lending modalities, collateral requirements, and additional compliance considerations across different financial institutions, including the Chinese entities.

Chart 2. Overview of Collateral Requirements, Guarantees, and Compliance Considerations for Different Financial Institutions.

	CEXIM	CDB	WBG (IFC)	ADB (Private sector financing)	JICA (Private sector investment finance)
Collateral / Pledge	• Pledge all movable assets (bank accounts, movable equipment, contractual rights & insurance proceeds) • Security interest over all immovable (concessionary land rights & land lease) • Pledges of shares		Security appropriate for the project - liquid assets	Security appropriate for the project – liquid assets	Security appropriate for the project – liquid assets
Offtake agreement /Government guarantee	PPA with government guarantee		PPA with or without government guarantee	PPA with or without government guarantee	PPA with or without government guarantee
Risk insurance	Offered through Sinosure		Offered through MIGA		
Eligibility of contractor	Chinese contractor or majority of Chinese equity participation		Open to local and international contractors	Open to local and international contractors	Open but Japan-nexus strongly encouraged
Environmental & Social consideration	Compliance with "Export- Import Bank of China Green Credit Guidance"	Compliance with "Notice of the General Office of the State Development Bank on Implementing Credit Policy & Strengthening Environmental Protection" & other notices	Compliance with "IFC's Sustainability Policy"	Compliance with "ADB Safeguard Policy Statement"	Compliance with "JICA Guidelines for Environmental and Social Considerations"

Source: Authors' compilation from various sources.

3.4. DEBT TREATMENTS

China is not a member of the Paris Club, which is an informal group of official creditors whose role is to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries. The club's members include primarily Western countries and several other major economies that provide public loans or guarantees to sovereign states. China, despite being one of the world's largest bilateral creditors to LMICs has chosen to operate outside the traditional Paris Club framework. China's approach to debt restructuring and relief is characterized by direct negotiations with debtor countries, often under terms that are less transparent than those of the Paris Club. It's important to note that the specific details of debt restructuring agreements can vary significantly and are often not fully disclosed to the public. The characteristics outlined below provide a general overview based on the literature review and case studies in section 4. While specific details can vary based on the agreements reached between the two countries, common features of debt treatments often include:

- **Strategic and Political Considerations:** debt restructuring often reflects broader strategic and political considerations, including maintaining favorable bilateral relations and ensuring continued access to valuable resources.
- **Bilateral Negotiations:** Debt restructuring agreements are typically negotiated bilaterally, without the involvement of multilateral institutions like the International Monetary Fund (IMF) or the Paris Club, which traditionally play roles in sovereign debt restructurings.
- **Transparency and Confidentiality:** Many loan agreements and subsequent restructuring deals have been noted for their lack of transparency, with details not always publicly disclosed. This has implications for understanding the full scope and terms of the restructuring.

- **Incremental Approach:** The restructuring process can be incremental, with China showing a willingness to negotiate terms over time as the debtor country's economic circumstances evolve.
- **Extension of Loan Maturities:** Debt restructuring agreements typically involve extending the maturity dates of existing loans. This gives the borrower country more time to manage its financial obligations and can help alleviate immediate liquidity pressures.
- **Interest Rate Adjustments:** There may be negotiations to adjust interest rates on existing loans, potentially lowering the cost of borrowing for the debtor country.
- **Grace Periods:** Debt restructuring deals sometimes include grace periods during which the debtor country is not required to make payments on the principal amount of the loans. This can provide critical breathing space for countries struggling with balance of payments challenges.
- **Debt-for-Resource Swaps:** In such arrangements, repayment obligations may be partially or entirely fulfilled through the provision of resources.
- **Collateral Adjustments:** The terms of collateral provided against the loans might be revisited. Given the collateral-backed nature of loans, adjustments in the collateral terms and debt for equity swaps could be part of the restructuring agreement.
- **Impact on Future Borrowing and Debt Sustainability:** The terms and conditions of the restructuring can have significant implications for the debtor country's future borrowing capacity and its overall debt sustainability.

China has endorsed G20's Common Framework for Debt Treatments, which was introduced in 2020 in response to mounting debt burden in LMICs post pandemic. The Common Framework represents a significant step forward in international efforts to address sovereign debt crises in a coordinated and structured way. However, its effectiveness depends on the willingness of all creditors to participate actively and adhere to its principles, as well as on the implementation of necessary reforms by debtor countries.

4. CHINA'S LENDING MODALITIES FOR INFRASTRUCTURE PROJECTS

This section presents an analysis of various projects financed by China, offering insights and recommendations through case studies. These studies are categorized into two types based on the financing modalities: goods for infrastructure and services for infrastructure. Additionally, Annex 1 provides comprehensive technical and visual descriptions of these lending approaches, detailing the development and operational phases of the projects, along with the corresponding financial transactions.

Case Study: Goods for Infrastructure

Goods for infrastructure is a transaction modality is a two-stage transaction model in which the supply of goods and labor for infrastructure construction in the first period is paid by goods exports in the second period. Employed for decades and commonly referred to as the Angola mode, or the oil-for-infrastructure model, this financing approach was deemed to withstand the test of time until the emergence of debt restructurings since 2020. Financing disbursements are equivalent to goods and labor supplied by China for infrastructure construction and the debt service paid by the borrower is equivalent to goods exports supplied to China by the host country. These are usually collateralized transactions with offtake guarantees and other pledges. See Annex 1 for the sequential flow of goods for infrastructure transaction modality.

4.0. ANGOLA MODE

The "Angola mode" of financing offers a solution for countries lacking sufficient financial guarantees to support their loan commitments. In this model, funds are not directly transferred to the government. Instead, a framework agreement for a specific infrastructure investment program is established with the government, which then contracts a Chinese construction firm for the work, while a Chinese petroleum company secures production rights. The beneficiary government directs the Chinese contractor to proceed with the infrastructure projects, financed through a credit from the China Ex-Im Bank. The repayment is made with oil produced by the Chinese petroleum company, offering a way for resource-rich but credit-constrained countries to leverage their natural resources for infrastructure development (Foster et al., 2008).

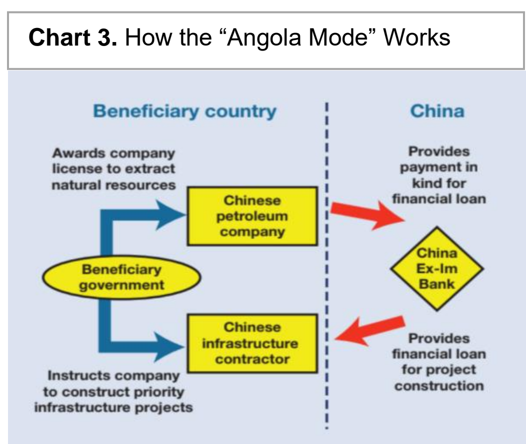
The financial nuances of the "Angola mode" are complex, largely due to the fluctuating implicit price of the traded commodity and its market price relationship. Consequently, any discount on future oil prices effectively alters the lending terms. This financing method provides China with a form of physical security over oil resources, usually at a marginally discounted rate. While the specifics of these oil-backed loans remain undisclosed, World Bank industry experts note that such deals seldom fix oil prices for the loan's duration. Instead, as oil prices vary, the loan's terms are adjusted, such as reducing the repayment period when oil prices increase, thus securing a steady medium-term supply (Foster et al., 2009).

The prevalence of resource-backed financing agreements in infrastructure projects has grown. The first instance occurred in the Republic of Congo in 2001, but the model gained traction after a significant oil-backed agreement with Angola in 2004. The use of resources to back these deals has broadened to include bauxite, chromium, iron ore, and even cocoa. The common state

ownership among major oil and infrastructure enterprises facilitates the coordination of these multi-sector deals (Foster et al., 2008).

In 2006, the state-owned enterprises the China Petroleum and Chemical Corporation (SINOPEC) and Angola National Oil Corporation (Sonangol) established a joint venture, Sonangol Sinopec International (SSI), focusing on exploiting crude oil across three offshore fields in Angola. Sinopec gained a dominant 75 % share, with Sonangol holding the remaining 25 %. As China's largest oil refining company, SINOPEC committed approximately US$2.4 billion to the venture, encompassing US$2.2 billion in government signature bonuses and a US$200 million investment in social projects (Foster et al., 2009).

Chart 3. How the "Angola Mode" Works



Source: Figure 2 from *China's emerging role in Africa. Part of the changing landscape of infrastructure finance.* Foster, V., Butterfield, W., Chen, Ch., & Pushak, N (2008).

Since 2020, Angola has pursued debt restructuring with China, a response to the considerable repayment challenges triggered by the 2018-2019 drop in oil prices. This downturn severely affected Angola's revenue from oil exports, which serves as collateral for loans from China. The specifics of how Angola's debt to China has been restructured remain largely undisclosed, reflecting the typically non-transparent nature of China's loan agreements and debt restructuring practices. Nonetheless, it is documented in IMF annual consultations staff reports that Angola has entered into bilateral negotiations with China to restructure its debt on multiple occasions, especially as a means to mitigate the financial strain brought on by the volatile global oil market and related economic difficulties.

Case Studies: Services for Infrastructure

Services for infrastructure modality is more complex; supply of goods and labor by China for transport services infrastructure (ports, railways) construction in a first period is paid by foreign exchange receipts from transport services operations in the second period. This requires low-income country transport services to generate sufficient foreign exchange cash flow to meet the debt service to a China. These are usually collateralized transactions with off take guarantees and other pledges. See Annex 1 for the sequential flow of services for infrastructure transaction modality.

4.1. LAO P.D.R – LAOS – CHINA RAILWAY PROJECT

Laos-China Railway construction project, connecting Lao Capital city - Vientiane to Lao's border with China. The railway project was perceived to be of great importance for the land-locked country and to increase connectivity and trade. On the other hand, the project also holds strategic significance for China, as it is part of the Kunming - Singapore Trans Asian Railway corridor, one of the key projects under the BRI. The project involved constructing a 420-kilometer electrified rail line from Vientiane to the China border, with 60% of the track in tunnels or on bridges. The total cost was estimated at US$6.7 billion (International Monetary Fund, 2017). The project commenced in 2017 and was completed in 2021. Since the project's completion Laos-China Railway Company has reported significant growth in the transportation of passengers and goods,

with a yearly 274.4% increase in the railway's export and import freight volumes, in the first quarter of 2023 (Busbarat et al., 2023).

At the beginning of the project Lao-China Railway Company — a joint venture between Chinese state-owned enterprises, holding 70% ownership and Lao National Railway State Enterprise, holding the remaining 30% ownership, was created and tasked with the construction of the railway.[5] The parties agreed on a build–operate–transfer (BOT) model, including a five-year construction period and a concession period of 50 years with a possible extension of 20 years (Chen & Dicarlo, 2021).

To finance the project, the Laos–China Railway Company borrowed 60% of the investment cost from the Eximbank of China, and Lao and Chinese parties provided equity investment for the remaining 40%. Lao P.D.R. contributed US$700 million in installments, including a US$480 million loan from China. Instead of issuing a sovereign guarantee to secure the loan, the government of Lao pledged revenues from a bauxite mine and three potash mines in Laos as collateral.[6] Researchers have also claimed that the statement released by China's National Development and Reform Commission showed that Chinese companies were also getting tax concessions, including exemptions from import duties on Chinese equipment related to the project (Morris, 2019). Additional concerns were raised about claims that contributions from the Laotian government included land concessions as well (Janssen, 2017).

One of the key concerns about the railway project is the potential obscurity of its implementation. Considering that the company is the official borrower of the project funds, the debt is recorded within the books of the Lao SOE member of the joint venture. On the other hand, the joint venture has the ability to filter and hide project-related information from the public, which has been especially problematic during the land appropriation and compensation proceedings (Chen & Dicarlo, 2021). Other concerns, including the reliance on Chinese workers and state-owned firms, as well as weaker regulations regarding the environment and working conditions have been highlighted (Morris, 2019).

The railway project has attracted international attention, following Laos's ongoing struggles with the mounting debt. In 2022, the country's public debt was US$13.9 billion, constituting 112% of the GDP (World Bank, 2023). Laos owns about half of its debt to China, who has financed the railway, as well as other infrastructure projects. It should be noted that according to the World Bank report, about 44% of the total public debt was accounted by SOEs, particularly those working in the energy sector. Notably, in 2020, the state-owned Electricite du Laos (EdL), together with China Southern Power Grid Co. established a new entity, Electricite du Laos Transmission Company Ltd. (EDLT), with the Chinese company holding majority equity share. Although details have not been made official, critics argue that this decision will transfer the control of Laos' electric grid to China (Zhai & Johnson, 2020).

4.2. DJIBOUTI - ETHIOPIA RAILWAY

The Addis Ababa–Djibouti Railway was another project, holding promise for the host countries and being at the same time of importance to China's BRI goals. The 759 km cross-border railway

[5] https://china.aiddata.org/projects/33726/
[6] Ibid

connects Addis Ababa - Ethiopia´s capital to the Port of Djibouti and was anticipated to facilitate more efficient freight and passenger transport and, therefore, improve Djibouti's position as a maritime hub and promote economic development in landlocked Ethiopia.

The railway line is owned by the EDR (or Ethio-Djibouti Standard Gauge Railway Share Company), a joint venture company of the two state-owned companies, the Ethiopian Railway Corporation (ERC) and the Société Djiboutienne de Chemin de Fer (SDCF), with Ethiopia holding a 75% share and Djibouti a 25% share. In 2011, the ERC awarded an engineering, procurement and construction contract for the railway line to two Chinese state-owned companies, China Railway Group Limited (CREC) and China Civil Engineering Construction Corporation (CCECC). In addition, the Chinese companies were responsible for operating the railway for six years after its completion and for subsequently transferring its operational control to the EDR. The railway became officially commercially operational in January 2018 and in May 2024 its operation and maintenance was handed over to the EDR (Africa News, 2024, May 12).

The project's overall cost amounted to USD 5.09 billion. Funding from the Governments of Ethiopia and Djibouti covered 30% of the total cost, with the remaining 70% financed through concessional loans from China's Exim Bank (Eximbank), the China Development Bank, and the Industrial and Commercial Bank of China (Gi Hub, 2020, November 30).

Since the beginning of railway operations, the project has faced some financial risks, due to lower traffic volumes than predicted. Additionally, the depreciation of the Ethiopian Birr contributed to challenges in meeting debt service payments that were structured in US dollars. The situation was further exacerbated by the civil war in Ethiopia and related security concerns, that led to the underperformance of the railway and caused economic concerns. As a result, the Ethiopian debt was restructured and the repayment period was extended from 15 to 30 years (Gi Hub, 2020, November 30).

On the other hand, according to the IMF reports, Djibouti is also facing similar challenges. During 2013 - 2018 the country's debt rose sharply due to infrastructure projects financed largely by China. This has led to a notable increase in Djibouti's debt-to-GDP ratio. While the country has reportedly agreed with the China Export-Import Bank on restructuring the payments, the IMF has predicted the debt service to increase over the medium term (International Monetary Fund, 2019).

4.3. SRI LANKA – HAMBANTOTA PORT

The Hambantota Port project in Sri Lanka is widely considered as a prominent example of China's strategy of financing infrastructure projects abroad through substantial loans. It has led to speculations about China's "debt-trap diplomacy" and political corruption in the host country.

The construction of a port in Hambantota has been part of Sri Lanka's official development plans since at least 2002. Following a feasibility study in 2006, predicting optimistic results for the port's development, Sri Lankan President Mahina Rajapaksa decide to initiate the project, together with several other high-investment projects, with the support of Chinese financing (Hillman, 2018). However, the positive expectations were not shared by investors, especially considering Hambantota's proximity to the Colombo port, that was at the time responsible for about 95 % of Sri Lanka's international trade. Due to several reports, China was the only potential lenders interested in getting involved (Grey, 2018, September 18).

The concerns were raised about the direct involvement of the Chinese government, instead of selecting the construction company through an international tendering process. Different media outlets have highlighted potential corruption schemes and the involvement of the Sri Lankan president and senior officials (Grey, E., 2018, September 18). In 2018, the New York Times reported that US$7.6 million had been transferred from a Standard Chartered Bank account controlled by China Harbor Engineering Co. to affiliates of President Rajapaksa's re-election campaign.[7]

The first phase of the Hambantota Port project was financed through a US$307 million loan from the Export-Import Bank of China. The Government of Sri Lanka and China Eximbank agreed to restructure the loan in 2008, with a fixed interest rate of 6.3%.[8] Additionally, in 2012, the Exim Bank agreed to provide another loan of US$809 million for the second phase of the project.[9]

The Government of Sri Lanka on-lent the proceeds of the loan agreement to Sri Lanka Ports Authority (SLPA), the state-owned operator of major commercial ports in Sri Lanka.

Due to a broader debt crisis, the Sri Lankan government agreed to a controversial debt-for-equity swap with China. This agreement granted China Merchants Port Holdings Company (CMPort) a 99-year lease on Hambantota Port in exchange for US$1.12 billion, which was used to partially repay Sri Lanka's debts (The New York Times, 2018, June 25). CMPort and state-owned Sri Lanka Port Authority (SLPA) formed a joint venture to operate Hambantota Port, with CMPort holding 70% share in the total equity, including 85% share in Hambantota International Ports Group (HIPG) and a 49.3% share in Hambantota International Port Services (HIPS). CMPort acquired the right to operate and manage the port services and the right to develop the Hambantota port area (11.5 square kilometers of land). At the same time, the SLPA transferred its loan responsibility to the China Eximbank to the General Treasury of Sri Lanka.[10]

Lessons drawn from case studies

Certain collateralized transactions are more conducive to positive development outcomes, while others pose significant risks:

- **Beneficial Collateralization:** Projects related to the extraction of natural resources and financed through project-specific collateralizations backed by revenue streams from these natural resource exports could be structured advantageously. Starting with meticulous project design to ensure viability and efficient resource use, architects of such transactions can incorporate elements like full disclosure, fair valuation, and simplicity, making the overall arrangement straightforward and beneficial. That said, experience shows that during times of volatile commodity prices, resource-backed loans often become distressed and necessitate subsequent debt restructuring, as seen in the case of Angola.
- **Problematic Collateralization:** On the other hand, in service-related industries collateralization involving assets and/or revenues not directly related to the financed project tends to be fraught with issues. Such large-scale transactions can precipitate a

[7]https://china.aiddata.org/projects/33256/
[8] Ibid
[9] https://china.aiddata.org/projects/65812/
[10] https://china.aiddata.org/projects/33256/

liquidity crisis, prove difficult to unwind, and complicate debt treatment efforts—as seen in services for infrastructure cases.

- **Variable Impact Transactions:** Between these two extremes lie various types of transactions whose impact on development can vary widely, depending on their design and implementation. These transactions require careful consideration and structuring to ensure they contribute positively to development outcomes rather than hinder them.

To support beneficial outcomes, borrowing countries should work to establish a sound institutional and legal framework to help manage and mitigate risks. To ensure the successful development and execution of transactions, borrowers must establish robust internal and external frameworks. This involves relevant governmental entities to implement policies aimed at:

- Conducting thorough reviews of contractual terms to verify compliance with domestic laws and existing obligations.
- Aligning commercial agreements with legal particulars and ensuring adherence to transaction covenants and requirements post-financial closure.
- Minimizing the potential for corruption and self-dealing practices.
- Promoting transparency and accountability throughout the transaction process.
- Guaranteeing that each transaction aligns with the borrower's comprehensive debt strategy and the nation's macroeconomic policies.
- Enabling supervisory and back-office teams to have immediate and comprehensive access to review and contribute to transactions as they happen.

To support these efforts, it is crucial for the government to bolster its capabilities in key areas. Strengthening capacity is vital to prevent excessive dependence on external advice and actions during transaction execution, acknowledging that the expertise of external advisors cannot fully compensate for a borrower's lack of technical know-how and resources. Essential capacity-building areas include legal expertise, debt management proficiency, fiscal risk management (including debt sustainability analysis), and public investment management capabilities.

Considering China's major role as a bilateral creditor and its practices beyond the conventional Paris Club framework, it is vital to promote multilateral collaboration. This includes encouraging China to engage in multilateral debt relief efforts like the G20's Common Framework for Debt Treatments, aiming to secure coordinated and fair solutions for countries facing debt challenges.

5. THE GEORGIA CASE STUDY

This section evaluates the potential Chinese investment in Georgia's Anaklia Deep Sea Port project, highlighting the strategic importance of the port as a transit hub between Asia and Europe and the challenges posed by Chinese involvement, including concerns of debt distress risks and geopolitical influences. The selection of a Chinese-Singaporean consortium through a 2024 tender, alongside the project's PPP execution and funding considerations, prompts significant scrutiny regarding transparency, debt distress, and the broader implications of reducing Western engagement in favor of Chinese investment.

Case studies of problematic China's lending modalities for large scale transport services projects (section 3) raise concerns about its possible implications for Georgia in the case of the Anaklia Deep Sea Port project. With recent shifts in geopolitical dynamics, including Georgia's political tensions with the West, possible deterioration of the EU candidacy path, and growing interest from China resulting in a strategic partnership with our country, the prospect of Chinese investment in Anaklia raises important concerns. Will Georgia's objective of creating a major transit hub be undermined by the dangers of debt distress like in other countries, or can the country successfully manage these complexities to ensure a prosperous future for the Anaklia port? This analysis explores the potential risks that could be associated with Chinese investments in such a critical infrastructural project, drawing on global lending practices discussed earlier.

5.1. ANAKLIA DEEP-WATER PORT PROJECT THEN AND NOW

The Anaklia Deep Sea Port, one of Georgia's major infrastructural projects, has a long and complex history dating back to the 1960s. Building a port in Anaklia was first considered by Soviet specialists. The proposal reappeared after the USSR's dissolution, during Eduard Shevardnadze's presidency from 1992 to 2003. The project was then revived by Mikheil Saakashvili back in 2012 (Daly, 2020). Strategically located, the port aimed to create a faster maritime corridor between Asia and Europe, with the capacity to handle 100 million tonnes of cargo annually by 2030. Despite its potential, the project has faced numerous challenges, primarily centered on political obstacles.

In 2014, under the new ruling party of the Georgian Dream, the Ministry of Economy and Sustainable Development conducted a feasibility study to assess the capacity and strategic importance of the Anaklia Deep Sea Port. After analyzing several potential sites along the Black Sea coast, Anaklia was identified as the optimal location for the new port.[11] In 2014, the Government of Georgia announced the tender for the construction and development of the Anaklia Deep Sea Port. In February 2016, the Anaklia Development Consortium (ADC), jointly established by TBC Holding and the U.S. firm Conti International, was selected as the winner. The Investment Agreement was signed in 2016, and construction began by the end of 2017. The Anaklia Development Consortium committed to investing $2.5 billion, with significant support from the Georgian government committed to providing 1,000 hectares of land for the port and Free Industrial Zone, as well as undertaking the construction of railway and road connections to the port, amounting to a total input cost of $114 million.[12] Notably, in 2017, amendments to the

[11] https://agenda.ge/en/article/2016/8#gsc.tab=0
[12] https://traceca-org.org/en/countries/georgia/transport-infrastructure-projects-in-georgia/

Georgian constitution envisaged the establishment of an exclusive economic zone in Anaklia, where a special legal regime would be applied.[13]

The U.S. support for the Anaklia port project provoked a negative response from Moscow. Russia viewed the port as a geostrategic threat due to its potential to host U.S. and NATO warships near Abkhazia's border. Additionally, the Anaklia deep sea port seemed economically disadvantageous for our Northern neighbor since it would compete with Russia's Black Sea ports, threatening their cargo traffic from Asia to Europe (Daly, 2020).

The Anaklia Development Consortium soon encountered major obstacles. Although initially supportive, the Georgian government started questioning the project's viability. In early December 2019, the Ministry of Infrastructure declared its intention to cancel the contract with ADC unless the consortium could secure funding from potential investors and financial institutions required for port construction by the year's end.[14] In January 2020, as stated by the Minister of Economy and Sustainable Development (MOESD) at that time, the project was terminated due to the investor's failure to meet their obligations, despite significant support from the state.[15] As mentioned in the Eurasia Daily Monitor publication, the Anaklia Development Consortium was unable to secure the necessary funds due to two main factors. Firstly, since January 2019, a criminal case has been ongoing against Mamuka Khazaradze, the former chairman of the ADC, and his deputy, Badri Japaridze, with the state accusing them of money laundering. Investigations against Mamuka Khazaradze started back in June 2018. As of now, the Anaklia Development Consortium and its investors are pursuing two international arbitration cases against the state, with the requested compensation exceeding 1.5 billion dollars.[16]

Many believe that the Anaklia project's troubles are not solely due to commercial issues as the investigation against the former chairman of ADC coincided with Russian efforts to disrupt the port's construction. The experts also anticipated that the US investment would be replaced by the Chinese one for the port development (Menabde, 2019).

Rerouting transport corridors from Russia’s Novorossiysk sea port to alternative routes through Central Asia and the Caucasus, driven by sanctions against Russia for its ongoing war in Ukraine, increased Georgia’s role as a crucial transit hub. This shift likely contributed to the revival of the Anaklia port project (Anjaparidze, 2022). It is noteworthy that there have been no contradictory statements from the Russian side regarding the construction of the port at this time, prompting beliefs that the Anaklia port could also serve Russia’s interests, particularly with China's planned involvement in the play.

5.2. 2024 TENDER FOR THE CONSTRUCTION OF THE ANAKLIA PORT

On March 18, 2024, the government of Georgia announced a closed international tender for the construction of marine infrastructure of the Anaklia port but the tender documentation has not been made public. The statement of the MOESD on the tender announcement asserts that the

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[13] See Article 7 - Basis of Territorial Arrangement of the Constitution of Georgia at https://matsne.gov.ge/en/document/view/30346?publication=36

[14] https://agenda.ge/en/news/2019/3297#gsc.tab=0

[15] https://tabula.ge/ge/news/638072-turnava-anakliis-proekti-ar-mokhda-imis-gamo-rom

[16] https://bm.ge/news/anakliis-ports-chinuri-konsortsiumi-aashenebs-vin-shearchia-saqartvelos-mtavrobam-proeqtis-gansakhortsieleblad

international tender aligns fully with the World Bank's procurement procedures.[17] This is by the Resolution N65 of the Government of Georgia on the methodology for managing investment and capital projects stating that international tenders should be executed following procedures agreed upon with the donors.[18] At this stage, questions remain regarding the extent to which the procurement requirements of the World Bank were adhered to and whether an open tender should have been mandated.

According to World Bank procedures, the preferred approach for complex, high-risk, and/or high-value contracts is open international competitive procurement (World Bank, 2020). The World Bank also provides guidelines specifying the thresholds for procurement approaches and methods by country (World Bank, 2024). The guideline document specifies that projects in Georgia exceeding $20 million should undergo an open international tender process. The MOESD's statement indicates that "the procurement shall be based on a one-stage procurement procedure using limited international market approaches," referring to a closed tender instead of an open one. This is similar to the World Bank's "limited competition" approach, which is permissible when there are few companies available or when exceptional circumstances justify departing from open competitive procurement practices. However, it is generally not the preferred selection method for complex international projects, as mentioned earlier.

As stated in the tender announcement by the MOESD, the "Big Four" European companies (Boskalis, DEME, Jan De Nul, Van Oord) were selected to receive the tender documents due to their significant expertise in marine construction. It was further mentioned that these companies collectively own 80% of the global dredging fleet, crucial for meeting the extensive dredging needs of the Anaklia port project.[19] The Anaklia Sea Port LLC, established by the state in 2023, engaged the international consulting firm HAEDES B.V., which concluded that the Big Four could participate in a closed tender, facilitating a limited competition method. Despite this, it appeared that none of the Big Four companies participated in the tender and the winner was ultimately announced to be a different entity, the Chinese-Singaporean consortium comprising China Communications Construction Company (CCCC) Limited (China) and China Harbor Investment Pte. Ltd (Singapore). According to Minister Levan Davitashvili, this consortium was the only entity that submitted a proposal for the Anaklia port development project.[20]

Notably, this consortium was one of two companies that qualified during the Statement of Intent (SOI) stage, which was published in February 2023.[21] The other qualifying company was the Swiss-Luxembourg holding, Terminal Investment Limited Holding S.A. (T.I.L Holding S.A).[22] This circumstance implies that the ministry might have had prior knowledge that none of the Big Four companies were interested in the tender and had a potential winner in mind. It seems they formally engaged these firms to endorse the "limited competition" approach.

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[17] http://www.moesd.gov.ge/?page=news&nw=2479&lang=en
[18] See the Article 13 of the Resolution N65 of the Government of Georgia on the methodology for managing investment and capital projects.
[19] http://www.moesd.gov.ge/?page=news&nw=2479&lang=en
[20] https://bm.ge/news/anakliis-ports-chinuri-konsortsiumi-aashenebs-vin-shearchia-saqartvelos-mtavrobam-proeqtis-gansakhortsieleblad
[21] https://www.economy.ge/?page=economy&s=149&lang=en
[22] https://rustavi2.ge/en/news/265123. See also https://bm.ge/news/anakliis-ports-chinuri-konsortsiumi-aashenebs-vin-shearchia-saqartvelos-mtavrobam-proeqtis-gansakhortsieleblad.

Notably, during the SoI stage in 2023, state-owned enterprises or those in which the state directly or indirectly holds more than 30% shares were not permitted to participate in the selection process.[23] However, it appears this requirement was relaxed without any official communication from the government, as the winning consortium is composed of state-owned companies. CCCC Limited was founded in 2006 by the whole state-owned enterprise China Communications Construction Group (CCCG), which holds a controlling share of 57.64% in CCCC.[24] In 2021, CCCC ranked 61st on the Fortune Global 500 list by revenue. It is currently the world's largest company in port design and construction, highway and bridge design and building, dredging, container crane manufacturing, and offshore oil drilling platform design.[25] CCCC was involved in numerous projects under the "Belt and Road Initiative". Though, the company lacks a good international reputation. China Communications Construction Company was prohibited from bidding on World Bank finances projects for eight years, beginning in 2009, due to corrupt practices in the Philippines (The New York Times, 2018). The company appears in the United States (US)' list of sanctioned entities.[26] In 2020, the US prohibits financial transactions by US citizens in CCCC due to its involvement in building artificial islands and contributing to the militarization of contested areas in the South China Sea and discouraged the People's Republic of China from leveraging CCCC and other state-owned enterprises as tools to enforce an expansionist agenda.[27]

Regarding China Harbour Investment company, based in Singapore, it is affiliated with China Harbour Engineering Company, a subsidiary of CCCC and one of the largest state-owned enterprises in China. China Harbour Engineering Company itself has faced corruption allegations, including a notable case in Bangladesh where it was accused of attempting to bribe officials and was banned from future contracts (The New York Times, 2018). This history raises concerns about the integrity and ethical practices of the entities involved in the development of the Anaklia port.

5.3. ANTICIPATED CONTRACTUAL AGREEMENT: WHAT RISKS TO EXPECT?

Little is known about the planned contract arrangements with the tender winner. Negotiations to finalize the contract with the selected Chinese-Singaporean consortium are anticipated to take several weeks to several months from date of its announcement at end-April 2024. Currently, the confirmed arrangement stipulates the Anaklia New Deep Sea Port project will be executed in the format of an institutional Public-Private Partnership (PPP). The government of Georgia will hold a controlling 51% ownership stake through the state-owned company Anaklia Sea Port LLL, with the Chinese-Singaporean consortium acquiring the remaining 49% share.[28]

The Statement of Intent (SOI) document for the selection process of the private partner specifies that the government will allocate up to 340 hectares of land for the project, with consideration given to establishing a free industrial zone (FIZ). Importantly, there are no plans to offer exclusivity

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[23] https://www.economy.ge/?page=economy&s=149&lang=en
[24] Corporate Governance Annual 2023 Report of CCCC. Available at https://en.ccccltd.cn/tzzgx/dxbg/
[25] https://en.ccccltd.cn/gyjj/ggjj/gsjs/
[26] https://sanctionssearch.ofac.treas.gov/Details.aspx?id=32072
[27] https://2017-2021.state.gov/u-s-imposes-restrictions-on-certain-prc-state-owned-enterprises-and-executives-for-malign-activities-in-the-south-china-sea/ . See also : https://asia.nikkei.com/Politics/International-relations/US-China-tensions/US-blacklists-Belt-and-Road-builder-for-role-in-South-China-Sea
[28] https://ppp.gov.ge/en/chairperson-of-ppp-agency-took-part-in-the-session-of-anaklia-project-governmental-commission/

arrangements for port development and operations in the country. However, the Concession Agreement may include provisions to safeguard the investor against natural force majeure or certain political risks, as well as compensation arrangements for specific scenarios or termination grounds. The contractor will be responsible for both equity and debt financing for its obligations on the project. The initial investment for the first phase of the project totals US$600 million[29], while the total cost of the project was initially estimated in the range of US$2 billion This phase encompasses constructing a wharf capable of handling 7 million tons of cargo annually and must be operational within 3 years since the construction initiation. The project is envisioned to span 49 years.[30]

It is of note that the proposed PPP contract will follow a Build-Own-Operate (BOO) model rather than Build-Operate-Transfer (BOT).[31] A noteworthy distinction here lies in compliance with the International Public Sector Accounting Standards (IPSAS), which requires all BOT contracts to be classified as debt on the government's books.[32] This recognition of debt demands a high level of transparency and ensures clarity about the financial obligations arising from the BOT contract, which contrasts with the typically opaque nature of Chinese loan agreements. This prompts the question of whether, because of these transparency requirements, the government has opted not to reclaim ownership of the port after a specified period. Although there is no contract in place yet, Georgia entering into an agreement with the state-owned company and not directly through the state also reinforces the hidden nature of Chinese lending. Horn et al. (2019) discuss this issue, noting that China's overseas lending is typically conducted through state-owned entities rather than directly between governments. The debt recipients are also usually state-owned enterprises. This type of lending often goes unrecorded by developing countries, resulting in significant underreporting in international debt statistics (see Section 3).

Given the significance of the matter, the obligations to be assumed by the state concerning the construction of the Anaklia Deep Sea Port must be public and discussed with a wide range of stakeholders. There are concerns that the government might take contingent liabilities, with the possibility that the contractual agreement could include a state guarantee on cargo volumes (offtake guarantees), project-related or unrelated revenue streams, and liquid and physical asset pledges, such as land. If the projected cargo volume is not achieved and the investing company does not receive the anticipated income, the government could be liable to compensate for the shortfall from the state budget. If the state is unable to cover the difference from budget resources, other guarantee pledges might be activated. The literature indicates that Chinese contracts often contain various forms of collateral pledges and offtake guarantees, which have a cascading nature. Typically, these terms are confidential and may not be disclosed unless a breach occurs, as exemplified by Sri Lanka's Hambantota port. Similarly, the Anaklia project in Georgia might also entail such offtake guarantees and collateral asset pledges such as land surrounding the port and/or state’s liquid assets. Initially considered contingent liabilities, these offtake guarantees and collateral asset pledges could evolve into direct liabilities impacting the state budget, potentially placing claims on international reserves, including gold, held by the National Bank of

[29] https://bm.ge/news/anakliis-ports-chinuri-konsortsiumi-aashenebs-vin-shearchia-saqartvelos-mtavrobam-proeqtis-gansakhortsieleblad
[30] https://www.economy.ge/?page=economy&s=149&lang=en
[31] https://ppp.gov.ge/en/chairperson-of-ppp-agency-took-part-in-the-session-of-anaklia-project-governmental-commission/
[32] See IPSAS 32 – Service Consession Arrangements: Grantor. Available at https://www.ifac.org/_flysystem/azure-private/publications/files/B8%20IPSAS_32.pdf

Georgia. Furthermore, the complex cascading structure of asset pledges and offtake guarantees might also draw upon the liquidity of the pension fund, especially if it decides to invest in the venture (see below).[33]

The profitability of the current Anaklia project is uncertain due to concerns about whether trade flows with Europe will meet the volumes projected in the economic feasibility study. It is known that the port of Anaklia was intended to serve as a transit hub between Europe and Asia, facilitating increased throughput. According to Ted Jonas, a member of the supervisory board of the Anaklia Development Consortium, ADC conducted several studies in the early stages of the port's development, confirming the economic viability of the Anaklia port. He further emphasized that the Anaklia project was never intended for Chinese cargo due to poor infrastructural connectivity between Asia and China. Instead, the project targeted cargo from Central Asia, Caucasus, and legal trade with Russia. Even before the war in Ukraine, the Anaklia project was seen as attractive, a fact the government was aware of. Its attractiveness has only increased since the start of Russia's full-scale war in Ukraine, evidenced by the support for the port's development from Kazakhstan, Uzbekistan, and Azerbaijan, as noted by Ted Jonas in his interview.[34] Given the current geopolitical situation, it is unclear whether the planned trade flows with Europe will be maintained or if the cargo will be redirected elsewhere. These uncertainties cast doubt on the project's profitability. Conversely, some argue that the Anaklia port can only operate if China invests in it. Paata Kvizhinadze, Chairman of the Finance and Budget Committee in the Parliament of Georgia, commented in May 2024 that American and European companies did not participate in the tender, a decision he supported by asserting that the port of Anaklia would lack significance without Chinese cargo (Civic Idea, 2024).

Another concern is how the Georgian government will finance its 51% share of the port's first phase development cost, amounting to US$600 million, and whether it will resort to using pension fund for this purpose. According to the recent amendment to the Law on Funded Pension the current supervisory and investment boards of the pension fund, appointed by Parliament, will be replaced by a single governing board appointed solely by the Prime Minister. While this reform might aim to centralize management and streamline administrative processes, there are concerns about how this might affect investment decisions, transparency, stakeholder involvement, and the independence and effectiveness of the Fund's governance. The amendments also propose increasing investment limits, allowing the pension fund to invest in a wider range of assets, including those of higher-risk. The vague term "other types of assets" introduces risks, particularly regarding potential investments in government projects, such as Anaklia port development (Surguladze & Keshelava, 2024). There are concerns that these investments, if not carefully managed, could threaten the fund's integrity and financial security. On the other hand, there is a perspective that the required funds will be secured by the Georgian government through loans from Chinese companies. This raises concerns about the country falling into debt distress which, in the worst-case scenario, could lead to the loss of the government's stake in the Anaklia port, similar to what happened with the Hambantota port in Sri Lanka, should Georgia encounter significant difficulties in servicing its debt.

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[33] See ISET PI note on recent amendments to Pension Law which opens a door for such risky investment ventures.
[34] BMG interview with Ted Jonas, Member of the Supervisory Board at the Anaklia Developemnt Consortium.
https://www.facebook.com/watch/?mibextid=w8EBqM&v=1397058467668598&rdid=H1p9eKKy2OmaWudN

In addition to the above-mentioned fiscal risks, the Anaklia project carries geopolitical risks. It is evident that the West was sidelined in favor of Chinese involvement, which raises concerns given the current global tensions and power dynamics and geopardizes Georgia's EU aspirations. While Chinese involvement could bring much-needed capital to Georgia, it also raises concerns. Increased Chinese influence and control over critical infrastructure could potentially align Georgia more closely with Russian geopolitical interests. These risks could encompass Russia's geopolitical manipulation as well as its economic and trade control. In response to increasing Western sanctions and trade barriers against Russia, the Anaklia port could become a conduit for illicit goods, potentially prompting sanctions against Georgia and isolating the country economically from the West. Although Georgia is not formally linked to international sanctions, none of its international partners have stated that the country violates these sanctions, particularly in the areas of imports and finance. However, Georgia's shared border with Russia presents certain risks.[35] Managing these risks requires a robust strategic framework to protect Georgia's national interests and maintain its alignment with Western allies.

The Anaklia project carries potential corruption risks as well, with several factors warranting attention. The lack of transparency associated with Chinese contracts raises concerns about the project's financial and operational details. Additionally, the reduced involvement of international oversight may affect accountability. Moreover, the companies in the China-Singaporean consortium that won the tender have been linked to suspected corrupt deals in countries such as Tanzania, Bangladesh, Malaysia, and Sri Lanka (Civic Idea, 2024). These factors collectively create conditions that could facilitate future corrupt activities.

Given these potential risks, it is pertinent to examine the potential benefits associated with the construction of the Anaklia port by Chinese investors. According to a member of the ADC's Advisory Board, the economic benefits that the country could derive from Chinese investments in the port are perceived to be less significant compared to those from the US. It is commonly recognized that Chinese companies typically employ their own workforce for such projects, which may lead to limited job creation prospects locally. Additionally, the presence of a Free Economic Zone (FEZ) is critical for the port's operations. A FEZ near a sea port significantly enhances the port's economic prospects by attracting investment, increasing trade volumes, improving infrastructure, and enhancing global competitiveness. The Anaklia Free Economic Zone is currently owned by ADC. In a televised interview with BMG, Ted Jonas stated that ADC does not intend to sell the area to Chinese investors or the state.[36]

When discussing potential benefits, it's worth considering the possibilities outlined in official documents. According to the joint statement on strategic partnership of Georgia and China, China has indicated readiness to offer preferential loans for Georgia's social and infrastructure projects.[37] However, given the potential risks involved, these preferential loans may not generate long-term benefits for the country. Instead, in the worst-case scenario, they could potentially lead Georgia into a debt trap. It's crucial to carefully evaluate the potential long-term consequences before committing to such financial arrangements.

[35] BMG interview with Ted Jonas, Member of the Supervisory Board at the Anaklia Developemnt Consortium. https://www.facebook.com/watch/?mibextid=w8EBqM&v=1397058467668598&rdid=H1p9eKKy2OmaWudN
[36] Ibid.
[37] https://www.gov.ge/print.php?gg=1&sec_id=583&info_id=85067&lang_id=GEO

6. CONCLUSION

China's prominent role as the largest bilateral creditor to LMICs underscores the pivotal influence it wields in shaping the economic landscapes of developing nations. Its investment strategy, heavily concentrated in infrastructure, transport, energy, and mining sectors, has led to substantial borrowing spikes in regions like Sub-Saharan Africa and Asia. However, the opacity surrounding Chinese lending practices, characterized by confidentiality and collateralized transactions, presents significant challenges. These include the increased risk of debt distress and complexities in debt restructuring, necessitating a push towards greater transparency and proper disclosure. The endorsement of the G20's Common Framework for coordinated debt treatments signals a potential shift towards more systematic approaches to debt relief and restructuring, yet the effectiveness of such measures remains contingent on China's willingness to engage in more transparent and coordinated negotiations.

The examination of various Chinese-financed projects reveals a recurring pattern of challenges and complexities, particularly in instances of collateralized transactions. The "Angola mode" or oil-for-infrastructure model, along with projects like the Laos-China Railway, the Addis Ababa–Djibouti Railway, and Hambantota port exemplifies the precarious balance between leveraging natural resources and or transport infrastructure services for debt repayment and the ensuing risk of debt distress. These case studies underscore the critical need for robust institutional and legal frameworks to manage such risks effectively. As LMICs navigate the precarious waters of foreign investment and debt, enhancing internal and external governance structures becomes imperative to safeguard project success and maintain financial integrity. The lessons drawn from these international experiences highlight the importance of sound risk management practices and the need for borrowing countries to assert greater control and oversight over foreign-financed projects.

In light of these insights, the Anaklia Deep Sea Port project in Georgia emerges as a cautionary tale, emblematic of the risks associated with substantial Chinese investment. The project's uncertain profitability, compounded by potential fiscal liabilities and geopolitical ramifications, calls for a meticulous re-evaluation of its strategic viability and financial sustainability. As Georgia contemplates the future of the Anaklia port, it must carefully evaluate the risks of embracing Chinese investment, especially considering the potential for increased Chinese influence and the shadow of debt distress. Drawing from the experiences of other LMICs, Georgia should prioritize transparency, foster diversified international partnerships, and implement stringent risk management frameworks to navigate the complex dynamics of foreign investment in critical infrastructure projects.

For the Anaklia Deep Sea Port project to thrive and deliver its intended benefits, Georgia must adopt a robust approach to risk management and governance. Essential to this is the establishment of sound institutional and legal frameworks, including thorough contract reviews, transparent procurement processes, and alignment with domestic and international standards to protect national assets. Promoting transparency, accountability, and ensuring the project's alignment with Georgia's debt strategy and macroeconomic policies are critical steps toward mitigating corruption risks and fostering informed decision-making. Moreover, the Georgian government should enhance its internal capabilities across legal, debt management, fiscal risk management, and public investment sectors. This comprehensive strategy will not only address the project's complexities but also position the Anaklia port as a pivotal economic driver, all while safeguarding Georgia's national interests.

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ANNEX 1: TECHNICAL NOTES ON FINANCING MODALITIES

Key actors

- HG – host government of a country with an infrastructure development need.
- SOE – state-owned enterprise in a host country.
- CG – China government.
- CB – Chinese Bank.
- CC - Chinese Company.

Note that CB and CC are state-controlled operations and fully accountable to CG. It presents an institutional hierarchy on the Chinese side.

CG → CB1,2,... →CC1,2,…. = CG

Goods for Infrastructure Model (oil, energy) – two-stage simultaneous game

Stage 0.

0. HG and CG sign a MOU identifying priority areas of cooperation.

Stage 1.

Agreement 1. Infrastructure development project in resource industries.

1. HG signs a loan agreement with the CB for infrastructure development in the natural resource-based industry (oil, hydro).
2. CC1 is selected to implement the project.
3. CB finances CC1's supply of labor and equipment to implement the project.
4. CC1 presents to CB accounts of volumes of labor and goods supplies, which CB converts in the monetary values using CG determined price valuations.
5. CB presents a note of invoice to HG determining the value of goods and services supplied by CC1.
6. HG assumes this note of invoice as its debt obligation to CB.

Stage 2.

Agreement 2. Concession agreement for extracting natural resources.

7. HG signs an agreement with CC2 to extract natural resources supported by infrastructure development in the agreement 1.
8. CC2 extracts natural resources and supplies them to CG.
9. CC2 presents to CB accounts on volumes of resources extracted, which CB converts in the monetary value using CG determined price valuations.
10. CB matches CC2 and CC1 valuations and presents a note of invoice to HG on the debt settlement accrued from agreement 1 by the natural resources extracted in agreement 2.

Observations:

- Barter non-monetary transaction - exchanging supply of Chinese goods and labor by CC1 for natural resources extracted by CC2 on the soil of HG with HG guaranteeing transactions by signing agreements 1 and 2.

- CB offsetting bookkeeping (circular transaction) - non-monetary transaction matching CC1 and CC2 accounts with the HG's contractual debt obligations.

- Terms of the agreements could be communicated publicly so that it meets around 30 % grant element requirement. However, the agreement may not have clearly defined upfront disbursement, amortization and repayment schedules, as these depend on implementation of transaction volumes by CC1 and CC2 and valuations by CB.

- Gestation period/grace period = time gap between Agreements 1 and 2. The loan value from agreement 1 is carried at the books of CB until agreement 2 starts being implemented and gradually offsets obligations accumulated under agreement 1. Pace and valuation of offsetting is determined by CB.

- Disbursement and debt service are done through non-monetary barter exchange of goods and services for natural resources

- The debt disbursement could be an equivalent term to invoice valuations by CC1 presented to CB and then by CB to HG, while debt service would be equivalent term for the invoice valuation presented by CC to CB and then by CB to HG.

    - Disbursement = goods and labor supplied by CC1 and valued by CB.
    - Debt service = natural resources supplied by CC2 and valued by CB.

- Outstanding debt = a difference between all goods and labor supplied by CC1, various service charges, and natural resources supplied by CC2 all valued by CB.

- If HG decides to expropriate or re-assign CC2's operations, the outstanding debt needs to be repaid in monetary terms to CB.

Services for Infrastructure Model (Port and railroads) – two-stage or more sequential game

Stage 0.

0. HG and CG sign a MOU identified priority areas of cooperation.

Stage 1.

Agreement 1. Infrastructure development project in the port.

1. HG signs a loan agreement with the CB for infrastructure development for port or railways.
2. CC1 is selected to implement the project.
3. CB finances CC1's supply of labor and equipment to implement the project.
4. CC1 presents to CB accounts of volumes of labor and goods supplies, which CB converts in the monetary values using CG determined price valuations.
5. CB presents a note of invoice to HG determining the value of goods and services supplied by CC1.
6. HG assumes this note of invoice as its debt obligation to CB.
7. HG appoints SOE to run and operate the port with the intention to use receipts from port/railways operations to repay the debt obligation in agreement 1.

    - Disbursement = goods and labor supplied by CC1 and valued by CB.
    - Debt service = repaid in FX by SOE to CB.

Stage 2.

If SOE fails to make timely debt service payments, the second stage concession agreement is implemented.

Agreement 2. Concessional agreement for the port/railways operations.

8. Sign a concession agreement with CC2 giving partial access to the port/railways operations which are on the books of SOE. This could be implemented by a separate company CC3 formed with a joint ownership of CC2 and SOE, or CC2 assuming shares, and/or long-term management contract from the SOE.
9. CC2,3 operates the port/railways and repays CB.
10. CB matches CC2,3 and CC1 valuations and presents a note of invoice to HG on the debt settlement accrued from agreement 1 by the port/railways operations in agreement 2.
    - Disbursement = goods and labor supplied by CC1 and valued by CB.
    - Debt service = repaid in FX by CC2,3 to CB.

Stage 3.

If receipts from CC2,3 are deemed insufficient to meet debt obligations under the agreement 1, CG may seek additional agreement 3 for the development of trade or industrial zones in the vicinity of the port.

Agreement 3. Concession agreement of developing port/railways industrial/trade zones.

11. Sign a concession agreement with CC4 leasing land in the vicinity of the port/railways for trade and industrial development by various Chinese companies. This could be implemented by a separate company CC5 formed with a joint ownership of CC3 and SOE, or CC4 assuming a long-term land lease for which CG could pay separately.

12. CC4,5,6 …. Operate in the trade and industrial zone and repay CC2,3, which in turn repays CB.
13. CB matches CC4,5,6, CC2,3 and CC1 valuations and presents a note of invoice to HG on the debt settlement accrued from agreement 1 by the port operations in agreements 2 and 3.
    - Disbursement = goods and labor supplied by CC1 and valued by CB.
    - Debt service = repaid in FX from CC4,5,6 to CC2,3 and from CC2,3 to CB.

Observations:

- Stage 1. Loan agreement where the supply of Chinese goods and labor by CC1 and subsequently valued by CB is repaid by SOE in FX.

- Stage 2. Concession agreement where the supply of Chinese goods and labor by CC1 and valued by CB is repaid by CC2,3 all transactions guaranteed by agreements with HG.

- Stage 3. Additional concession/lease agreement where supply of Chinese goods and labor by CC1 and valued by CB is repaid by CC2,3 which in turn is paid by CC4,5,6 all transactions guaranteed by agreements with HG.

If HG decides to expropriate or re-assign CC2,3,4,5,6's operations, the outstanding debt needs to be repaid in FX to CB.

Visual Aids

Modalities: Goods for Infrastructure

Key Actors

Symbols

HG – host government of a country with an infrastructure development need

H_SOE – state owned enterprise in a host country

CG – China government

C_SOB – Chinese Bank

C_SOE - Chinese Company

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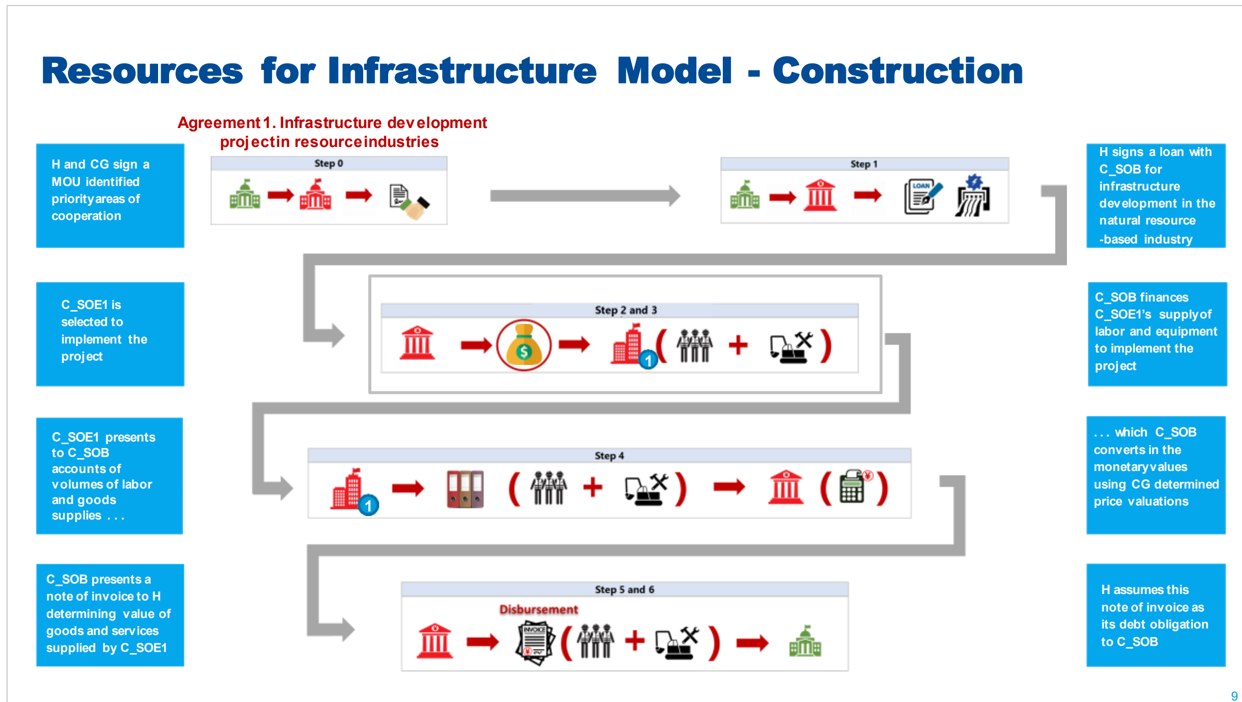
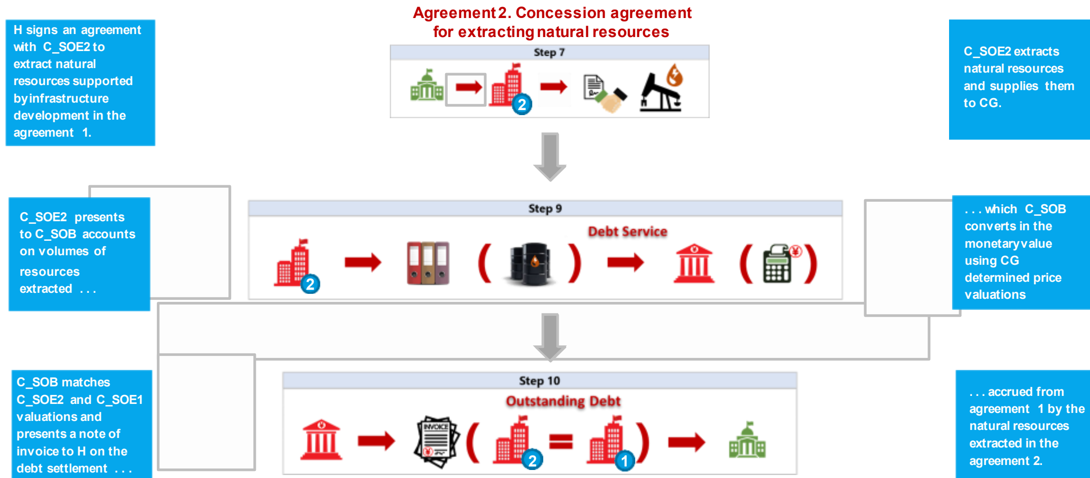


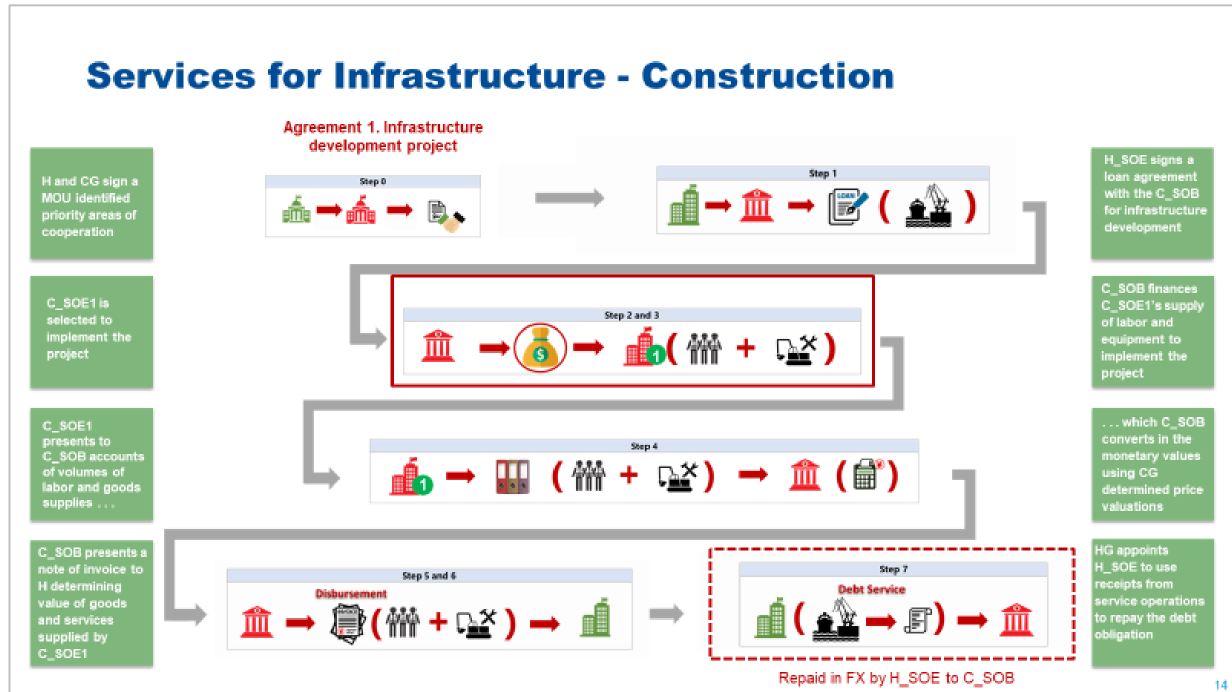
Resources for Infrastructure Model - Extraction

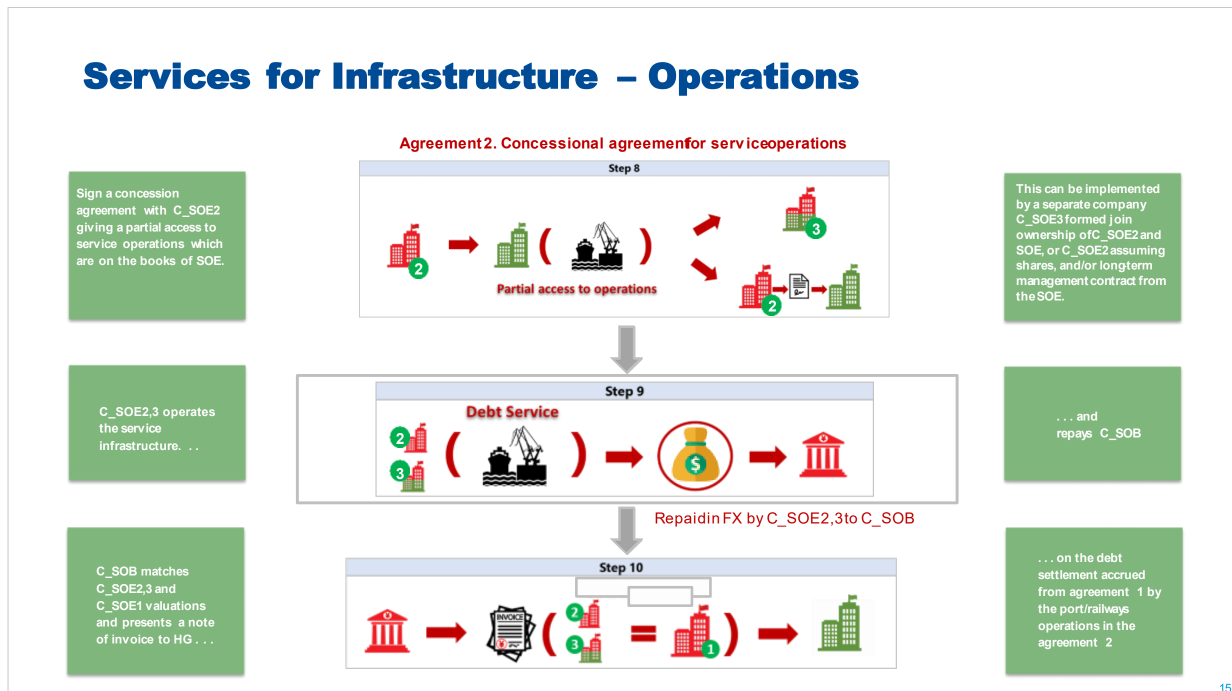


Transactions

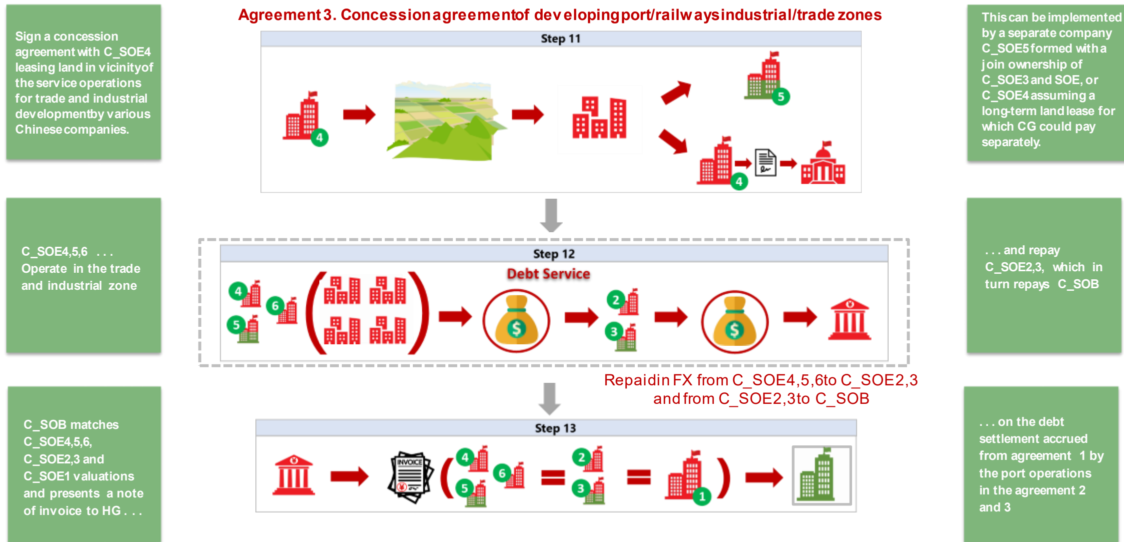
- Disbursement = goods and labor supplied by C_SOE 1
- Debt service = natural resources supplied by C_SOE 2
- Outstanding debt = a difference between all goods and labor supplied by C_SOE 1, various service charges, and natural resources supplied by C_SOE 2
- Bookkeeping by C_SOB
- If host government decides to expropriate or re-assign C_SOE 1, 2 operations, the outstanding debt needs to be repaid in monetary terms

Modalities: Services for Infrastructure





Services for Infrastructure – Linkages



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Transactions

Disbursement = goods and labor supplied by C_SOE1 and valued by CB

Debt service = repaid in FX from C_SOE2,3,4,5,6 to C_SOB

- Need FX liquidity to service the debt
- Time inconsistency between capacity utilization and the debt service needs
- Cascading supply chain

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