

Branding Debt as a Chinese Weapon*

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Declared the leading threat to global stability by the United States and a group of its allies, China has been accused of transgressions varying from stealing hi-tech secrets, spying, and interfering in domestic politics abroad to spreading viruses. Sometimes, even normal measures adopted by countries as part of their international economic relations are presented as crimes when practised by China. A case in point is lending abroad, especially to developing countries, including the poorest among them. China, of course, deploys its hard currency surpluses in multiple forms in a wide range of countries, including the US, with a small share flowing to developing country partners. Rather than being seen as an inevitable fall-out of China's successful accumulation of those surpluses, such capital transfers to developing countries are read as evidence of China's effort at trapping countries in debt and exploiting their vulnerability to control their natural and physical resources and bring them into its sphere of influence. The Belt and Road Initiative (BRI), which promises large investments in infrastructure in countries in need of foreign finance is seen as a convenient tool in this effort.

It is indeed true that in recent years China has become a major creditor in the world economy. According to the Institute of International Finance, China's outstanding debt claims on the rest of the world had risen from \$875 billion in 2004 to \$5.5 trillion in 2019. The latter figure amounts to 6 per cent of world GDP. This expansion in China's claims reflect the fact that, because of large current account surpluses earned over the years, China had also accumulated large reserves and been forced to export capital to earn reasonable returns on those accumulated surpluses. Much of that went to developed country destinations. The outflows of capital in the form of portfolio investment in debt securities from China, include investment in reserve assets, or low return and liquid paper in which foreign reserves are invested by central banks and government. Flows of this kind amounted to as much as 4.5 per cent of global GDP. On the other hand, lending to overseas investment and construction projects that can be included under the BRI, is estimated at around \$730 billion or 13 per cent of China's total overseas debt claims. That figure is also only a third of the total value of value of China's overseas investment and construction exposure, estimated by the American Enterprise Institute's China Global Investment Tracker database as standing at \$2.1 trillion. Since there are limits (that have been falling) on the Chinese investment that developed countries and better off developing countries would be willing to host, moving to less developed countries was an option that China had to exercise.

Lending to and investing in those countries do carry high risks. It is likely therefore that Chinese investment there would flow predominantly from government or state owned enterprises, and they too would invest in countries and activities that are seen as benefiting the Chinese economy in multiple ways. For example, given its voracious appetite for natural resources during its long phase of extra-high growth, a significant share of investment went into activities that facilitated the extraction, transportation and export of those resources. The large investments this involved resulted in a spike in Chinese capital flows to these economies, many of which were income poor but resource rich.

It is true, as a result, that exposure to China is high for some low income countries. Thus, according to the International Monetary Fund, China accounts for around 11 per cent of the external public debt of a group of 37 low income countries covered in a study by the organisation. That is significantly higher than the share in total debt (5.9 per cent) of bilateral credit to these countries provided by members of the Paris Club. On the other hand, it is well short of the 25.7 per cent coming from bilateral credit flows from countries (excluding China) who are not Paris Club members, the 42.1 per cent from multilateral lenders and 15 per cent from commercial creditors.

A more elaborate and recent database, built by the World Bank, relates to 73 countries eligible for the G20's post-Covid Debt Service Suspension Initiative (DSSI), which provides for suspension of interest and amortisation payments from 1 May 2020 till the end of the year. According to those numbers the governments of this group of countries owed China \$104 billion at the end of 2018 or 20 per cent of their foreign debt, and that China accounts for around 30 per cent of their debt service in 2020. Exposure of individual countries varies significantly around this average, from a negligible share in a country like Comoros to more than 90 per cent in the case of Tonga and Maldives. Overall, this is indeed a substantial level of exposure, but the total owed to China is lower than the \$106 billion they owe the World Bank. These governments even owe \$60 billion to private bondholders. In Africa, the continent that is often presented as a test case of Chinese expansionism, multilateral institutions and the private sector are estimated to account for 35 and 32 per cent of debt, as compared with China's 20 per cent. Not satisfied with these figures, controversial efforts are under way to argue that China's presence in these countries is underreported because of a conscious Chinese strategy of hiding evidence on large parts of its international engagement.

That being said, as a single country, China has emerged as a major player in the developing world. This not just because of the surpluses it accumulated, but developments in poor countries as well. The picture that emerges is that poor countries have pursued development trajectories that have kept them debt-dependent. The level of their exposure to debt is not restricted from the demand side, given the failure of these countries to hold back on incurring additional external debt, but from the supply side. On the other hand, capital flows from the developed countries on a bilateral basis are waning, with flows increasingly mediated through the multilateral institutions. Even though globally private flows are becoming more important, such flows to poor countries or the so called "frontier markets", while rising, do not as yet make up for the inadequacy of official bilateral and multilateral flows relative to their demands.

It is not surprising, therefore, that when China decided to put its large foreign exchange hoard to use abroad, including in developing countries rich and poor, the exposure of these countries to China increased significantly. But because of fears about China's rise as a global economic power, breaching frontiers in high technology exports, and concern about its growing military prowess, this increased exposure has given rise to a narrative that sees even the pursuit of commercial and economic interests as a sign of expansionism. Credit from and investment by China are seen as means of subordinating countries materially, politically, and even culturally. Investment in or loans for production and export of raw materials are cited as evidence of colonial plunder. Resolution measures adopted in dealing with debt stress

and default, involving sale of assets in lieu of debt service payments, are interpreted as evidence of that lending being (secretly) backed with those assets as collateral, the acquisition of which is seen as the real intent of Chinese engagement.

It is definitely true that China's interests are not just altruistic. But that is true of all countries that have the wherewithal to increase their presence abroad and was definitely true (and remains so) of the international engagement of the developed market economies that are part of the G20. The issue, if any, is whether China has insidiously exploited its advantageous position and deployed its resources in the form of debt to serve substantially expansionist objectives in the poorest countries.

Here too opinion can differ on how the evidence has to be interpreted. If a country chooses to take on excess debt from the rest of the world including China, and finds itself unable to meet its debt service commitments, debt restructuring or rescheduling is inevitable. If the loan concerned is large, then the restructuring must go beyond a mere temporary suspension of payments or an extension of the term of the loan. These are the principles China too has adopted. For example, in the case of the loan provided to Sri Lanka for the Hambantota port, which the Sri Lankan government decided was no longer viable, China worked out an arrangement wherein it took over the port and 15,000 acres of surrounding land on a 99 year lease in lieu of payments due on the loan. This outcome of a wrong investment decision on the part of the Sri Lankan borrowers has been interpreted by its critics as the successful realisation of China's real goal when financing the project. That was not a commercial decision, it is held, but was based purely on strategic considerations, on the grounds that it "gave China control of territory just a few hundred miles off the shores of a rival, India, and a strategic foothold along a critical commercial and military waterway," as The New York Times argued. When Myanmar suspended construction of the Myitsone dam because of popular protest against its adverse environmental consequences, but was not in a position to repay China which had financed the project, China agreed to accept repayment in the form of equity in new dams in the country. This too could be interpreted as part of a process of economic expansion. Criticism of China often seems to suggest that these loans had no economic rationale in the first place and were solely contracted to get these extraneous benefits.

This response to China's engagement with developing countries has on occasion taken a bizarre turn. Developed countries have opposed IMF support for debt stressed developing countries on the grounds that the IMF's (and therefore their) money would be used to meet interest payments and pay off loans due to China. In the US, a group of 16 Republican senators have demanded of the Trump administration that it must insist that developing countries being considered for a debt restructuring or aid package must be required to disclose their debt and other obligations to China. If China is seen as using debt to buy influence, providing money to pay off that debt must be a good thing, because it keeps those countries free of Chinese influence. But in the all-in opposition to China born out of fears originating in its perceived rise to economic and military dominance, rational decision making is sometimes the casualty.

China, meanwhile, continues to do what it thinks it must do, and claims to follow all international rules of economic engagement. When the G20 took the decision in the wake of the Covid-19 shock to provide debt relief in the form of suspended debt-service payments to poor countries seeking help, China signed on. It agreed to

reschedule debt owed to it according to the G20 guidelines, rather than going solo and extracting strategic concession from its debtors. But, clearly, the effort to isolate it economically and brand it enemy no 1 is bound to tell, as the growing aggression in China's rhetoric suggests. Whether and how this would affect its relations with its developing country partners is yet not clear.

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