Beyond the Narrative of China's Debt Trap Diplomacy

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In the last three decades, the People's Republic of China has seen an astronomical rise from a reclusive economic backwater to a premier global power. Accompanying this rise is China's emergence as a leader in international development finance (Singh, 2021). This comes at a crucial time for developing nations facing an ever-rising infrastructure-financing gap (Carmody, 2020). In response to the increasing demand, Beijing has helped fund two new multilateral development banks, the New Development Bank and the Asian Infrastructure Investment Bank, along with 13 regional and bilateral funds (Singh, 2021). Chinese banks are also present across the developing world, extending loans to countries that traditional lenders have avoided (Singh, 2021). However, China's growing footprint in international development financing has also attracted fierce criticism. Former U.S. Secretary of State Rex Tillerson made this damning indictment of China's dealings with African nations: "China's approach encourages dependency using opaque contracts, predatory loan practices, and corrupt deals that mire nations in debt and undercut their sovereignty, denying them their long-term, self-sustaining growth […] its approach has led to mounting debt and few if any jobs in most countries. When coupled with the political and fiscal pressure, this endangers Africa's natural resources and its long-term economic and political stability" (US Department of State, 2018).

More recently, current U.S. Secretary of State Janet Yellen expressed her worries 'about some of the activities that China engages in globally, engaging in countries in ways that leave them trapped in debt and don't promote economic development (Baptista, 2023).' Both officials are, in fact, echoing a claim initially made by Braham Chellaney (2017), the Indian pundit who coined the term "debt-trap diplomacy." Chellaney claimed in 2017 op-ed that China practices predatory loaning by deliberately ensnaring developing countries in burdensome loans that the recipient will struggle to repay (Chellaney, 2017). By leveraging the debt, Beijing is able to force concessions from the debtor country, such as the acquisition of critical assets and natural resources, and expand the reach of China's military and navy (Chellaney, 2017). Chellaney (2017) concluded that China's debt-trap diplomacy aimed to further its 'neo-colonial ambition' and cautioned developing countries to avoid Chinese financing or risk falling victim to Beijing's nefarious design.

Following its publication, Chellaney's work was picked up by two Harvard University graduate students who furthered his claim by re-christening the practice as 'debt book diplomacy' (Brautigam, 2019). The term then spread like wildfire as it was eagerly picked up by major media outlets and policymakers from Washington to Delhi and Tokyo as proof of Beijing's imperial aspirations (Brautigam, 2019).

But what evidence substantiates the claim that China is practising debt trap diplomacy? In a 2019 study, the independent American research institute Rhodium Group reviewed 40 cases of Chinese external debt renegotiations to see if there was a debt forgiveness pattern for asset or natural resource swap agreements. The study concluded that asset seizures are by far the exception, and even when an acquisition of assets did occur, it was difficult to ascertain if it was directly linked to debt renegotiations (Kratz et al., 2019). The following paper will deconstruct aspects of China's debt-trap diplomacy to uncover the reality behind its claims.

Chinese loans and debt distress

The first step of China's supposed debt-trap tactic is intentionally extending a burdensome loan to a country for a project that produces little to no economic return and then leveraging the resulting financial distress of the recipient to

Beijing's advantage. Africa is often the focus of the debt-trap accusations against China, as many African countries receiving Chinese loans have soaring public debt. At a joint conference between the IMF and the People's Bank of China in 2018, former IMF chief Christine Lagarde warned that ''[w]ith any large-scale spending [...] there is always a risk of potentially failed projects and the misuse of funds' and that even 'much-needed infrastructure financing [...] can also lead to a problematic increase in debt, potentially limiting other spending as debt service rises, and creating balance of payment challenges' (IMF, 2018). Looking at Chinese lending practices on the continent could therefore shed light on the validity of the claim that China actively contributes to the debt distress of its loan recipients.

By far, the most comprehensive and reliable data on Chinese loans in Africa are collected by the China-Africa Research Initiative (CARI) at John Hopkins University. According to CARI, between 2000-2017, Beijing lent African countries $146 billion (China Africa Research Initiative, 2020). Out of the more than 1000 loans recorded in CARI's database, not one has been an example of China deliberately inducing debt distress in the recipient country (Brautigam, 2020). In a study done in 2017 by CARI on 17 African countries considered to be debt distressed or on the verge of, China was a significant creditor to only three countries (Brautigam et al., 2018). On average, Chinese debt comprised 15% of these countries' total external debt, with only three governments found to owe more than a quarter of such debt to China (Brautigam et al., 2018). Another study by the Jubilee Debt Campaign (2018), a British advocacy group for debt relief in developing countries, similarly concluded that China was not a primary source of African debt distress. Through compiling data from the IMF, Club de Paris, the World Bank, and CARI, Jubilee (2018) found that over two-thirds of external debt owed by African countries was to multilateral institutions like the World Bank and non-Chinese private creditors. It is also important to note that the rates at which China lends money are far from exorbitant. According to CARI, between 2000 and 2017, 80% of loans (totalling $97.5 billion) from China to sub-Saharan African countries were issued from China's two official policy banks (Brautigam & Gallagher, 2018). These policy banks issue loans at fixed interest rates (usually 2%) or at commercial rates (i.e. The London Inter-Bank Offered Rate plus a margin) (Brautigam & Gallagher, 2018). In the case of Angola, Chinese oil-backed loans were of a lower rate than loans of the same type from Western financiers (Brautigam & Gallagher, 2018).

Asset seizure

The second claim of China's debt-trap diplomacy is that Beijing leverages debt to force concessions from the debtor, usually in the form of seizures of critical assets and natural resources. This claim equally fails to hold up when confronted with facts and figures. The aforementioned databases of CARI (Brautigam, 2020) and Rhodium Group (Kratz et al, 2019) show that no cases provide clear evidence to support this claim. In the case of CARI, none of the more than 1000 loans between China and African countries recorded in their database were shown to be examples of debt leveraging to extract concessions (Brautigam, 2019). According to Kratz et al. (2019), debt renegotiations between China and borrower countries usually end in a balanced outcome, with the most common being a partial or total debt write-off. Debt forgiveness is often conceded by Beijing unilaterally, even in the absence of debt distress on the part of the debtor (Kratz et al., 2019). Such cases suggest that Beijing frequently uses debt-write-offs as a political tool to signal support to the debtor country and improve bilateral relations (Kratz et al., 2019). The study also found that China's ability to leverage its economic weight is limited in these negotiations, as most of the cases reviewed had a favourable outcome for the borrower, especially when these countries had access to alternative sources of funding or were aided by external factors (e.g. change in leadership) to request a change in terms (Kratz et al., 2019).

With regards to asset seizures, Kratz et al. (2019) could only point to two cases that could suggest China "leveraging" debt to acquire holdings. The first is the central Asian nation of Tajikistan, which ceded 1,158 square km to China in 2011 (Kratz et al., 2019). However, it is unclear if the land transfer was done in exchange for a Chinese debt write-off, as it is considered to be part of a historical dispute settlement between the two countries, which also saw China relinquish claims over 28,000 square km of Tajik territory (Sodiqov, 2011). The second case, Sri Lanka, merits a detailed recounting of the events and how they unfolded, for this controversial case gave rise to the term 'debt-trap diplomacy.'

The Hambantota Affair

According to the inventor of the term 'debt-trap diplomacy', Sri Lanka is 'Exhibit A' of China's neo-colonial designs (Chellaney, 2017). The popular account is as follows: China lent money to Sri Lanka to build a major port on their southern coast at Hambantota, and with advanced knowledge, the loan would induce debt distress in the country. This would then allow Beijing to demand port ownership in exchange for debt relief, opening its use to the Chinese navy (Chellaney, 2017). Hambantota is thus part of a larger *modus operandi*: Beijing's debt trap stratagem. However, a careful look at how events transpired reveals a different story.

The first misconception of this story is that China intentionally proposed the project to Sri Lanka to indebt the county. In reality, the port project was presented by the former Sri Lankan President Mahinda Rajapaksa (Brautigam & Rithmire, 2021). In 2007, Colombo made an 'open request for funding' and approached the United States and India, but was rejected by both (Jones & Hameiri, 2020). Chinese construction firm China Harbor Group took up the bid, and along with financing from China Eximbank, totalling $307 million, it won the contract (Brautigam & Rithmire, 2021).

The second misconception is that the project had geostrategic motivations. In reality, it was a purely commercial project that the Sri Lankan government heavily mismanaged. Following the opening of Hambantota in 2010, Rajapaksa did not wait for the port to generate revenue, as many feasibility studies have advised, and pushed ahead with transforming Hambantota into a container port (Brautigam & Rithmire, 2021). To do so, in 2012, Colombo borrowed an additional $757 million from China Eximbank at a rate three times lower than its previous loan (Brautigam & Rithmire, 2021). Two years later, however, the port remained unprofitable. Sri Lanka's finance ministry estimated that between 2011 and 2016, losses of Hambantota totalled $230 million (Jones & Hameiri, 2020). The consensus amongst local experts is that the blame for the commercial disaster falls on the government's 'incompetence and disregard of any commercial sense' (Jones & Hameiri, 2020).

The third misconception is that Chinese debt was responsible for inducing Sri Lanka's debt distress. In reality, Sri Lanka's debt crisis arose from excessive borrowing on Western-dominated capital markets to finance the government's exorbitant and unsustainable deficit spending. (Jones & Hameiri, 2020). By 2016, 61% of the government's budget was funded by foreign loans, with total government debt increasing by 52% between 2009 and 2016 (Jones & Hameiri, 2020). As a result, an estimated three-quarters of external government debt was owed to private financial institutions (Jones & Hameiri, 2020). In 2016, Sri Lankan debt related to Hambantota Port totalled $1.3 billion, comprising only 4.8% of the government's total external debt (Jones & Hameiri, 2020). In the same year, according to the Sri Lankan Central Bank, repayment costs for the project were $67.5 million, making up a mere 3.3% of the $2.03 billion that went to servicing foreign debt (Jones & Hameiri, 2020).

The fourth misconception is that, as loans to China Exim Bank defaulted, the Sri Lankan government was forced into a 'debt-equity swap', giving Hambantota over to the Chinese in exchange for Beijing to write off its debts. In reality, no transfer of ownership occurred, and no debt was written off. What happened was that Colombo negotiated a bailout from the International Monetary Fund, and seeking much-needed capital, it decided to lease the unprofitable Hambantota Port to an experienced operator (Singh, 2021). Sri Lanka chose Chinese SOE China Merchants to lease the port for a sum of $1.12 billion, which Colombo used to repay Western creditors, while the debt to China Exim Bank remained in place (Brautigam & Rithmire, 2021). China Merchant's lease of the port was far from a strategic land grab, as its lease of Hambantota figured into a wider corporate strategy of overseas expansion (Brautigam & Rithmire, 2021).

Lastly, the Chinese Navy is not able to exploit the port, as the Sri Lankans use the port themselves as the base of their southern naval command. When asked about China's potential use of the port as a naval base, Sri Lanka's ambassador to China, Karunasena Kodituwakku, stated, "China never asked us. We never offered it." (CGTN, 2018). In the same interview, Kodituwakku categorically declared that "If anybody is saying that the Chinese government gave its money to put Sri Lanka into a 'debt trap', I don't agree with that. It's an absolutely wrong conclusion." (CGTN, 2018).

Resource seizure

Another popular account is that the primary motivation for China to give out loans is to get a hold of natural resources. Chellaney (2017) asserted that Chinese loans are 'often intended not to support the local economy, but to facilitate Chinese access to natural resource.' The logic is that Chinese infrastructure financing is a way of recolonizing developing countries by leading them into deep debt so they will eventually surrender their natural resources to China as a way of debt repayment.

Indeed, resource-backed loans account for a large percentage of Chinese finance in developing countries. In Latin America, half of all Chinese loans are secured by oil, the majority with Venezuela and Ecuador (Singh, 2021). Whereas in Africa, one-third of Chinese loans are commodity-backed finance, secured by various resources ranging from oil to cocoa to platinum (Singh, 2021). These commodity-secured loans, however, are not aimed at ensuring access to natural resources. They are made to reduce the high risks of lending to low-income countries with poor credit ratings (Brautigam & Hwang, 2017). Through enhancing security and mitigating risks, commodity guarantees allow infrastructure financing at reasonable interest rates to countries with poor credit ratings (Brautigam & Hwang, 2017). A common misconception is that debtor countries pay back the loans by simply delivering the resource to China, which robs them of the revenues from the potential sale of said resource. In reality, loans are repaid not by the supply of commodities but by the profits from their sale at market price (Singh, 2021). It is worth noting that this loaning practice is inspired by China's experience as a newly developing country pursuing modernization. In 1978, just as China was emerging from the chaos of the Cultural Revolution, Beijing secured a line of credit worth $10 billion from Japan to develop ports, power plants, and other critical infrastructure with the help of Japanese contractors (Brautigam, 2019). Like many other loans that followed, this loan was repaid with profits from oil and coal exports (Brautigam, 2019).

It is also important to note that Beijing is unable to leverage resource-backed loans against debtors, and these loans are not a strong guarantee against repayment problems (Kratz et al., 2019). The cases of Ukraine and Venezuela attest to China's commodity back financing limits. In the case of Ukraine, loans from Beijing were backed by grain shipments (Kratz et al., 2019). However, when Kyiv consistently failed to meet the required annual grain shipments to repay its loan, China had to turn to international arbitration to resolve the disagreement (Kratz et al., 2019). In the case of Venezuela, China's loans to Caracas were in the form of long-term oil for loans partnership of the type described between Japan and China (Ferchen, 2018). Due to a range of factors, from the fall of global oil prices to strict sanctions imposed by the United States, Venezuela was plunged into a deep economic and political crisis that greatly diminished its oil output, leaving Caracas unable to fulfil its promised oil deliveries to Beijing (Ferchen, 2018). In response, Beijing decided to restructure the loan terms, giving Caracas a two-year respite from repayments (Ferchen, 2018). Throughout this period, China purchased Venezuelan oil for cash instead of using the profits from the sale of the oil to repay the loan (Ferchen, 2018). However, by the end of the two years, Venezuela's situation had deteriorated even further, and China was left with no way of obliging Venezuela into resuming loan repayment (Ferchen, 2018). It is fair to say that the situation resulted in more of a lending trap for China than a debt trap for Venezuela (Ferchen, 2018).

The Belt and Road Initiative: a vehicle for Chinese neo-imperialism?

Since its launch in 2013, China's flagship investment project, the Belt and Road Initiative (BRI), has attracted much controversy. It has been accused of being a grand geopolitical strategy to subjugate developing countries through the use of debt-trap diplomacy. However, like all the other claims previously reviewed, there is a lack of evidence to suggest that the BRI is a vehicle for China's neo-imperialist designs.

Firstly, the BRI is primarily an economic project, as the initiative's main objective is to offload and export China's burgeoning infrastructure surplus capacity (Jones & Hameiri, 2020). By 2008, China's under-developed interior provinces were seeing an 'oversupply of infrastructure' resulting from the BRI's national-level predecessor, the Great Western Development Campaign (Ye, 2019). With the demand for Chinese exports falling and China's internal market unable to absorb the surplus in production (especially in infrastructure), Beijing needed to find a way to stimulate external demand to keep up with Chinese industrial output (Ye, 2019). As official documents show, the main impetus for BRI projects was industrial overcapacities, with funding mainly diverted to state-owned construction firms facing a shortage of domestic demand[1] (Ye, 2019).

Secondly, the BRI's financing system is fragmented and poorly coordinated, therefore unable to pursue detailed or strategic objectives (Jones & Hameiri, 2020). As Michael Dwyer (2020:1) states, "the BRI is more an effort to marshal a variety of existing initiatives under a single grand narrative associated with the leadership of Xi Jinping than it is a *de novo* plan." China's development financing framework is dominated by economic agencies and State-Owned Enterprises (SOE), which reflects its profit-seeking orientation and support for SOEs' overseas expansion (Jones & Hameiri, 2020). There has also been a diversification of funding sources for BRI projects as the burden becomes too heavy for Chinese banks to carry alone (Lai et al., 2020). Traditional financial hubs like Hong Kong and London have begun to play an active role in financing BRI projects, such as offering deep capital markets for debt financing, integrated financial services, raising equity, and expert advice from big players in the financial realm (Lai et al., 2020). New financial hubs are also being created to meet the demand for BRI financing, as demonstrated by the creation of the Astana International Financial Center (AIFC) by Kazakhstan, with the backing of major financial institutions such as the Shanghai Stock Exchange, Goldman Sachs, and Nasdaq stock exchange (Lai et al., 2020).

Lastly, the BRI is far from being a unilateral strategy of Beijing because recipient countries largely shape its progress. Far from being vulnerable prey to China's predatory lending, developing countries determine how BRI projects take shape on their territory (Jones & Hameiri, 2020). BRI projects are always initiated by a formal request from foreign governments (*supra* the Hambantota Affair), meaning China cannot simply force states to accept projects it wants to build on their territory that is modelled off Beijing's interests (Jones & Hameiri, 2020). Therefore, the BRI is being developed piecemeal through numerous bilateral negotiations, with projects generally reflecting the needs and interests of recipient countries (Jones & Hameiri, 2020).

Conclusion

Looking beyond the popular narrative of Chinese debt-trap diplomacy, it becomes clear that this much-circulated narrative does not hold up to scrutiny. There is no intention on the part of Beijing to actively induce debt distress in recipient countries, as its loans usually make up too little of a percentage of the countries' external debt for there to be any influence. In the cases where Beijing could theoretically leverage the massive sums owed to it (e.g. Venezuela), it had no coercive means to do so. There were also no asset seizures, and resource-backed loans proved to be a typical, non-malignant practice when financing countries with poor credit ratings. The BRI equally does not live up to accusations of strategic use of predatory lending to further geostrategic aims due to its commercial and recipient-driven orientation, lack of coordination, and diversified funding sources.

Yet past behaviour does not always predict the future. The cases of Pakistan and Montenegro are to be watched out for. Pakistan has, since 2013, borrowed heavily from China to fund infrastructure projects as a part of the China-Pakistan Economic Corridor (CPEC) initiative (Shaikh & Chen, 2021). With an estimated cost of $62 billion, it aims to connect the Chinese region of Kashgar with Pakistan's seaport at Gwadar, 3000 kilometres away from each other, with roads, railways, and bridges (Shaikh & Chen, 2021). As a result, Beijing is now Islamabad's largest creditor, owning 27.4% of Pakistan's external debt (Younus, 2021). Notably, most of the loans from China to Pakistan are at near-zero interest rates with generous grace periods (Younous, 2021). China has so far refrained from shaping Pakistani fiscal policies, as it is the IMF, the World Bank, and Asian Development Bank who help Islamabad formulate such policies (Younous, 2021). However, given its geographic proximity to Pakistan and the importance of Gwadar in its maritime strategy, it remains to be seen if Beijing will decide to exploit Pakistan's debt for leverage.

With regards to Montenegro, in 2014, Podgorica borrowed nearly €1 billion from China Exim — at a 2% interest rate with a grace period of 6 years — to build a highway connecting the port of Bar to Serbia and the wider Balkan region (Vladisavljev, 2021). However, by 2021 the Montenegrin economy had shrunk by 15% due to the pandemic, and the government found itself unable to afford the first tranche of debt repayment (Vladisavljev, 2021). At this point, Montenegro's national debt ballooned to 103.28% of GDP, with a quarter of its external debt owed to China (Vladisavljev, 2021). In the loan contract between Exim and Montenegro, it is stipulated that if payments are not made on time, the bank has the right to seize land in Montenegro as long as the land is not used for military or diplomatic purposes (Schmitz, 2021). Through negotiations with the EU and the United States, Podgorica was able to hedge the debt – bringing the interest rate from 2% to 0.88% – and make the payment on time (Vladisavljev, 2021). Beijing has also expressed willingness to extend the loan repayment grace period in talks with Montenegro

(Trkanjec, 2021). However, given the attractive possibility of establishing a solid foothold in the region, Beijing could decide to leverage this favourable position and force concessions from Montenegro. Only time will tell if China's policies will live up to the "debt trap" label.

Notes

[1] Between 2014 and 2018, construction projects absorbed 63% of the $404 billion allocated for the BRI, with Chinese state-owned companies receiving 96% of the construction contracts (Joy-Perez & Scissors, 2018).

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