Unmasking the Narrative: Is China's Debt Trap Diplomacy Fact or Fiction?

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Debt Trap Diplomacy (DTD) refers to a scenario in International Relations where countries with a powerful economic position and enormous finances provide loans to relatively less endowed developing countries for inefficient or vanity projects. Subsequently, this traps the less endowed country in huge debts and holds leverage over them if they are unable to repay that debt (Onyango, 2021). DTD has gained considerable notoriety in international politics as a tool of Chinese foreign policy under its Belt and Road Initiative (BRI) to arm-twist nations into giving forced sovereign concessions. This narrative is in part forwarded by the USA and other Western Countries as they see Chinese loans as a challenge to the current world order dominated by Western financial institutions and rules. For instance, in November 2023, US President Joe Biden hosted the America Partnership for Economic Prosperity Leaders' Summit, and he declared that the US would provide "a real alternative to Chinese DTD with high-quality infrastructure development" (Eric Martin and Justin Sink, 2023). Meanwhile, the Philippines and Italy, the only G-7 members to participate in BRI, have recently withdrawn from the initiative out of fear of a Chinese debt trap (Times Now, 2023).

As DTD has become an international issue, this essay aims to analyse the underlying assumptions being made to dub Chinese loans "debt traps" or "predatory". Further, the essay will use empirical examples to argue that the DTD is fiction. The mere gaining of favourable terms for investment in exchange for financial assistance cannot be dubbed DTD. The essay will analyse two case countries that were chosen based on their participation in BRI and the high share of foreign debt owed to China. These are Pakistan and Sri Lanka (Buchholz, 2023). To ascertain if the Chinese DTD is fact or fiction, the loans made by China will be analysed using criteria that are loosely based on conditions used by Michael Himmer & Zdenek Rod (Himmer and Rod, 2023, p. 254). But unlike their four criteria, this essay will narrowly define them into the following three questions: 1) Is there a clear "intent" present in Chinese debt conditions that point to an eventual debt-for-equity exchange? 2) If a debt-for-equity swap has taken place, what conditionalities govern it? 3) Has China restructured the debt of its borrower country regardless of its economic health?

For this essay, debt-for-equity or sovereign concessions would entail any infrastructural exchange that allows the Chinese government to increase its comprehensive national power, as defined by Wuttikorn Chuwattananurak (2016, p. 3), like gaining a strategically located seaport or a crucial diplomatic sway in favour of its interest. This essay will take into account the nuances that govern international finance and hence would not dub mere increase in diplomatic influence in exchange for debt as DTD. Every nation in the world gains some influence in exchange for financial support to a borrower country. DTD will stand out based on the clear intent of the Chinese nation to trap a nation in debt and gain strategic assets or debt-for-equity in return; the intent would be measured as China's willingness to restructure debt and provide concessions. Thus, the structure of the essay would be such that, first, it will analyse why Chinese loans are seen as predatory, followed by the critical analysis of the "predatory" or "DTD" narrative through the role of agency, inherent biases, etc. This would then be followed by two case countries taken based on, one being touted as the quintessential example of DTD while the other is seen as the potential DTD victim, i.e., Sri Lanka and Pakistan, respectively. Lastly, I will conclude by giving a definitive stand on why DTD is fiction and not a fact.

Why are Chinese loans seen as predatory?

According to Brahma Chellaney (2017), providing loans to economically unstable nations for infrastructural development in itself is not wrong, but China uses its financial capacity with intent to gain control over the borrower country's strategic assets such as natural resources, ports, and trade concessions. Therefore, he claims that China practices predatory behaviour in its lending (Himmer and Rod, 2023, p. 252). The claim that Chinese loans are predatory further stems from the secrecy China demands concerning the contractual conditions it attaches to its lending. This secrecy is amplified by China giving loans to highly fragile developing countries with corrupt governments and inefficient economies. However, it misses the point that developing countries need the most loans. A recent report analysed the 100 debt contracts from more than 2000 loan agreements signed between Chinese state-owned lenders and developing countries. It pointed out that of 100 debt contracts analysed, 47% of them were with African nations (Anna Gelpern et al., 2021, p. 4). Many of these also rank very high in the Fragile State Index. Unlike Western nations, which generally provide indirect loans through multilateral institutions like the World Bank and IMF for infrastructure development and Balance of payment crisis, respectively, China predominantly provides commercial development loans, particularly for BRI, through its state institutions like the Export-Import Bank of China and the Chinese Development Bank. Out of the 100 debt contracts signed between 2000-2020, 84 were accounted for by just the former two Chinese state banks. These contracts contained a clause that prohibits the borrower country from disclosing the conditions (Anna Gelpern et al., 2021, p. 4). This paints a picture of China deliberately pursuing an ambiguous lending policy akin to that of a commercial bank and building a dependency between itself and the borrower country. DTD proponents argue that while international financial institutions consider the country's infrastructural needs, economic health and human rights records, China provides loans for vanity projects with little to no economic output (Mlambo, 2022, p. 2). Further, the loans made by China for BRI projects are carried out by Chinese companies and predominantly employ Chinese workers. This gives the impression that China aims to provide minimal economic opportunity to the borrower country to repay the loan and, thus, subsequently, trap it in DTD (Anna Gelpern et al., 2021, pp. 4-9).

Problematising the predatory assumption

Agency of borrower countries

The DTD argument, although compelling, overlooks some critical aspects. The quoted report itself points out that China agrees that confidentiality obligations and loan agreements will be subordinate to the national law of the borrower country (Lynch et al., 2021). This provides a key level of agency to the borrower country, which the report and the larger DTD debate do not give sufficient importance to. Also, the DTD debate often takes the borrower country as not having any influence on the loan conditions it accepts or infrastructural projects it requires. The entire transaction is portrayed as unidirectional, with only China deciding what to build and its financial conditions. This is not the case; the recipient country plays a decisive role in the projects that would be financed with China as an advisor and financier. As Jones and Hameiri point out in their research, China cannot and does not dictate unilaterally what is built under the BRI project using its finances; instead, the borrower countries play the quintessential role in determining which infrastructural projects they want China to finance and build (Jones and Hameiri, 2020, pp. 2-4). The unique thing about Chinese development financing is its recipient-driven approach to projects with Chinese as advisors, and this distinguishes Chinese financial assistance from traditional Western financiers, giving more agency to borrower countries. Therefore, it is natural for borrower countries to only support those infrastructure projects that serve their national interest (Jones and Hameiri, 2020, pp. 10-12). This negates the DTD argument of China forcing borrower countries to accept lopsided agreements that may result in debt-for-equity in future. Further, as mentioned, the loan conditions, although opaque, are subordinate to national law; thus, anything that is against national interest would undoubtedly be unacceptable to the borrower country.

This can be enumerated in the case of Djibouti, whose public debt in 2016-17 had risen to 80% of GDP, of which the lion's share was owed to China. Some scholars like Mark Green argued that China had forced Djibouti into letting it open its first foreign military base there in exchange for restructuring the debt (Green, 2019). But this misses the point that there are many other foreign military bases in Djibouti, including that of the USA, France, and Italy, all of whom have given substantial financial assistance to the country. The USA invested over $338 million in Djibouti between 2001 and 2020, with over $89 million in 2007 also (U.S. Embassy in Djibouti, 2020). Interestingly, in January 2007, the US and Djibouti signed an agreement that hitherto 88 acres of Camp Lemonnier base would be expanded to 500 acres, and it would be put under the separate US African Command while giving liberty to the US to allow its allies to use the base as well (U.S. Navy, 2024). This can be seen as the US extracting concessions in exchange for financial support, but hardly anyone would dub this as DTD. It can be instead seen through the lens of a unique foreign policy of Djibouti, under which it uses foreign military bases as a source of stability and revenue for its domestic economy (Reel, 2016), pointing towards the agency the country poses in its dealings with global power. In allowing China to build a military base, both nations have signed a 10-year lease agreement that is a $20 million per year payment to Djibouti's government (Congressional Research Service, 2019). Providing a vital source of revenue for a developing country with limited revenue streams.

The case of Djibouti points to the borrower countries agency regarding financial assistance from great powers like China and the USA, which further points towards the hedging capacity these countries have to extract the best possible agreements from great powers. This negates the DTD argument that claims China arm-twists the nation into signing an ambiguous loan agreement and then forces them to concede strategic assets. This is not to say that financial assistance did not play a favourable role for China in gaining access to a military base in Djibouti. Still, an overt intention of DTD is absent. Therefore, it cannot be attributed to China's concerted aim to provide financial assistance in the hope of receiving a strategic asset.

Prejudicial lens

The DTD argument partially stems from biases that China should follow the lending practices of the West not to be considered predatory. This narrative has been forwarded by the West, but the opaque terms and conditions of the loans given by China make it more believable. Some of these opaque conditions, which are general to all lending contracts by China Development Bank and China EXIM bank, include the cross-default clause, which entitles these state-run institutions to terminate and demand immediate full repayment when the borrower country defaults on loan repayment to any of its other lenders. Chief among them would be the Paris Club and international financial institutions. Approximately three-quarters of the debt contracts analysed by the How China Lends report contain a "No Paris Club" Clause, which expressly commits the borrower country to exclude the debt restructuring initiative taken by the multilateral Paris Club and keep Chinese debt restructuring negotiations limited to bilateral talks (Gelpern et al., 2021, pp. 6-7).

Although the contractual agreements do have high ambiguity, as was previously mentioned, all the lending conditions are subordinate to the national law of the borrower country. Thus, it can be reasonably assumed that no borrower nation would have in its constitution or similar law of the land a provision that allows the exchange of a strategic asset like a seaport in exchange for debt relief by China. In fact, the only known case of strategic asset transfer to China, other than the infamous Hambantota Port in Sri Lanka, was in Tajikistan in 2011, when the Government of Tajikistan ceded 1,158 square km of land to China, although there is limited information on the background conditions for the transfer (Niewenhuis, 2019). Some scholars believe it was due to a historical border dispute rather than a debt-for-equity exchange.

Besides the dearth of anecdotal evidence for debt-for-equity transfer, most of the rhetoric against Chinese debt has come from Western nations and not the Global South, which is the largest recipient of the said debt and is supposedly the target of DTD. Since 2018, the United States has been the main narrative builder of DTD: in the summary of the 2018 National Defense Strategy and 2019 Indo-Pacific Strategy report of the USA, it was stated that China practices "Debt-Trap Diplomacy" and "predatory economics to coerce nations" (US Department of Defense, 2018, pp. 1-3; Xu and Li, 2020, p. 72). However, there is little to no official record of developing nations using the DTD narrative to describe the Chinese financial assistance. This points to the prevalence of a notion that Global South nations do not share the Western perspective of seeing Chinese financial assistance as debt-trap diplomacy. In fact, as the case of Djibouti showed and subsequent examples will further corroborate, Chinese financial assistance is seen as a viable alternative by developing countries (Mlambo, 2022, pp. 2-3) to stringent conditions demanded by Western financial institutions. Thus, DTD remains a fiction for much of the developing South.

Missing intent for DTD

There is a lack of evidence of China's clear intent to trap the borrowing nations into a debt-for-equity agreement. Gaining diplomatic clout and favourable terms of trade are not enough to justify a DTD argument because this is ubiquitous to all foreign investments, loans and aid provided by countries around the world. Therefore, a clear intent to entrap the borrower country in a near future debt-for-equity agreement is essential for Chinese financial assistance to be dubbed as DTD (Himmer and Rod, 2023, pp. 252-254). China's lack of intent on DTD can be enumerated in the case of Zambia, which defaulted on its foreign debt repayment in 2020. At the end of 2022, Zambia owed China EXIM Bank $4.1 billion and another $1.8 billion to other Chinese lenders (Mfula, 2024). Since then, China, along with other international lenders under G20 Common Framework Process, has agreed to restructure the debt. Under the restructuring agreement, international lenders, including China, agreed to forego approximately $840 million of their claims (Do Rosario and Strohecker, 2024). This exemplifies China's propensity to restructure the debt of troubled lenders instead of taking a hawkish approach to extract debt-for-equity concessions from its borrowers. However, this is not to say that China is willing to restructure debt in all cases because a large share of China's government revenue is derived from debt-servicing payments due to its status as a leading provider of international finance. This is why China prefers lengthy extensions on debt repayment with marginal interest rates instead of an outright reduction on the principal amount. Hence, China will see Zambia pay an interest rate of as low as 1% until 2037 and push out maturities on a total of $6.3 billion in bilateral debt to 2043, representing an extension of approximately 12 years (Abeyrathne, 2023). China's tendency to allow debt restructuring counters the DTD argument, which portrays it as a predatory lender, thus providing empirical evidence that the DTD remains a fiction.

Case Analyses

Sri Lanka and Hambantota

The case of Sri Lanka is touted by many scholars as the quintessential example of DTD owing to its overt debt-for-equity transaction in terms of a 99-year lease of Hambantota port in 2017 to Chinese company CM Port in exchange for debt relief by China of up to $1.12 billion (Gangte, 2020, p. 55; Moramudali, 2020). Sri Lanka was embroiled in a civil war in its northern region for decades, but as the war fizzled out in the late 2000s, the country needed foreign investment to kick-start its economy. Aiming to capitalise its geostrategic position, Sri Lanka started searching for foreign investors, but its proposal for the port was rejected by the US, India and Asia Development Bank; only China agreed to loan it $307 million at a 6.3% interest rate in late 2007 (Himmer and Rod, 2023, pp. 259-260). In 2012, the Sri Lankan government borrowed an additional $757 million from China Exim Bank for the port but for a much lower 2% interest rate (Jones and Hameiri, 2020, pp. 15-16). Thus, the Development of the Hambantota Port was carried out in two phases, first from 2008 to 2010, followed by the expansion of the port in 2012-2014.

The construction was jointly done by the Sri Lankan Port Authority (SLPA), China Harbour Engineering and China Merchant Port both state-operated enterprises. Although by 2014 the port had become the largest in South Asia, its cargo traffic declined year on year. By the end of 2016, the port only generated revenue of $11.8 million compared to operating expenses of $10 million (Jones and Hameiri, 2020, p. 15). The continuous borrowing over the past 8 years and little to no profit from the port made the interest repayment reach unsustainable levels by the end of 2014. Subsequently, Sri Lanka requested China Exim Bank to restructure the loans obtained to build Hambantota Port. However, the China Exim Bank declined to either reduce the interest rate or increase the repayment time frame as it could set a dangerous precedent for other loans (Moramudali and Panduwawala, 2022). This culminated in SLPA handing over 70% of the stake in Hambantota port to Chinese CMPort in 2017 in exchange for $1.12 billion, but the remaining 30% stake still rests with SLPA.

Overtly, this paints the picture that, indeed, China carried out DTD in the case of Sri Lanka, but essential criteria to dub it as such are missing, as Lee Jones and Shahar Hameiri note in their report (Jones and Hameiri, 2020, p. 13). First, the ownership of the port still rests with Sri Lanka, which means that Chinese naval ships are not allowed to use the port without explicit permission from the Sri Lankan government. Second, the port was a commercial venture, not a geostrategic one, which created vast surplus shipping capacity but with no takers due to fraught economic conditions in Sri Lanka itself. Third, Sri Lanka's debt distress predated the construction of the Port and related loans. Instead, it was rooted in economic mismanagement by the Sri Lankan Government itself, particularly in the commercial market loans share of its foreign debt. For instance, they made up 39% of the total foreign debt of Sri

Lanka in 2017, while China accounted for only 10% of the total debt, less than what Sri Lanka owed to Japan and the Asian Development Bank (Himmer and Rod, 2023, p. 261). There is also a lack of clear evidence of "intent" on the Chinese side to trap Sri Lanka in debt-for-equity. The port construction was a Sri Lankan initiative that did not find any financiers among the international players; therefore, they turned to China, which provided the necessary finance. This does not mean China was altruistic in its lending; it, indeed, wanted to support its national interest by bringing Sri Lanka into the BRI. However, the Sri Lankan case lacks the core matrix to define it as DTD. It lacks a clear intent, and the conditions for debt-for-equity transfer were exceptions to the norms of lending, not its example. The DTD remains a fiction in this analysis. Although China does support vanity projects through BRI, it only does it at the behest of the borrower country; hence, China is no different than any other lender in the international economy in furthering its interest.

Pakistan and CPEC

The case of Pakistan is unique because of the long-running economic partnership between China and Pakistan that predates BRI, yet DTD proponents argue that it might be the next victim of Chinese predatory loans. The China-Pakistan Economic Corridor (CPEC) is part of the Southeast Asian Silk Road under the umbrella of BRI. CPEC was announced in 2015 as a flagship project of BRI that will "promote the phenomenon of development for mutual destiny" (Khan and Khan 2019, p. 68). Under CPEC, the Chinese government and its companies will invest and build projects worth $45.6 billion, ranging from energy to infrastructure. Key among them is the major transport infrastructure, the Karakorum Highway, which connects the Xinjiang province in Western China to the strategic Gwadar Port in Baluchistan. Other projects include the East Bay Expressway, Karachi-Lahore Highway and Gwadar International Airport (Khan and Khan, 2019). Pakistan needs this investment to reinforce its lacking infrastructure, which is essential to shore up its weakening economic growth. The CPEC project, once completed over the 15 years, is projected to lift Pakistan's GDP by 15% (Ashraf, 2015). The project could act as a game changer for Pakistan, at a time when its rival India's economy is five times greater than it. CPEC is supposed to turn it from a net importer to a regional trading hub between China and the Western world (Shaikh and Chen, 2021). The project brings benefits for China as well; most crucially, it enables it to bypass its "Malaca Dilemma", which could choke its energy-import-dependent domestic economy if ever an adversary decided to block the Malaca Strait (Shaikh and Chen 2021, p. 2). CPEC also enables China to develop its relatively poor Xinjiang region and open a land corridor directly to the Arabian Sea through which goods can reach European Markets much faster. Additionally, Gwadar Port is a deep harbour port, which means China can dock its submarines there and use it as a strategic port for projecting power in the Indian Ocean (Boyce, 2017). Interestingly, the military benefits of the port, like docking submarines since 2016 (Iwanek, 2019), stem from the deep military relationship between China and Pakistan and not because of the port's location. Therefore, it cannot be termed a sovereignty concession from Pakistan in exchange for debt as both countries call each other "Iron brothers" and point towards a high level of relations (Li, 2021). Further, the mutual benefits mentioned above point to the symbiotic relationship between the two, although China benefits more from CPEC than Pakistan. However, such is ubiquitous in all economic agreements regardless of the countries involved be they Western or Eastern. China has also demonstrated considerable flexibility in providing Pakistan with debt relief and additional loans, even while suffering major terror attacks on Chinese citizens working on CPEC (Aamir, 2023). This is essential to take into account because China has all the necessary ammunition to take control of Gwadar port in a debt-for-equity transaction but has chosen not to do so. This points to the lack of DTD intent and flexibility towards its international partners, which is seldom seen in other international lenders. Hence, even with all the ammunition, China has continued to provide debt relief to Pakistan, thus pointing to the fictitious nature of the DTD argument.

Conclusion

DTD debate will continue to evolve as the relations between the USA and China pass through their highs and lows. The purpose of this essay is to shed light on the factual underpinnings of the DTD debate and show its fictitious nature. Although China engages in opaque loan conditions and always has an eye for its own interest, this is ubiquitous among all lender countries, regardless of whether they are Eastern or Western. Further, there exists little to no evidence to suggest China intentionally provides such loans that may result in debt-for-equity transfer by the borrower country. In fact, during the analysis of the research, it was found that Sri Lanka was given an economic lifeline by China when they defaulted in 2022. Furthermoe, before 2017, China was not the one who proposed the Hambantota Project, but it was the then Sri Lankan government led by Mahinda Rajapaksa who hastened the project and mismanaged its economy. The case of Pakistan shows that even when China had the opportunity to take over the strategic Gwadar Port in exchange for debt relief, it did not do so and even provided additional funds to Pakistan to shore up its foreign reserves. DTD stems from an inherent Western bias against China because of its political system and, on its part, China also keeps its lending practices opaque, thus lending credence to the DTD label. But the fact remains that DTD is fictitious and has no empirical evidence to support its predatory lending claim.

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