China in Africa

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Thank you for the opportunity to address the Commission at this difficult moment. Even as we in the United States continue to grapple with the deep challenges posed by the Coronavirus pandemic, it is important to consider the global context in which this crisis unfolds. In the months ahead, it will be critical for US policy to be well coordinated with other governments and international institutions to defeat a virus that does not respect national borders, and in turn to address the economic effects across economies that have become mutually dependent through many decades of integration. The unique challenges this crisis poses for the poorest countries, which lack basic health and social safety net capacity, ultimately represent vulnerabilities for all of us. And when it comes to an international response, the question of China's role is unavoidable.

Given its origins, the pandemic has already put China in the spotlight. In some ways, China's political leadership has embraced this visibility through high profile humanitarian assistance measures, along with a surge in global leadership rhetoric. But the pandemic also amounts to a highly visible reckoning for China's political leaders, one that they would surely wish to avoid if they could.

I will address one aspect of this reckoning in my testimony: what the pandemic and its attendant economic effects mean for China's program of overseas investment, particularly in Sub-Saharan Africa. The region contains the largest concentration of low-income countries in the world and as such is most vulnerable to the twin health and economic effects of the current crisis.

Sub-Saharan Africa has also received a great deal of inward investment from China over the past decade, much of it in the form of government-to-government lending. For the Chinese government, the past decade has been a favorable period for lending to developing countries globally, which has served China well with the rollout of the Belt and Road initiative and a rapid expansion of financing activities generally. But this massive scale up in lending always carried risks. Perhaps no one would

have predicted a systemic debt crisis triggered by a global pandemic in 2020. But a program of lending so seemingly indifferent to underlying borrower vulnerabilities was bound to face a reckoning. China's reckoning is now happening amidst the chaos of a global pandemic.

Africa's Debt Picture and China's Role

Early research we conducted at the Center for Global Development in 2017 and 2018 pointed to debt risks posed by China' Belt and Road initiative for vulnerable countries. Subsequent analysis by the World Bank and other leading scholars has reinforced our initial assessment that China's lending model has been exacerbating and even driving debt risks in low-income countries in recent years.

Extreme cases like Djibouti suggest a willingness on China's part to be the dominant external creditor to a highly vulnerable country. Djibouti's external debt is now 150% of national income, which is extraordinarily high for a poor country, and a large majority of this debt is owed to China. More typical cases like Ethiopia and Kenya demonstrate China's rise as a leading lender alongside multilateral institutions and commercial lenders. International Monetary Fund (IMF) analysis points to China's outsized role in the most debt vulnerable countries—whereas China has emerged as a leading creditor to low-income countries in general, it is a dominant creditor to the highest risk of these countries.

Prior to the current crisis, the debt position of low-income countries had already deteriorated. By the end of 2019, more than half of these countries were either in debt distress or at high risk of debt distress. These risks are a function of higher levels of lending, but importantly, also a function of lending terms. In new research published by the Center for Global Development, we demonstrate that harder terms from China in the form of higher interest rates, shorter grace periods and shorter repayment periods, have contributed to debt risks.

Although the Chinese government does not lend on strictly commercial terms, which would imply even higher interest rates and shorter maturities for most of these borrowers, China's terms are markedly harder than the World Bank's, which establishes terms with sensitivity to the vulnerabilities of their client governments. With lending at a scale the rivals the World Bank in Africa, China's lending terms (along with a growing share of commercial creditors) have undermined longstanding frameworks for sustainable financing espoused by the Bank, the IMF, and other government lenders that adhere to Paris Club and OECD standards and norms.

China's Procurement Model

So, what interest does China have in lending to "risky" countries and governments, given the higher probability that these loans will not be repaid on the agreed terms? Here, it is important to understand the central role that China's "tied" financing plays as a motivating factor for lending decisions, as well as the effects of this model on the borrowing countries themselves—increasing debt risks, potentially inflating the cost of projects, and creating vulnerability to corruption.

It is helpful to consider Chinese procurement practices in relation to the other leading source of development finance globally, the World Bank. When the Bank works with a client country partner,

say the government of Rwanda, to finance a road project, it brings standards on procurement for the project based on transparent, international competitive bidding, sometimes with preferences for local firms. As a condition for World Bank financing, Rwanda's government is required to provide for an open tender, clearly specified to promote competitive bidding among domestic and international firms to guard against corruption through a transparent and predictable process. This well-established approach aims to achieve high quality projects and the lowest price. It also aims to improve the overall quality of the government's procurement systems.

Contrast this with the Chinese model. Under a tied financing model, the offer of a loan from China Development Bank or China Exim Bank comes with a Chinese construction firm in hand. Typically, there is little evidence of, or process for, competitive bidding arrangements even among Chinese firms, let alone on a global basis. Lack of transparency makes this system particularly vulnerable to corrupt practices. It also raises the risk that projects costs will be inflated—a virtue of competitive procurement is that it forces bidders to price competitively in order to win the contract. This model speaks to the motivation for China's overseas lending, even in situations where default risks are high. The country's overseas lending, to a significant degree, seeks to employ domestic economic capacity abroad. And while recent regulatory shifts within China have sought to exercise greater prudential oversight, Chinese government lending institutions have historically been bailed out, suggesting that lax lending practices are tolerated in order to support Chinese firms in other markets.

Of course, China's tied financing model also greatly limits the ability of competitive US firms to participate in some of the largest infrastructure projects under development globally today. It is striking that Chinese officials have sought to frame the Belt and Road initiative as a global project, welcoming participation from all countries. But at a basic level, non-Chinese firms simply do not have the ability to participate due to the restrictive stance of Chinese lenders.

Evidence of Growth and Other Effects

Recognizing these problems, it is nonetheless important to have a clear picture of China's investments and their impact on African economies. Based on available evidence, I believe the economic impact of China's lending program is not as negative as some would suggest and certainly not as wholly positive as Chinese officials claim. Cross-country studies point to growth effects from China's infrastructure investments, consistent with general findings about the linkages between infrastructure and economic growth. These studies introduce a more nuanced view of Chinese financed projects, demonstrating that so-called "white elephant" projects that fail to deliver any benefit are not the norm. In general, evidence suggests that in many countries, the economic growth effects of Chinese-financed projects are not dissimilar to those of other lenders.

At the same time, systemic studies like these also point to unique problems associated with Chinese infrastructure lending. World Bank modeling suggests that the debt burdens associated with Belt and Road will outweigh the growth effects for certain developing countries. And other studies identify the ways in which China's model lends itself to corruption. For example, one well known study observes that Chinese-backed projects heavily favor the home districts of African policy leaders, attributing a 164% increase in funding from China for leaders' home districts during the years they are in office. No such effect is observed from institutions like the World Bank.

Glimmers of New Coordination

So, how to respond to China's lending to Africa, particularly now? I have long promoted a US approach that relies on multilateral disciplines along with a clearly articulated and detailed bilateral negotiating agenda, more akin to a trade negotiation. Unfortunately, when it comes to the Belt and Road initiative and China's overseas lending more generally, US policy seems satisfied with broad brush criticism in hopes that developing country governments will be convinced to decline China's investments. That has never been a realistic strategy. Resource-constrained countries will always seek external financing where it is available to them. The better path is to seek stronger disciplines on Chinese practices, particularly in the areas I have highlighted in my testimony. And on this front, the current crisis presents an opportunity.

The April 2020 announcement from G20 finance ministers and central bank governors for a debt "standstill" marked a modest positive step in helping low income countries managing their debt burdens during the pandemic. But it also represented a landmark step when it comes to coordinated policy between China and the West. China, as the largest of the G20 creditors, agreed to a standstill in payments due to its lenders and signed off on a new degree of transparency around this lending. Namely, any country seeking a standstill would be required to report the full extent of its obligations to external creditors. This basic level of transparency has been lacking to date and stands as an obstacle to effective debt management practices globally.

These are early days, and we could certainly be disappointed by delivery on the G20 commitments. Much more difficult decisions lay ahead when it comes to dealing with the current debt crisis. It is increasingly likely that widescale debt reductions will be needed beyond a simple standstill, applied to many low- and middle-income countries. Again, China will bear a significant amount of the burden of any major debt relief initiative. The April decision to take an initial step under the G20 umbrella and in coordination with the IMF and World Bank bodes well, but it does not guarantee that China will stay on this path.

Ultimately, the Chinese government will need to see a coordinated approach, including new commitments to external disciplines on procurement and sustainable lending policies, as in its own interest, not simply as a concession to other countries. The good news is that this case will be much easier to make by advocates within the Chinese government as they are forced to deal with the fallout of a decade-long lending spree. It simply will not be feasible to maintain a go-it-alone strategy as the leading creditor amidst a global debt crisis. Already, over 100 countries have approached the IMF for assistance, and many of them count China among their major creditors. As much as Chinese officials might want to approach each of these countries on a case-by-case basis, wrapping debt restructurings in the traditional cloak of foreign policy, there is no precedent for China or any other government to address a systemic crisis in this way, and the prospects for a successful go-it-alone strategy seem remote.

The United States can capitalize on these dynamics by lowering the political rhetoric and taking a pragmatic approach to crisis management. Fortunately, the US government has nothing like the level of exposure to debt risks that China currently faces, reflecting a US foreign aid strategy that greatly favors grant-based aid over lending. But like China today, the United States bore much of the pain of the last major debt relief initiative for poor countries, reflecting a legacy of robust lending

programs from an earlier era. We learned from that experience alongside other countries and worked in a coordinated fashion to achieve landmark debt relief initiatives in 1990s and early 2000s. Treating China as a partner in a new round of debt relief and setting clear expectations that China will behave as such is the right approach for now.

Retrenchment and the Post-Crisis Period

No matter how Chinese policymakers respond to calls for debt relief action, it is likely we will see a major retrenchment in China's overseas lending over the medium term. Even before the current crisis hit, China had begun to pull back on its lending programs. Economic activity of any sort is severely constrained now, and the larger financial and economic risks emanating from the crisis will mean less lending capacity from China for some time. China's overseas lending is highly dollar dependent and thus relies on China's reserves, which will be more stressed during this crisis period. There is also the direct effect of this crisis on the balance sheets of the Chinese government's large external lenders. Large scale write offs may become inevitable, even if not part of a coordinated international program. This will greatly limit the capacity of these institutions to expand future lending.

Over time, it is less plausible that China's role in global development finance will simply disappear. Perhaps the outsized role that China played during the 2010s will adjust to something more modest. But for the United States, policies aimed at China's overseas financing, particularly in Africa, should continue to be a priority in the post-crisis period. The current period presents an opportunity for progress but with no guarantees. It will be important to keep the pressure on the sustainable lending agenda as we work through this difficult time and emerge in a post-crisis period. I very much hope the Commission will maintain its commitment to this critical work. Thank you.

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