Commentary

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An Overview of China's International Development Finance - Issues and the Way Forward

The Chinese government officially unveiled its new international development cooperation agency (IDCA hereafter) on 18th April. The agency is directly under the administration of the State Council. It integrates the role of aid policy formulation, management, and coordination from the Ministry of Commerce and the Ministry of Foreign Affairs. Its establishment marks China's ambition to further engage itself in the arena of international development finance.

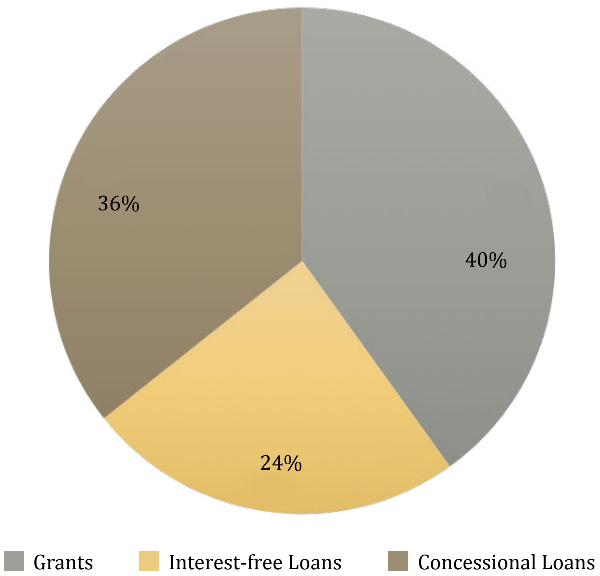
The economic development of China over the past few decades was staggering. It took China less than half a century to transform from one of the poorest nations to the second largest economy in the world, lifting hundreds of millions of people out of poverty. When one is amazed by the skylines of Beijing and Shanghai today, it is difficult to imagine, about 25 years ago, the GDP per capita of China was still significantly below the level of Sub-Sarah Africa (SSA).

Between 1980 and 2000, China has received over US$38 billion of foreign aids from the international community. Although China is still a recipient country in practice, it gradually becomes one of the major donors. Having an aid agency separated from the title of 'Commerce' could be a good start.

Issue 1 - Data Discrepancy

China's overseas development finance can

Figure 1: Chinese ODA by Categories



Source: China's Foreign Aid (2011, 2014) be broadly classified into two categories: Official Development Assistance (ODA) and Other Official Finance (OOF). ODA includes grants, interest-free loans, and concessional loans. OOF captures official financing sources that are not qualified for ODA. Unlike the Development Assistance Committee (DAC) members, who typically keep regular updates of their aid data, data from China are relatively less transparent. As a result, a lot of analyses on China's ODA still rely on the White Paper of China's Foreign Aid (2011, 2014).

According to the State Council of PRC, up until 2012, the total amount of foreign aid reached US$53.2 billion (Using an exchange rate of 6.5RMB/US$). Of which, US$21.3 billion are grants, which comprise technical assistance, humanitarian responses, and social welfare projects; interest-free loans amount to US$12.9 billion, which are mainly used for the construction of public facilities and projects that may improve people's livelihood; US$19 billion are in the form of concessional loans, supporting economically and socially productive projects, medium to large scale infrastructure development, and equipment procurements.

The budget of foreign aid expenditure is formulated by the Ministry of Finance based on proposals received from various MDAs, while the administration is mainly attributed to the Ministry of Commerce (other MDAs also play a role based on their respective jurisdictions). The concessional loans are managed by the Export-Import (EXIM) Bank of China.

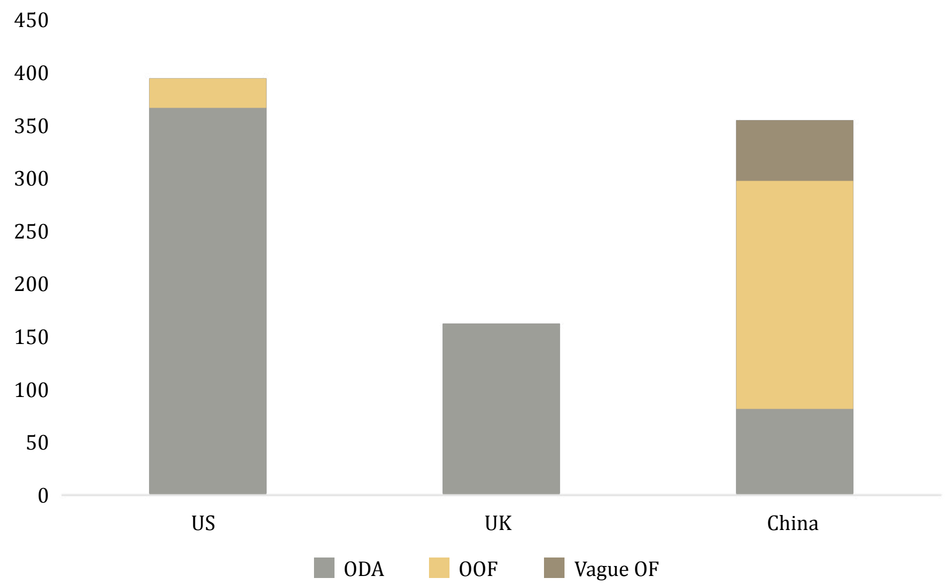
However, the AidData database shows that the size of Chinese ODA is much larger than stated. Between 2000 and 2012, the Chinese ODA reaches US$64.7 billion, which exceeds the official data by US$10.5 billion. Aid flows before 2000 seems unlikely to eliminate the discrepancy, and the White Papers do not offer project-level data or data by the recipient countries for crosscheck.

Also, up to 2014, AidData records US$216.3 billion of OOF and US$57 billion vague official finance sources that have little information to be grouped into either category. To be fair, transparency issue is not unique to China. Even for DAC members, around 17.3% of the ODA flows (2015-15 average) are unspecified for its use. The total official finance from China amounted to US$354.3 billion, which is almost on par with the US (US$394.6 billion). (see **Figure 2**)

The lack of transparency in official statistics has led to a lot of concern and confusion about the motivation behind such financing. The potential impacts of the Chinese lending can be misinterpreted.

One of the common claims is that Chinese

Figure 2: Comparing the official finance (2000-2014), US, UK, and China



Source: AidData and OECD

investments and aids are heavily biased towards mining and resource-rich countries in Africa. However, the data shows that Chinese official finance covers more than 140 countries, hence not particularly biased toward resource-rich nations. Much of the financing end up in infrastructure projects such as transport, energy, and communication, instead of mining and natural resources (see **Figure 3**). Some may argue that many of the loans are resource-backed, but that's far from the complete picture. Brautigam (2011) has described the diverse nature of Chinese aids with numerous case studies across Africa.

Therefore, it is critical for China to improve data transparency. Following the international standard guidelines for data and operational transparency will significantly reduce misunderstandings from the international community. Domestically speaking, the official finance is also part of the fiscal expenditures. Transparency and effective internal evaluation process are also important measures to improve government's accountability for taxpayers' money. More engagement in multilateral agencies (e.g., AIIB and NDB) might offer an alternative solution. The establishment of AIIB and NDB also enables developing nations to become the majority shareholders so that the financing strategies can be more aligned to their development agenda.

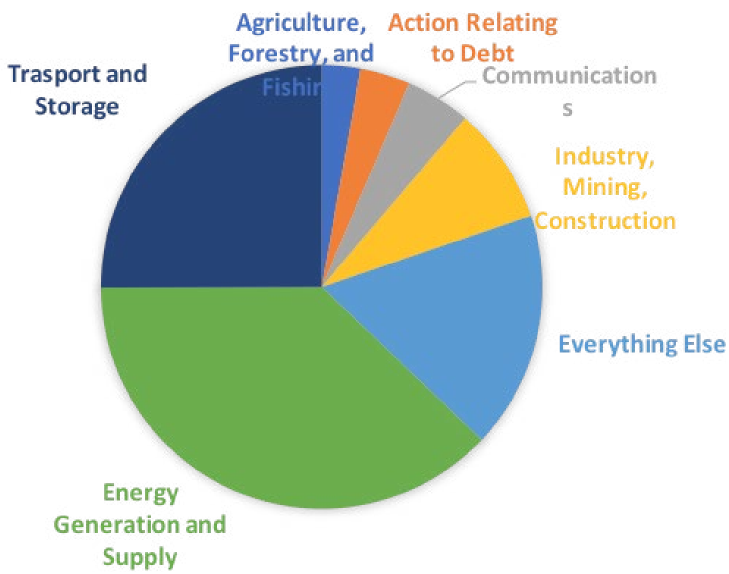
Issue 2 - Is the Chinese model too Commercial?

Another common belief is that Chinese aid projects are too commercial. **Figure 2** seems to confirm such impression. The ODA as a percentage of total official financing from China is indeed lower than some traditional donor countries.

Although the debt positions in many recipient countries improved massively after 2005, because of a series of debt relief programmes implemented by the World Bank, IMF, and other bilateral creditors, the gross debt to GDP ratio in these countries started to pile up again after the financial crisis (See **Figure 4**). The debt to GDP ratio is relatively low by international standard, but costs of finance are also higher due to high-risk premium. Hence many worry that China's relatively commercial driven model will cause further debt distress to recipient countries.

To better understand the issue, one should look at the definition of ODA carefully. Firstly, financially speaking, the two flagship development credit programmes from the EXIM Bank: Concessional Loan (CL) and Preferential Buyer's Credits (PBC) both satisfy the Grant Elements (GE) conditions for ODA, but the latter, as a type of export cre-

Figure 3: Chinese Official Finance by Sector



Source: AidData

dits (the US and Germany also provide such credits), is excluded by OECD definition. The risks associated with both programmes are low, due to the favourable financing terms. A typical concessional loan from EXIM bank has a fixed interest rate no greater than 3 percent per annum, and maturity ranges between 15 and 20 years. So, some of the official financings may not necessarily cause financial distress to the recipient.

Furthermore, confusion may arise when dealing with financing from state-owned commercial banks in China. The OOF statistics in AidData also include several loans from the Bank of China and the Industrial and Commercial Bank of China. Although these banks are state-owned, the loans are more likely to reflect private lending than official financing. Therefore, the level of Chinese OOF data could be exaggerated.

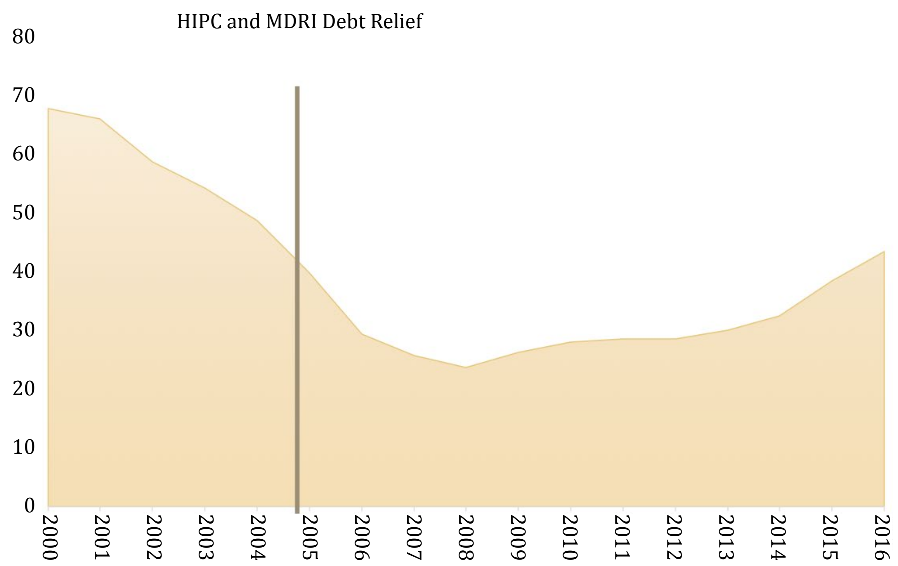
Dollar (2017) maps out the top recipient countries of China's official finance between 2012 and 2014. Many of them are also strategic partners under China's ambitious One Belt One Road (OBOR) Initiative. Over half of the top recipients rank poorly in the World Governance Indicator for the rule of law. If the GE of the financing is too low to be ODA, then it is likely to burden these countries with increasingly high levels of debt and create default risks. Many of the project financing require guarantees from local sovereign entities (e.g. Ministry of Finance and Central Bank). However, if default happens, it is unlikely for Chinese government to apply punitive actions, debt reliefs will be the only way out (Hurley et al., 2018) Such an awkward situation is unfavourable on both ends.

Therefore, China should endeavour to draw a clear distinction between ODA and OOF. Dreher et al. (2017) point out the positive impact from the Chinese ODA on the economic growth of recipient countries (an average of 0.7% increase in GDP growth is identified) is no less than any other donor agencies, but no such impacts observed using the OOF data. The finding has important implication for the BRI projects. More innovative financial products should be developed to accommodate the diverse nature of its projects.

The Way Forward

Development finance is not a one-way channel. A win-win situation for both donor and recipient countries can be achieved. In the era of globalization, the political and economic instabilities of any nation could have significant impacts on not only its neighbouring region but the entire world (e.g., the refugee crisis in Europe and nuclear test in North Korea). The success of China's development finance strategy rests on the

Figure 4: Gross Debt in Sub-Sahara Africa (% of GDP), 2000-2016



Source: IMF

premise of shared prosperity between China and its recipient countries. It is up to China's interests to come up with a new model of foreign assistance, to develop more innovative development financing products, and to seek more international collaboration. It should be welcomed an embraced by the International community.

According to the UN resolution in 1970, DAC member countries should aim to raise ODA to 0.7 percent of their Gross National Income (GNI). However, the target is often put aside when these countries face domestic political and economic pressures. In 2016, only the UK, Denmark, Norway, Luxembourg and Sweden met the target. The US is leading in the absolute amount, but the ODA to GNI ratio was only 0.18% in 2016.

As the second largest economy in the world, the average ODA to GNI ratio for China is averaged at 0.1% between 2000 and 2014. If looking at the GDP per capita, China is still a middle-income country. The 0.7% target may seem a bit unreasonable considering its development stage. However, if taking the OOF into account, the OF to GNI ratio is up to 0.5%. With the ambitious OBOR initiative, the official finance from China and outward FDI are expected to expand much further. In the meanwhile, China may need to focus on how to increase the GE of many OOF to make them ODA.

Also, comparing with traditional donors, soft power development is by far the weakest link of all. Establishing Confucius Institutes overseas and inviting government officials from developing countries to attend training will promote mutual understanding and cultural exchange in the long run. In the short-run, however, China may need to learn from other countries' experience - collaborating closely with universities, NGOs, and think tanks to have more Chinese development professionals engaged in technical assistance and development research.