1 Why Do We Know So Little about the Aims and Impacts of China's Overseas Development Program?

From "Hide and Bide" Donor to Lender of First Resort

Over the past two decades, Beijing has achieved something truly extraordinary: it has established itself as the lender of first resort for many low-income and middle-income countries.[1] In doing so, it has become "public enemy number one" in the eyes of many Western governments and multilateral institutions. According to the US government, China is deploying a US$3 trillion war chest of foreign currency reserves to gain the upper hand in a zero-sum competition for global influence. The 2018 US National Defense Strategy asserts that "[t]he central challenge to US prosperity and security is the reemergence of long-term, strategic competition ... [with] revisionist powers."[2] It calls upon the development, diplomacy, and defense agencies of the US government to "out-think, out-maneuver, out-partner, and out-innovate" these powers and singles out China as a "strategic competitor" that "us[es] predatory economics to intimidate its neighbors."[3] The US National Security Strategy is even more direct in its criticism, arguing that "Chinese practices undermine ... long-term development by corrupting elites, dominating extractive industries, and locking countries into unsustainable and opaque debts and commitments."[4]

The US Agency for International Development (USAID) operationalized these strategies through its 2018 adoption of a "Clear Choice Framework," which sought to distinguish the American and Chinese value propositions and proactively communicate these differences to the

[1] During the summer of 2020, the World Bank took the unprecedented step of publishing data on public and publicly guaranteed debt stocks and debt service by creditor country. These data are available for sixty-five of the poorest countries that participate in the World Bank's Debtor Reporting System (DRS). The publicly available debt stock data from the DRS indicate that China is the single-largest bilateral lender to forty-six of these sixty-five countries. See https://datatopics.worldbank.org/debt/ids/, last accessed November 10, 2020.
[2] US Department of Defense (2018: 2). [3] US Department of Defense (2018: 1).
[4] Office of the President of the United States of America (2017: 52).

leaders of low-income and middle-income countries.[5] US legislators from different ends of the political spectrum followed suit. In October 2018, they passed the Better Utilization of Investment Leading to Development (BUILD) Act, which established a "full service" development finance institution to help the US government compete with China around the globe. Then, in September 2019, they voted unanimously to create a US$375 million "Countering Chinese Influence" fund.[6]

China has faced an equally relentless barrage of criticism from European governments and multilateral institutions. Some have warned that Beijing bankrolls economically inefficient but politically expedient "white elephant" projects. Others have raised concerns about China saddling its overseas borrowers with unsustainable debt burdens. Another common refrain is that, in its zeal to help partner countries install the "hardware" of economic development (e.g., highways, railroads, dams, bridges), China prioritizes speed over quality, green-lighting projects without appropriate environmental, social, and fiduciary safeguards or monitoring and evaluation systems.

The Belt and Road Initiative (BRI) has provided a focal point for these concerns. Launched in 2013 by Chinese President Xi Jinping, the BRI is a US$1 trillion global infrastructure program that the *New York Times* describes as having "little precedent in modern history."[7] Before it was announced, Western diplomats and leaders of multilateral organizations questioned the aims and impacts of China's overseas development program from the sidelines with a sense of bemusement. Beijing's role in the global development finance market was a popular topic at cocktail parties and roundtable discussions governed by Chatham House rules.[8] But their concerns did not spill into public view – or inform official policy – until they understood the true scale, scope, and ambition of the BRI.

In June 2019, the president of the World Bank, David Malpass, faced questions about the wisdom of the BRI. He responded by admonishing China for the secrecy surrounding its global infrastructure program and emphasizing that "[i]f debt is executed in an opaque manner, it is difficult

[5] USAID's Clear Choice Framework characterizes the "American model" as one that privileges transparency, accountability, financial sustainability, the right to self-determination, and free-market principles. By contrast, it characterizes the "Chinese model" as one that privileges authoritarian governance, state-led capitalism, opaque and unsustainable debts, and subordination to the dictates of a foreign power (Igoe 2018a; USAID 2018; Green 2019).

[6] In September 2019, the US Senate Committee on Appropriations voted 31–0 to create this fund "to combat malign Chinese influence activities and increase transparency and accountability associated with the Belt and Road Initiative."

[7] Perlez and Huang (2017).

[8] According to Chatham House rules, participants can freely use and speak about the content of discussions without attributing it to any specific participant.

for other lenders to know the conditions, making it difficult for them to invest in the business, which ultimately hinders the development of the borrowing countries."[9] In January 2020, a top International Monetary Fund (IMF) official doubled down on this admonishment. He announced his organization's "number one message" to the Chinese authorities in Beijing: "[i]f you are a big lender, there is no free-riding.... If you fail to be transparent, you make it more difficult for everyone else."[10] Two months before this dressing down, Japan and Australia announced that they would join forces with the United States to launch the "Blue Dot Network" to counter the BRI. They established this network to "evaluate and certify nominated infrastructure projects based upon adherence to commonly accepted principles and standards" and to "promote market-driven, transparent, and financially sustainable infrastructure development in the Indo-Pacific region and around the world."[11]

The fact that we have reached the point where China's overseas development program inspires awe and contempt from international donors and lenders is extraordinary – and puzzling. Just fifteen years ago, China was a *net recipient* rather than a net donor of aid.[12] So, how did we get here?

The central claim of this book is that during the first two decades of the twenty-first century, China has undergone a major transition from a "benefactor" to a "banker," and this shift has had far-reaching impacts in low-income and middle-income countries that are not yet widely appreciated or understood.[13] During the twentieth century, China's international development expenditures were roughly on par with those of a small, Northern European donor like Denmark. Beijing kept an especially low profile during the 1980s and 1990s, adhering to the principle of "hide your capabilities and bide your time," put forth by Deng Xiaoping, China's former paramount leader.

But everything changed in 1999, when Beijing adopted a "Going Out" strategy. That was the point at which the government tasked its state-owned

[9] Kawanami (2019). [10] Zettelmeyer (2020).
[11] International Development Finance Corporation (2019). In a high-profile speech laying the groundwork for this new initiative, US Vice President Mike Pence said, "as we're all aware, some are offering infrastructure loans to governments across the Indo-Pacific and the wider world. Yet the terms of those loans are often opaque at best. [The] projects they support are often unsustainable and of poor quality. And too often, they come with strings attached and lead to staggering debt" (Pence 2018).
[12] Chin (2012) estimates that China became a net donor in 2005 or 2006.
[13] Throughout much of this book, we use "China" or "Beijing" as a shorthand term to refer to all of the Chinese government institutions, state-owned banks, and state-owned enterprises that provide development finance to low-income and middle-income countries.

"policy banks" – China Eximbank and China Development Bank – with helping Chinese firms gain a foothold in overseas markets.[14] The Going Out strategy came into existence because of several challenges that Beijing faced at home. First, the country suffered from a domestic industrial overproduction problem because its state-owned steel, iron, cement, glass, aluminum, and timber companies were over-leveraged, inefficient, and unprofitable.[15] Beijing viewed domestic industrial overproduction as a threat to the country's long-term growth prospects and a potential source of social unrest and political instability.[16] It wanted to reduce domestic supply (through the offshoring of industrial input production facilities) and increase international demand (by encouraging foreign buyers to purchase more industrial inputs from China). Second, Beijing faced a foreign exchange oversupply problem: annual trade surpluses facilitated a rapid expansion in foreign exchange reserves, and the country risked macroeconomic instability (inflation or a currency revaluation) if it allowed these reserves to enter the domestic economy, so the authorities decided to instead look for productive overseas outlets where they could park their excess dollars and euros. Third, Beijing recognized that to sustain high levels of domestic economic growth, it would need to scour the globe for those natural resources that it lacked in sufficient quantities at home.[17] To address these challenges, the Chinese government enlisted the support of its policy banks; they were given a mandate to support overseas projects focused on industrial production, infrastructure, and natural resource acquisition and to facilitate the participation of Chinese firms in these projects. In the fifteen-year period (2000–2014) following Beijing's adoption of the Going Out strategy, China's overseas development spending skyrocketed.

During this period, the *nature* of Beijing's participation in the global development finance market also changed in a fundamental way. At the turn of the century, China mostly offered Renminbi-denominated grants and interest-free loans to its counterparts in the developing world. It used

[14] China Development and China Eximbank are state-owned banks that pursue profit and national policy objectives.

[15] The Chinese government characterizes the problem as "industrial overcapacity," which is a term that usually refers to the difference between domestic production capacity and actual production for the domestic market. However, for the sake of clarity, we prefer the terms "industrial overproduction" and "excess industrial production" because China overproduces industrial inputs relative to demand on the domestic market. It then attempts to sell its overproduced industrial inputs to foreign buyers (often in developing countries) because of its domestic overcapacity problem.

[16] More specifically, they feared that if this problem was not resolved, some of the country's biggest employers would lay off large numbers of Chinese workers, which could in turn lead to public antipathy toward the government and the Chinese Communist Party (CCP).

[17] These natural resources included oil, gas, copper, and cobalt, among others.

its largesse to cultivate and cement diplomatic ties and political alliances with other countries, constructing projects such as presidential palaces, parliamentary complexes, and soccer stadiums. However, over time, Beijing began to behave less like a benefactor and more like a banker. As we explain in Chapter 2, China's own experiences with outbound and inbound development finance during the last two decades of the twentieth century paved the way for this transition. But China did not fully embrace its role as a major international lender until the turn of the century, when it saw that doing so could help it address the challenges of industrial overproduction, excess foreign exchange reserves, and limited access to the natural resources needed to sustain high levels of economic growth. In response to these challenges, China's policy banks made three changes: they ramped up foreign currency-denominated lending at or near market rates, they contractually obligated overseas borrowers to source project inputs (such as steel and cement) from China, and they made it easier for countries to secure and repay loans with the money that they earned from commodity sales to China.

Consequently, after 2000, Beijing's overseas development spending became less focused on aid and more focused on debt. Only 23 percent of China's overseas spending between 2000 and 2014 met the Organisation for Economic Co-operation and Development's (OECD) definition of official development assistance (ODA) – that is, aid in the strict sense of the term. China used debt to finance most of its overseas projects. By contrast, the members of the Development Assistance Committee (DAC) of the OECD – wealthy, industrialized countries that dominated the international development finance market during the last five decades of the twentieth century – devoted nearly all (~90 percent) of their overseas spending to ODA between 2000 and 2014.

The blurring of the distinction between Chinese aid and debt has far-reaching implications that are not well understood by many politicians, journalists, or researchers. Indeed, much of the controversy about China's overseas development program arises from a failure to differentiate between projects financed with grants and low-interest loans (aid) and projects financed with loans at market or close-to-market rates (debt). Beijing's critics and rivals characterize China as a rogue actor that uses its largesse for nefarious purposes: to purchase the loyalty of ruling elites in corrupt and authoritarian regimes, to exploit natural resources without concern for environmental consequences, and to create unfair commercial advantages for Chinese firms in overseas markets. Beijing's allies and clients take issue with this characterization; they view China as a flexible and demand-driven financier that is willing to bankroll and build big-ticket, high-impact projects.

How should we evaluate these competing narratives? We address this challenge by separately analyzing Chinese development projects financed with aid and Chinese development projects financed with debt. To this end, we have assembled a granular and comprehensive dataset of Chinese government-financed projects around the globe that allows for such parsing. Our analysis of the dataset suggests that China is neither the "hero" promoted by its allies and clients nor the "villain" caricatured by its rivals and critics.

Beijing, we argue, uses financial instruments that are *fit-for-purpose*. If its objective is to buy foreign policy favors from another government, it provides financing on favorable terms through grant and zero-interest loan instruments. If its objective is to maximize investment returns or secure natural resources, it uses commercial financing instruments, such as loans that are priced at or near prevailing market interest rates. Chinese aid and debt are means to different ends, and when this distinction is ignored, policymakers, journalists, and researchers misunderstand the motivational factors that guide Beijing's overseas spending and the impacts that its projects achieve in low-income and middle-income countries.

Our findings also suggest that, in some ways, China and its OECD-DAC counterparts have more in common than they realize. We find that Chinese aid is no more likely than US aid to flow to corrupt or authoritarian regimes. Beijing does use aid as a tool to secure influence at the United Nations and other venues, but so do Western donors. Also contrary to conventional wisdom, Chinese aid does not flow disproportionately to countries with abundant oil and other extractable resources. In fact, Beijing relies heavily on one of the same aid allocation criteria used by Western donors: a country's per capita income level. Those with higher levels of need get more aid, regardless of whether it comes from Washington, London, Brussels, or Beijing. Similarly, China and its OECD-DAC counterparts are guided by the same motivation when they issue loans that are priced at or near market rates: ensuring repayment. The biggest difference that we found between China and its Western peers is which tools they use the most: China relies heavily on debt to finance its overseas development program, while OECD-DAC countries rely on aid.

But it is still difficult to directly compare the overseas spending practices of China and its OECD-DAC counterparts because the former is a state-led economy and the latter represents a group of market-led economies. As such, China's approach is fundamentally different from that of its peers and competitors in the OECD-DAC. In market-led economies, the government expects a decentralized set of actors in the private sector to pursue profit and lend with the objective of maximizing investment returns, and there is no strong rationale for government involvement in commercial lending activities. By contrast, in China, the government is a major economic actor that pursues profit, so the country's state-owned banks are heavily engaged in commercial lending activities; the lending behavior of China's state-owned banks resembles that of private sector banks in OECD-DAC countries.

Another major source of debate among policymakers and practitioners is how Chinese development projects affect social, economic, environmental, and governance outcomes in low- and middle-income countries. Beijing's critics claim that it bankrolls ill-conceived and risky projects that would not be funded by Western aid agencies or multilateral development banks. In the words of *The Economist*, "China seems to be repeating many of the mistakes made by Western donors and investors in the 1970s, when money flowed into big . . . infrastructure projects that never produced the expected economic gains."[18]

Here, too, our empirical findings suggest that China and its OECD-DAC peers have more in common than they think. When we separately analyze aid-financed and debt-financed development projects, we find that projects financed with grants and low-interest loans consistently boost economic growth in the countries where they take place, regardless of the funding source. Both Chinese aid and OECD-DAC aid promote economic growth in low-income and middle-income countries.[19]

Previous research demonstrates that Western development projects achieve different effects in different settings, and our empirical findings suggest that the Chinese development projects are no different. Their effects depend upon the choices and characteristics of host countries. Chinese development projects consistently improve economic development outcomes in Africa, but not necessarily elsewhere. They reduce political instability in some countries that experience sudden withdrawals of Western aid, but not in others. They accelerate environmental degradation in jurisdictions where the enforcement of environmental laws and regulations is weak, but not in localities where economic actors generally comply with environmental rules.

[18] *The Economist* (2017a).

[19] A more complex pattern emerges when we analyze Chinese and OECD-DAC projects financed with loans at or near market rates. Due to the short time series of data we have available, we can only investigate the short-run effects of development finance. Our results are thus not directly comparable to studies that investigate the long-run effects of aid on growth. Results across such studies are mixed, finding no statistically significant effects of aid on growth in the medium to long run or small positive effects. For surveys, see Werker (2012); Dreher, Lang, and Ziaja (2018); and Doucouliagos (2019).

In a nutshell, our argument in this book is that much of the conventional wisdom about Chinese development finance that is published by international media, promoted by think tanks, and accepted by governments outside China rests on untested assumptions, individual case studies, and incomplete data sources. The primary reason why we know so little about the aims and impacts of Chinese aid is that Beijing shrouds its overseas portfolio of grants and concessional loans in secrecy. It does not disclose comprehensive or detailed information about its aid projects. Nor does it publish a country-by-country breakdown of its foreign aid activities. It considers its foreign aid program a "state secret" and ranks dead last among the forty-seven international donors evaluated by Publish What You Fund in its 2020 Aid Transparency Index.[20]

China keeps its commercial lending activities equally secret. The BRI aims to develop an overland "belt" of road, rail, port, and pipeline projects that will create an infrastructure corridor from China to Central Asia and Europe, as well as a "Maritime Silk Road" that will consist of deep-water ports along the littoral areas of the Indian Ocean that will link China to South and Southeast Asia, the Middle East, and Africa. This initiative, which is being largely financed with Chinese debt, is shielded from public scrutiny. As explained in the *New York Times*, "China has never released any official map of Belt and Road routes nor any list of approved projects, and it provides no exact count of participating nations or even guidelines on what it means to be a participant."[21]

Social science research on the aims and impacts of Chinese development finance remains in its infancy because of Beijing's unwillingness to share detailed information about its overseas development program. To close this evidence gap, we have spent the past nine years working with AidData to systematically assemble a comprehensive dataset of Chinese aid- and debt-financed development projects around the globe. We are dyed-in-the-wool empiricists, and many of the chapters of this book are based on statistical analyses of this new dataset. But we want our analysis to be readable and accessible to those who are not statisticians. We therefore describe our methods and findings in simple, clear language, avoiding statistical jargon wherever we can. For readers who would like to review our methods and findings in greater technical detail, we have added technical appendices to several chapters. At the beginning of most chapters, we will also refer these readers to a list of peer-reviewed journal articles that we published before writing this book. Readers who wish to be spared these technical details should feel free to simply skip these appendices and journal articles – or consult them only as needed.

[20] Bräutigam (2009: 2); Publish What You Fund (2020). [21] Mauk (2019).

Before we "zoom out," looking at major patterns and trends in our dataset (covering 138 countries and five regions of the world), let's "zoom in" on two countries – Sri Lanka and Tanzania – where China has used its aid and debt instruments for different purposes and with different results. These two cases are consistent with the notion that China is neither the hero promoted by its allies and clients nor the villain caricatured by its rivals and critics.

China's benefactor-to-banker transition has dramatically raised the stakes for developing countries. Its willingness to bankroll big-ticket infrastructure projects creates new opportunities for host countries to achieve rapid socioeconomic gains, but it also introduces major risks, such as corruption, conflict, and environmental degradation. The cases of Sri Lanka and Tanzania demonstrate that there is a tension between *efficacy* and *safety* in Chinese development finance, and some countries are more effective than others at managing these risks and rewards.

When the Risks of Banking with Beijing Exceed the Rewards: The Cautionary Tale of Sri Lanka from 2005 to 2015

Until recently, Hambantota was a small, seaside village at the southern tip of Sri Lanka with roughly 12,000 residents. Hambantota District is the birthplace of Mahinda Rajapaksa, who represented it as a Member of Parliament (MP) for sixteen years before being elected president of Sri Lanka. During his tenure as president (2005–2015), Rajapaksa attempted to transform his home district into an international shipping hub and a major urban center at a "breakneck pace."[22] He designated the town of Hambantota as one of the country's five public investment priorities and promoted the idea of making it a "second capital," using "bombastic propaganda through highly paid advertising agencies, including widely disseminated computer-generated videos."[23] His twenty-three-year-old son, Namal Rajapaksa, oversaw these efforts and succeeded him as the MP responsible for Hambantota District.

The Rajapaksa family convinced Beijing's policy banks to support their rather peculiar vision for the country's future: China Eximbank and China Development Bank issued loans worth approximately US$1.5 billion for the construction of a deep seaport in Hambantota, US$200 million for the construction of a nearby airport, US$412 million for a road from the seaport to the airport, and US$180 million for an expressway connecting Hambantota to the capital city of Colombo. With

[22] Fowler (2010). [23] Peebles (2015: 22).

support from Chinese state-owned companies, the Rajapaksa administration also fast-tracked the construction of a state-of-the-art international convention center, a 35,000-seat cricket stadium, a 300-acre botanical garden, a 235-acre "Tele Cinema Park" for TV and film production, an oil refinery, a sports complex, and a string of luxury hotels and housing developments in Hambantota.[24]

President Rajapaksa's push to transform this remote part of the country into a second capital was part of a broader effort to cement domestic political support for his administration by implementing highly visible infrastructure projects in the country's southern and predominantly Sinhalese region.[25] To do so, the president and his allies needed access to external financing, which they traditionally received from Western donors. However, when a ceasefire with the secessionist Liberation Tigers of Tamil Eelam (LTTE) collapsed in 2007, Rajapaksa pursued a military solution, plunging the country into civil war. This decision alienated the country's Western donors, precipitating a sharp reduction in Western aid.[26] Beijing stepped into the breach and made the 50 percent contraction in Western aid seem almost inconsequential. It dramatically increased its financial support to Sri Lanka during the Rajapaksa administration, committing a total of US$12.4 billion between 2005 and 2014.

By most accounts, Chinese government-financed infrastructure projects were an important driver of rapid economic growth in Sri Lanka during the first seven years of the Rajapaksa administration (2005–2011); the country's economy grew at an average annual rate of 8 percent during this period. However, some parts of the country benefited far more than others: Hambantota District experienced particularly rapid economic

[24] *The Economist* (2010); Crabtree (2012); Shepard (2016). In a 2010 interview, Rajapaksa explained that the Hambantota port project "was offered to India first. I was desperate for development work. But ultimately the Chinese agreed to build it" (Velloor 2010). On China-India competition in the realm of development finance, see Asmus, Eichenauer, Fuchs, and Parks (2021).

[25] Athukorala and Jayasuriya (2013: 20) refer to the southern (Sinhala) region of Sri Lanka as "the heartland of the electoral support base of the Rajapaksa family." In a 2009 cable dispatch, the US Embassy in Colombo characterized "the Hambantota [port] project [as] a huge deliverable to the President's home region and his electoral base" (Fowler 2009). It also warned that "some donors believe the Rajapaksa government is intentionally trying to steer aid and investment toward the Sinhala south while neglecting the north and east" and that "disproportionately [channeling resources] to peaceful [Southern] areas could exacerbate ethnic inequities and fuel the conflict" (Blake 2007).

[26] In the first year of the Rajapaksa administration (2005), OECD-DAC donors gave the country approximately US$1.1 billion of ODA (see Box 1.1 for a precise definition). However, by the last year of the Rajapaksa administration (2014), OECD-DAC ODA had contracted to less than US$500 million a year. During the same period (2005–2014), the average annual level of government financing from China to Sri Lanka was approximately US$1.2 billion.