

# Is China Actually Helping Improve Debt Sustainability in Africa?

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Emerging Powers in Global Governance:  
New Challenges and Policy Options

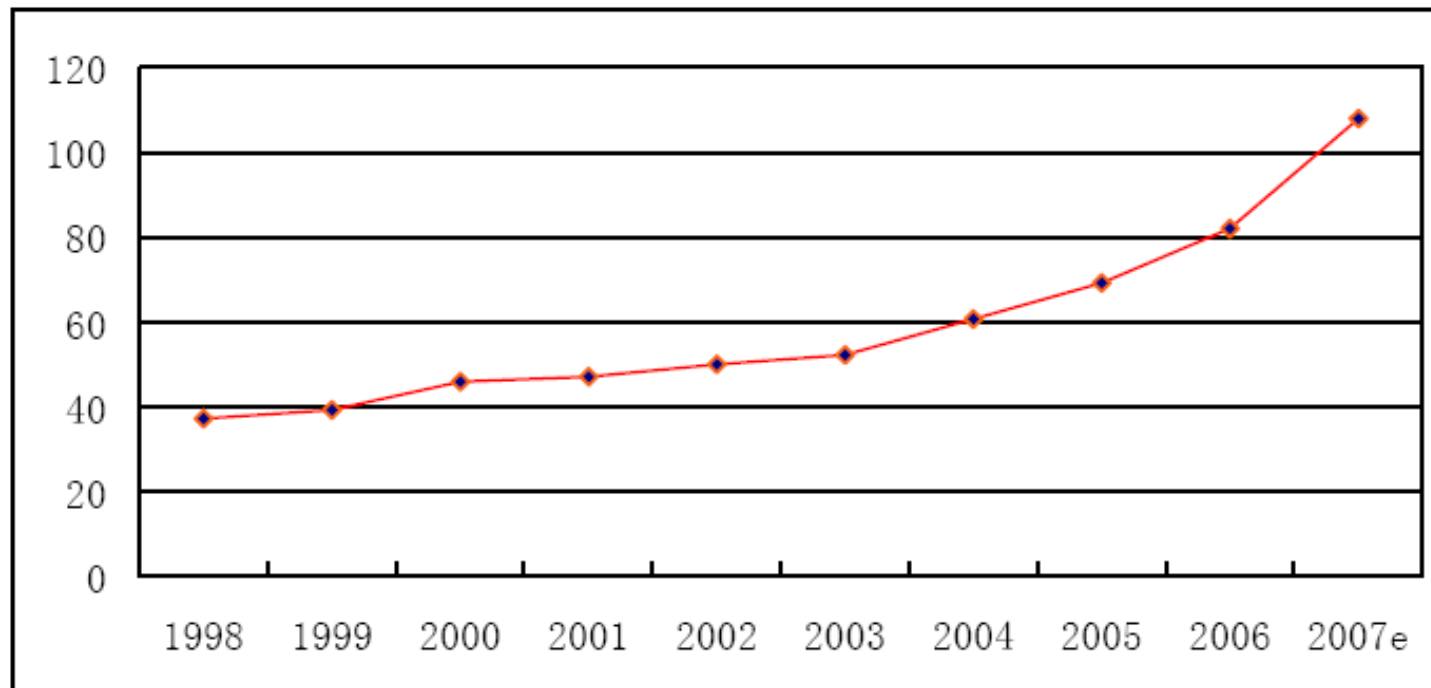
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# THE Big New Donor: China

- China has become the largest non-DAC donor, with big presence in Africa
- ‘Old’ donors are watching with suspicion:
  - “China free-rides on HIPC and MDRI”
  - “China’s lending may impair debt sustainability in low-income countries”
  - “China intensifies corruption”

# China's Foreign Aid Expenditure Increases

*Unit: RMB 100 million*



Source: Qi Guoqian (2007)

Notes: Aid figures cover aid in the forms of grant, interest-free loan, preferential loan, cooperative and joint venture fund, on a bilateral basis. They do not include debt relief, unlike DAC donors' reported ODA.

# Focus of China's Africa Engagement

- Infrastructure for resources extraction, telecom and transport: 28% are currently in the energy sector, 19% in telecom, and 13% in transport.
- *Angola Mode*: Chinese government mandates a Chinese Construction company (subsidized export credit); borrowing government provides equity stake in local (oil) company or production license.
- Angola, Nigeria, Sudan...

# Grant Element

of a Typical China ExIm Bank Export Buyer Credit

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- A simplified grant-element formula
- Discount rate = 10% (DAC norm)
- => Grant element = 22%
- ODA from 25% upward
- China aid = Interest subsidy 2.5%-2.0%

## DAC Grant Equivalent

### Concessional Export Buyer Credit

- 2% annual interest rate
- 0 grace period
- 15 year maturity

### ODA Grant Equivalent

- Cash inflow at start = 1000
- Constant annuities = 77.83
- Net present value at 10% discount rate = 591.9
- => Grant element =  $1000 - 591.9 = 408.1$

# China and Africa's Debt Tolerance

## Debt Distress Thresholds and their Parameters

| <i>Debt Burden Thresholds</i>                                 |                                 |          |                 | <i>Under the DSF</i>             |                      |
|---|---------------------------------|----------|-----------------|----------------------------------|----------------------|
| CPIA Score  | Net present value of debt, % of |          |                 | Debt Service, % of               |                      |
|   | Exports                         | GNP      | Public Revenues | Exports                          | Public Revenues      |
| Weak  | 100                             | 30       | 200             | 15                               | 25                   |
| Medium  | 150                             | 40       | 250             | 20                               | 30                   |
| Strong  | 200                             | 50       | 300             | 25                               | 35                   |
| <b>Debt Distress Thresholds, Secondary Market Prices, and</b> |                                 |          |                 | <b>Debt Crisis Probabilities</b> |                      |
| Debt/exports,%  | Secondary market prices         |          |                 | Debt/exports,%                   | Crisis Probability,% |
|   | -No crisis-                     | -crisis- | -severe crisis- |                                  |                      |
| 200   | 100                             | 36       | 28              | 200                              | 60                   |
| 300   | 77                              | 28       | 21              | 300                              | 93                   |

Sources: Cohen (2000); Kraay and Nehru (2006).

# China and Africa's Debt Tolerance

- The 'free-riding' concern is misplaced: The majority of the projects that receive Chinese financing are in non HIPC resource-rich countries.
- To be sure, debt vulnerability is still a concern in African raw material exporters, in view of their low governance scores and their exposure to real external shocks, such as a major drop in oil prices.
- Crucial: How is China impacting on the parameters  $D$ ,  $Y$ ,  $X$  of debt sustainability? And on governance?

# A Tale of Two: Angola & Sudan

**Debt Distress Indicators, 2000 vs. latest (2005/06)**  
in percentage terms

|   | Angola     |            | Sudan      |            |
|---|------------|------------|------------|------------|
|   | 2000       | Latest     | 2000       | Latest     |
| Debt/Exports                                | <b>114</b> | <b>48</b>  | <b>663</b> | <b>308</b> |
| Debt/GNP                                    | <b>126</b> | <b>41</b>  | <b>157</b> | <b>72</b>  |
| Debt Service/Exports                        | <b>21</b>  | <b>9</b>   | <b>10</b>  | <b>6</b>   |
| Annual external debt,<br>growth p.a 2000-05 |            | <b>3.8</b> |            | <b>2</b>   |

- **Despite no benefits from debt relief, they show big improvements in their debt indicators.**
- **Angola now below debt distress thresholds.**

# China and Africa's Debt Tolerance

## China's 'Contribution' to Income and Export Growth 2000-05

|        | Exports     | GNP        | China Share in exports | % 'China effect' |             |
|--------|-------------|------------|------------------------|------------------|-------------|
|        | % p.a.      | % p.a.     | %                      | Exports          | GNP         |
| Angola | <b>19.8</b> | <b>9.9</b> | <b>34</b>              | <b>29</b>        | <b>24.4</b> |
| Sudan  | <b>15.8</b> | <b>7.5</b> | <b>90</b>              | <b>74</b>        | <b>17.1</b> |

Source: 2006 GDF, COMTRADE; own calculations

- **China has a positive impact on debt tolerance through stimulating exports and GNP...**
- **... while recorded *gross* external debt in both Angola and Sudan has grown in the present decade at a pace slower than a rate that would imply future debt difficulties.**

# China's Presence Seems not to Have Fostered Corruption

## Transparency International CPI Scores in Africa

| Country      | Score 2002 | Score 2004 | Score 2006 | CPI Change | Fitch Foreign Currency Ratings | HIPC Status |
|--------------|------------|------------|------------|------------|--------------------------------|-------------|
| Angola       | 1.7        | 2          | 2.2        | +0.5       |                                | -           |
| Cameroon     | 2.2        | 2.1        | 2.3        | +0.1       | B                              | Completion  |
| Congo, Rep.  | -          | 2.3        | 2.2        |            |                                | Decision    |
| Gabon        | -          | 3.3        | 3          |            |                                | -           |
| Mozambique   | -          | 2.8        | 2.8        |            | B                              | Completion  |
| Nigeria      | 1.6        | 1.6        | 2.2        | +0.6       | BB-                            | -           |
| Senegal      | 3.1        | 3          | 3.3        | +0.2       |                                | Completion  |
| South Africa | 4.8        | 4.6        | 4.6        | -0.2       | BBB+                           | -           |
| Sudan        | -          | 2.2        | 2          |            |                                | Eligible    |
| Tanzania     | 2.7        | 2.8        | 2.9        | +0.2       |                                | Completion  |
| Zambia       | 2.6        | 2.6        | 2.6        | 0          |                                | Completion  |
| Zimbabwe     | 2.7        | 2.3        | 2.4        | -0.3       |                                | -           |

Source: [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi](http://www.transparency.org/policy_research/surveys_indices/cpi); [www.FitchRatings.com](http://www.FitchRatings.com)

# Exchange-Rate Risks

- *Renminbi* trend appreciation inflation-adjusted terms, due to the *Balassa-Samuelson effect*.
- No way to hedge against long-term real appreciation of the *Renminbi*.
- Optimal debt portfolio: maximum correlation with the changes in the terms of trade.
- For oil exporters, this calls for US dollar debt exposure.

# Outlook

- The rating industry perceives African debt as more sustainable than in the past.
- Drop in the ratio of non-performing loans (NPL) held by China's ExIm Bank.
- Rapid and intense investment in African infrastructure, but 'sour grapes'.
- Competition is doing more to promote African development than any high-flying donor cartel governance rhetoric.