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DEBT TRAP? CHINESE LOANS AND AFRICA'S DEVELOPMENT OPTIONS

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EXECUTIVE SUMMARY

Africa's growing public debt has sparked a renewed global debate about debt sustainability on the continent. This is largely owing to the emergence of China as a major financier of African infrastructure, resulting in a narrative that China is using debt to gain geopolitical leverage by trapping poor countries in unsustainable loans. This policy insight uses data on African debt to interrogate this notion. It explains why African debt is rising and why Chinese loans are particularly attractive from the viewpoint of African governments. It concludes that the debt trap narrative underestimates the decision-making power of African governments. However, there are important caveats for African governments. These include the impact of China's Belt and Road Initiative (BRI) on African development agendas, the possible impact of spiralling debt on African sovereignty, and the complex impact of corruption.

INTRODUCTION

The increase in public debt in Africa has been a subject of scrutiny in recent years. This policy insight examines the rise of sovereign debt in Africa, with a focus on Chinese lending. It seeks to understand why African debt is growing, taking into account the geopolitical context of China–Africa relations that informs the uptake of, response to, and implications of rising public debt in Africa.

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After a period of manageable public debt in Africa, debt is on the rise once more

After a period of manageable public debt in Africa, debt is on the rise once more. To understand why this is raising concern, one should look back to the impact debt has had on Africa in the past. During the 1980s, African economies had substantial sovereign debts that they were unable to repay, and by the mid-1990s much of the continent was frozen out of the global financial system.[1] This was followed by attempts to address the debt problem through structural adjustment programmes (SAPs). As will be explored in more detail below, these were largely destructive failures. The solution, reached in 2005, was for lenders to write off loans to heavily indebted poor countries (HIPCs), 30 of which were in Africa. With fresh credit and better economic policies, many of these countries turned their fortunes around. By 2012 the median debt level in sub-Saharan Africa (as defined by the International Monetary Fund, or IMF) had fallen to just 30% of gross domestic product (GDP). The IMF believes that the threshold for low-income countries is an external debt ratio of about 40%. For countries with debt ratios below this level, the probability of a debt crisis or 'correction' is around 2–5%; for countries with debt ratios above this level, the probability rises to about 15–20%.[2] Today, however, the median debt-to-GDP ratio in the region is back over 50%.[3] Africa's debt-to-GDP ratio had been trending downward until it picked up in 2012, with an increase from 37 to 56% of GDP between 2012 and 2016.[4]

The composition of the debt has shifted, as countries have moved away from concessional sources of financing toward market-based domestic debt.[5] Further, while African debt has grown recently, the continent has received less debt relief. This shift is informed by internal and external factors. Externally, the phasing out of the HIPC Initiative was enforced and linked to a decline in official development assistance. Internally, partly owing to debt relief, some African countries leveraged their healthier balance sheets and continued economic growth to explore new sources of funding such as international bond markets.[6] However, international capital markets are unlikely to be a good or stable source of development finance, as they tend toward a narrow, unforgiving view, and costs rise sharply with successive bond issues.[7]

The most recent country to receive debt relief under the HIPC Initiative was Chad in 2015. Presently, only three (out of the original 39, which included non-African countries such as Afghanistan) HIPC countries remain: Somalia, Sudan and Eritrea.[8] While, on the whole, debt ratios are still below the levels that necessitated the debt relief programme (which forgave $99 billion of debt in participating countries), 'the risks are higher because much more of the debt is on commercial terms with higher interest rates, shorter maturities, and more unpredictable lender behaviour than the traditional multilaterals'.[9]

The international community has been slow in sounding the alarm on Africa's debt, but this seems to be changing. By 2017 some economies had racked up significant debt – to the extent that multilateral organisations gently warned countries such as Ethiopia, Cameroon, Ghana, Kenya, Mauritania and Zambia that they needed to rein in public spending.[10] Indeed, Sudan, Angola, Kenya, Gabon and Mauritius have a collective GDP of more than $300 billion, and debt-to-GDP ratios above 60%.[11]

Chinese lending to Africa is driven by the financing of more than 3 000 infrastructure projects through which China has extended in excess of $86 billion in commercial loans to African governments and state-owned entities between 2000 and 2014, an average of about $6 billion a year.[12] In 2015, at the sixth Forum on China–Africa Cooperation, China's President Xi Jinping pledged an additional $60 billion in financing to the region. China has replaced traditional Western lenders as the region's largest creditor, accounting for 14% of sub-Saharan Africa's total debt stock.[13] This shift was informed by both a focus on infrastructure development by African governments and China's willingness to lend to the continent. In 2012, as China became Africa's largest trading partner, US–Africa trade began to decline. The main reason was the rapid expansion of American domestic oil production, leading to a sharp turn away from African oil imports. In addition, the lingering impact of the global economic crisis constrained Western energies for African financing.

The shift towards Chinese lending has rapidly changed African balance sheets. In Kenya, for example, Chinese loans come to KES[14] 478.6 billion ($4.756 billion) – far higher than the second largest creditor, Japan, at $91.4 billion.[15]

The shift towards Chinese lending has rapidly changed African balance sheets

WHY ARE AFRICAN GOVERNMENTS SEEKING OUT DEBT?

Three main factors are driving the appetite for debt among African governments. These relate to both the supply and demand side of debt. On the demand side, African decision-making is informed by the long decline in commodity prices since the global financial crisis of 2008. As proceeds from their chief exports have dwindled and economic growth has slowed, African governments have had to borrow more to fill the gap in their budgets.[16]

The second is an impetus from African countries to boost infrastructure, improve the investment climate on the continent, facilitate economic growth and attract investment. Given the fact that Africa has an annual infrastructure financing deficit of about $93 billion, infrastructure will likely continue to drive debt in Africa.[17]

On the supply side, there has been a notable increase in appetite for African debt in international markets. Partly buoyed by the commodities boom, which tapered off in 2016, Africa's continental GDP growth figures attracted the interest of creditors in developed countries, whose own markets were growing slowly. This encouraged appetite by high-risk, yield-seeking international investors for Africa's debt, enticed by relatively higher returns. The average returns from Africa stand at 6%, against 5.5% from emerging nations and 4% from developing economies in the Asia-Pacific region.[18] The higher returns in Africa are related to several factors, including a rapidly growing population with increased requirements for goods and services, an emergent middle class with augmented spending power, and highly priced credit that requires considerable returns to be effectively serviced.

There are thus both supply and demand factors driving the escalation of debt. But it should be clear that while there are supply factors, demand for debt from African governments is a key motivator, and this aligns well with increasing openness in international markets to fulfil this demand.

It is in this context that China becomes important. Its ambitious, infrastructure-driven BRI has made infrastructure financing a key source of Sino-African debt. The BRI was launched by Xi in 2013, and involves China's underwriting hundreds of billions of dollars of infrastructure investment across the world. According to a recent research report, the main thrust of the project is[19]

> to promote the connectivity of Asian, European and African continents and their adjacent seas, establish and strengthen partnerships among the countries along the 'Belt and Road', set up all-dimensional, multi-tiered and composite connectivity networks, and realize diversified, independent, balanced and sustainable development in these countries.

The BRI consists of two major components:

- Silk Route Economic Belt: overland rail and pipeline connections between China and Europe via Western China and Central Asia; and
- 21st Century Maritime Silk Road: a seaborne trade route linking China to Europe via South Asia and the Horn of Africa.

The agencies that will primarily be responsible for disbursing BRI funding are the state-owned Silk Road Fund, the China Development Bank and the Export-Import Bank of China. Further, two multilateral institutions led by China, the Asian Infrastructure Investment Bank (AIIB) and the Shanghai-based New Development Bank, are also major financiers of the BRI.[20] In 2016, for instance, the AIIB approved $1.7 billion in loans for nine BRI development projects. However, by the end of October 2017, it had made only one set of investments in Africa, in Egypt. As of late 2017, at least 76 public–private partnership (PPP) projects appeared to be in the pipeline in African countries associated with the BRI; 60% of these projects are in the transport sector.[21]

Clearly, the BRI presents Africa with an opportunity for development and will arguably be an important driver of infrastructure expansion on the continent. However, the BRI raises key questions for Africa: How will BRI projects be financed, and what will the impact of this financing be on African debt? What will qualify as a BRI project, and how will it relate to established priorities for infrastructure development set by African governments? How will BRI projects be distributed geographically, and will this exacerbate regional infrastructure imbalances? How will the current deficit in publicly available information about possible BRI projects be overcome in a way that African governments can optimise their involvement?

The combination of a growing appetite for debt from Africa, Chinese lending, and the emerging opportunities for infrastructure financing presented to Africa via the BRI will decide whether African governments decrease or increase borrowing. What should be clear, however, is that the demand for debt is emerging from African countries, and external parties, China included, are not 'pushing' debt on Africa. That said, Africa's exposure to Chinese debt is substantial, and several factors inform this trend.

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WHY IS CHINA AFRICA'S PREFERRED LENDER?

Growing exposure to Chinese debt is not a coincidence. As mentioned above, China accounts for 14% of sub-Saharan Africa's total debt stock. In Kenya, China accounts for 66% of the country's bilateral debt.[22] There are several factors informing this reality, the first of which is that China has a different experience of lending to Africa than the continent's traditional lenders. Past Western development programmes, such as the SAPs of the 1990s, had at best a mixed record. SAPs were both prescribed as a response to financial crises in least developed countries and envisioned as a way to kickstart their growth. The key characteristics of the World Bank and IMF SAPs included 'trade and financial liberalisation, monetarism, exchange decontrol and currency devaluation, removal of government subsidies and price controls, reduced social spending, and privatisation of state assets'.[23] SAPs 'reversed the development successes of the 1960s and 1970s, with millions sliding into poverty every year. Even the World Bank has had to accept that SAPs have failed the poor, with a special burden falling on women and children'.[24] In Kenya, SAPs were blamed for increasing inequality and unemployment while lowering living standards. In addition, governments were constrained in raising tax revenue from import duties because of SAPs' focus on trade liberalisation. This forced governments to implement steep cuts in public budgets for education and social services, which precipitated social unrest and further impacted growth. As a result, in many African countries the state was delegitimised.[25] The programmes also arguably led to a loss of trust between Africa and the West, and a growing wariness about the development solutions offered by traditional partners such as the Bretton Woods institutions.[26]

While the power imbalance between China and Africa is substantial, China has two advantages over the West in terms of Africa's receptivity to their presence on the continent. Firstly, China does not have the West's fraught legacy in Africa. SAPs, and the negative legacies of slavery and colonialism, have engendered an ongoing crisis in legitimacy that China can leverage to its advantage. Secondly, when the Chinese government interacts with African governments it does not present itself as the solution to and expert on Africa's problems. China frames its interactions in the context of South–South cooperation and multilateral engagement with bodies such as the UN, and emphasises its developing country status. This means that China is not generally characterised as talking down to Africa, and it presents initiatives such as the BRI as South–South development initiatives.[27]

In short, China's approach conveys respect and, despite the fact that African governments have limited power, particularly given the Chinese preference for bilateral agreements, the psychology of this approach is effective. China's hands-off approach also extends to issues of governance. It tends to emphasise that only Africa can solve its governance problems and does not make this resolution a prerequisite for development assistance. This is despite China's growing involvement on the continent, most recently in the form of its first foreign military base, situated in Djibouti. China explicitly gives room for Africa's governments and citizens to sort out their problems with limited outside interference. On a continent sensitive to issues of national sovereignty, China's hands-off attitude facilitates growing economic partnerships. Of course, these also boost debt levels. The relative opaqueness of negotiations around the terms of lending and China's willingness to entertain Africa's ambitious plans for infrastructure expansion further strengthen the perception that China provides an alternative source of financing, free from some of the constraints erected by traditional lenders.

BOX 1 CASE STUDY: SOUTH SUDAN

The complicated effect of Chinese financing becomes clear in the case of South Sudan. Ezekiel Lul Gatkuoth, South Sudan's Minister of Petroleum, explained why his country preferred to engage with China: 'Politics? Leave it to the politicians,' he told delegates at the Africa Oil and Power Investment Forum in May 2018. 'When you come to South Sudan, you need to be a pure company that doesn't have a hidden agenda.' He cited China National Petroleum Corporation (CNPC), a Chinese state-owned company, as an example: 'CNPC [is in South Sudan] purely to do business. They don't ask: "How is the political situation?" or when we are going to have an agreement with the rebels.' Gatkuoth referred to sanctions the US Department of Commerce had imposed on the South Sudanese Ministry of Petroleum, the Ministry of Mining and the State Oil Company (Nilepet), as well as the blacklisting of 15 oil operators, in response to the government's involvement in the country's ruinous civil war, as having negligible impact, largely because of China. Gatkuoth stated, 'US restrictions are not affecting us because oil is being produced [by CNPC] and all equipment is being brought in from China via Port Sudan.'

The case of South Sudan raises important questions about the impact of Chinese funding on attempts by the global community to keep African governments accountable. In addition, it also shows how the idea that Chinese funding has 'no strings attached' exercises a powerful influence on certain African governments. Whether this dynamic will be used to the benefit or detriment of Africa is the real concern.

WHY DOES CHINA LEND SO MUCH TO AFRICA?

The speed at which China has become a major creditor to Africa raises the question of why China is opening itself to the risk of African default. There are several arguments for taking on this risk, some more cynical than others.

The first argument is that debt to Africa provides business opportunities for Chinese contractors. The analyst Yun Sun argues that Chinese development finance aims at benefiting not only the recipient countries but also China itself: 'China's tied aid for infrastructure usually favors Chinese companies (especially state-owned enterprises)' and boosts China's Going Out strategy by creating international opportunities for Chinese companies and employment for Chinese personnel.[28] This arrangement has been a point of concern for many Africans, as it creates a dynamic where Africa is getting into debt with China and China then pays itself through contracting.

Secondly, Sun argues that some of China's financing to Africa is linked to securing the continent's natural resources by providing infrastructure paid for by commodity-backed loans.[29] In these cases, the recipient nations usually have low credit ratings and struggle to obtain funding from the international financial market. Chinese resource-backed loans solve this problem by enabling repayment in the form of commodities, frequently through extraction enabled by the infrastructure provided. Although commodity-backed loans were not created by China, Beijing has built the model to scale and applied it systematically.[30] However, Friedman and Snyder argue that natural resource-backed deals are not China's dominant mode of lending, making up only 33% of Chinese loans to Africa between 2000 and 2014.[31]

The third motivation is China's support for infrastructure financing. Xiaochen Su argues that infrastructure provision in Africa may benefit China by enabling faster and cheaper transportation of African natural resources to the Chinese economy.[32] It can also be argued that better infrastructure in Africa will facilitate the penetration of Chinese goods deeper into the continent.

Fourthly, some argue that China is saddling Africa with unsustainable debt and seeks to use indebtedness to further its geopolitical control over the continent. Su argues that by ensuring that 'debts are paid in some form or the other, whether it is economic concessions, political agreements, or a combination of both, China may in the long term formulate a new kind of diplomatic relationships with Africa'.[33]

Finally, debt from China opens African economies up to Chinese entrepreneurs. Even when not benefitting from Chinese debt directly as contractors, economic and debt agreements have provided the Chinese private sector with a foundation on which to invest and generate profits through business ventures in Africa. By acting as a major creditor, the Chinese government signals to the Chinese private sector that it seeks to engage with Africa for a long time to come. China may receive amplified benefits from any future economic developments in Africa – much more than can be calculated just in terms of debt repayment.[34]

All these arguments exclude one factor: China's financial liability should African governments default on Chinese debt. A statement from the Chinese embassy in Kenya addressed this issue in 2017:[35]

> China needs to keep an eye on certain African countries' risks of external debt. Currently the sustainability of external debt is generally controllable, but we need to remain cautious about the possibility of a debt crisis in certain countries, such as Sudan, Zimbabwe, Ghana and Mozambique. Those countries' development trends in external debt need timely analysis and evaluation, and precautions need to be taken when necessary. Regarding projects relating to Sino-African cooperation, China needs to pay special attention to projects that are guaranteed by the host countries and their governments' solvency, and if necessary a mechanism of insurance needs to be introduced to avoid default on debt.

It is clear that the Chinese government is assessing how sustainable its debt in Africa is, and what measures can be taken to prevent defaults. The statement also listed several possible initiatives aimed at increasing African debt sustainability. These include extending the PPP model to African infrastructure, providing more investment guidance to African governments, expanding Chinese cooperation in African industrialisation, and linking development finance advantage to credit building and market fostering.[36] While it is still too early to ascertain whether these initiatives will be implemented, they stand in contrast to the more sceptical accounts of Chinese lending practices outlined above. While it is certainly too early to claim that China's infrastructure financing is altruistic, the time horizon implicit in these official statements seems to belie the short-term benefits envisaged by critics.

AFRICAN CONCERNS ABOUT CHINESE DEBT

Western accounts of Chinese lending to Africa have frequently been relatively sinophobic. This includes allegations that China is saddling Africa with unsustainable debt to further its geopolitical control over the continent. Some in Africa have picked up on this narrative. As mentioned above, debt to China constitutes 66% of Kenya's bilateral debt. However, the notion that China is foisting debt on Kenya is cast in doubt by the fact that the Kenyan government has demonstrated a considerable appetite for debt over the past five years. The country's total debt has risen from KES 1.7 trillion ($17 billion) in 2013 to about KES 5 trillion ($50 billion) in 2018. To finance the debt, the Kenyan government has gone not only to China but also to other governments such as Japan, France and Germany. It has also floated several sovereign bonds in international markets, totalling $4.8 billion.[37]

Presenting Africa as a continent ripe for exploitation by China fails to take the agency of African governments into account. African governments are voluntarily seeking out debt

More broadly, presenting Africa as a continent ripe for exploitation by China fails to take the agency of African governments into account. African governments are voluntarily seeking out debt. Arguing that China plies clueless African governments with debt fails to acknowledge that African nations are aware of these debt obligations. Indeed, arguing that China is manipulating African governments into debt confers a childlike innocence on African governments, and it remains an open question whether this narrative will recur when the debt matures and it is time to pay up.

It should also be noted that Africa's growing debt to China is part of a wider concern in Africa about the continent's overall debt sustainability. Africa's cumulative debt-to-GDP ratio stood at 56% in 2016.[38] As these figures continue to grow, African governments will have to assign more revenue to debt servicing, rather than to the provision of goods and services to their populace. In Kenya, 45% of revenues earned from January to June 2018 will go towards debt payments.[39] That said, the composition of debt in each African country is different and singling out China as the main source of Africa's emerging debt woes is reductive. Indeed, from an African perspective the concern with debt is focused less on the source of debt but rather on whether a government uses debt responsibly; whether debt payments will lead to a reduction of government's financing of goods and services; and whether the debt is economically productive.

On the first point, in countries with high levels of corruption, there are concerns that the funds derived from loans will not support projects that drive growth but will rather be diverted into private pockets. In 2017 Transparency International's annual Corruption Perceptions Index listed several sub-Saharan countries (Somalia, South Sudan, Sudan, Guinea-Bissau and Equatorial Guinea) among the 10 most corrupt countries. Sub-Saharan Africa is one of the worst performing regions, with an average score 32 (where 0 is highly corrupt and 100 is very clean).[40] These figures underscore the concerns of Africans as to whether public funds are used appropriately.

The second major concern is the impact of debt on the ability of governments to provide goods and services to their citizens. Will debt repayments begin to eat into revenue that ought to have gone into government programmes? There are many factors that impede revenue generation by African governments, including illicit financial flows, the narrowness of the tax net, and the ease of tax evasion. Given subpar revenue generation, dipping into an already shallow pool to make debt payments is particularly painful for many Africans, no matter the source of debt.

Regarding Chinese debt specifically, there are concerns that the opaque nature of debt provision by China to Africa makes the real effectiveness and affordability of the debt unclear. How many loan agreements do African governments have with China? Are African governments presenting the right projects for debt financing? Is the financing being used efficiently? Will the debt be economically productive? Without answers to these questions, African citizens will become increasingly concerned about the scale of debt accrued, and whether it yields dividends in terms of economic growth and development. The opacity of loan negotiations between African governments and Chinese institutions adds to the perception that governments are enriching themselves and will saddle their citizens with the financial fallout. This is a concern repeated in relation to Chinese debt in other regions of the Global South, for example Ecuador, where even government ministers have confessed ignorance about the terms of Chinese loans.[41]

Concerns about this opacity have been raised in Kenya in relation to the cost of the Chinese- built and financed Standard Gauge Railway, and the debt Kenya has accrued from this project alone. These discussions have been fuelled by media reports that Tanzania will build an electric railway with twice the speed of the Kenyan line but at a fraction of the cost.[42] At $1.92 billion, Tanzania will be spending nearly half of what Kenya did to build the first phase from Mombasa to Nairobi (which was slightly longer, by about 50km, and was constructed at a cost of $3.8 billion).[43] As debt continues to grow in Africa, it is probable that Africans will scrutinise credit lines from China more closely. If the opacity of debt deals between China and African governments continues, this might be met with home-grown sinophobic narratives.

CONCLUSION

Going forward, there are several steps that ought to be taken to address these issues.

Firstly, the Chinese government should require high standards of fiscal reporting on debt provided to Africa. It should demand a fiscal regime from African governments detailing how debt will be absorbed.

Secondly, China should become more transparent about the terms of these agreements, allowing African governments less opacity.

Thirdly, there is a need for African governments to more explicitly link projects supported by Chinese debt to concrete benefits for Africans. Adegoke argues for the inclusion of guarantees or clauses in debt agreements that will ensure 'job creation, knowledge transfer, and technology transfer'.[44] This should apply to all debt, not just Chinese debt.

Fourthly, African governments need to present their countries with plans on how they intend to manage debt going forward and address citizens' concerns about spiralling debt. They should present a clear breakdown of the national debt by creditor and how it will be managed responsibly.

There is a need for African governments to more explicitly link projects supported by Chinese debt to concrete benefits for Africans

Fifthly, Africans need to play an active role in defining the narrative on Sino-African relations. As mentioned, Western accounts of Sino-African relations are highly influential and drown out African versions. It is important that African thinkers actively present an Africa-focused assessment of these relations so that the issues that Africans raise are front and centre.

Finally, China should refine its communications strategy in Africa. At the moment, this narrative is dominated by the theme of China's 'win–win' approach in economic diplomacy. This has been China's rhetoric in Africa for at least two decades and needs refreshing. China, like all nations, has national self-interest at heart and self-seeking elements in its interaction with the continent; and Africans know this. It is time for China's commentary on Africa to reflect the complexity of the relationship. The emotive impact of debt in the national conversation especially demands clarity and honesty. Continuing with oversimplified narratives in Africa will only create room for misunderstandings, and the relationship is too important to both sides to hazard such an outcome.

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