China in the Pacific: is China engaged in “debt-trap diplomacy”?

By Rohan Fox and Matthew Dornan

Recent media coverage has touted the rise of Chinese aid and lending as a threat to Pacific nations’ sovereignty and to the West’s influence in the Pacific. China, so the narrative goes, is aggressively lending to smaller nations who do not have the capacity to pay back the loans. Some commentators have even described such lending as “debt-trap diplomacy”, implying that lending forms part of an intentional strategy by the Chinese state to pressure Pacific island governments.

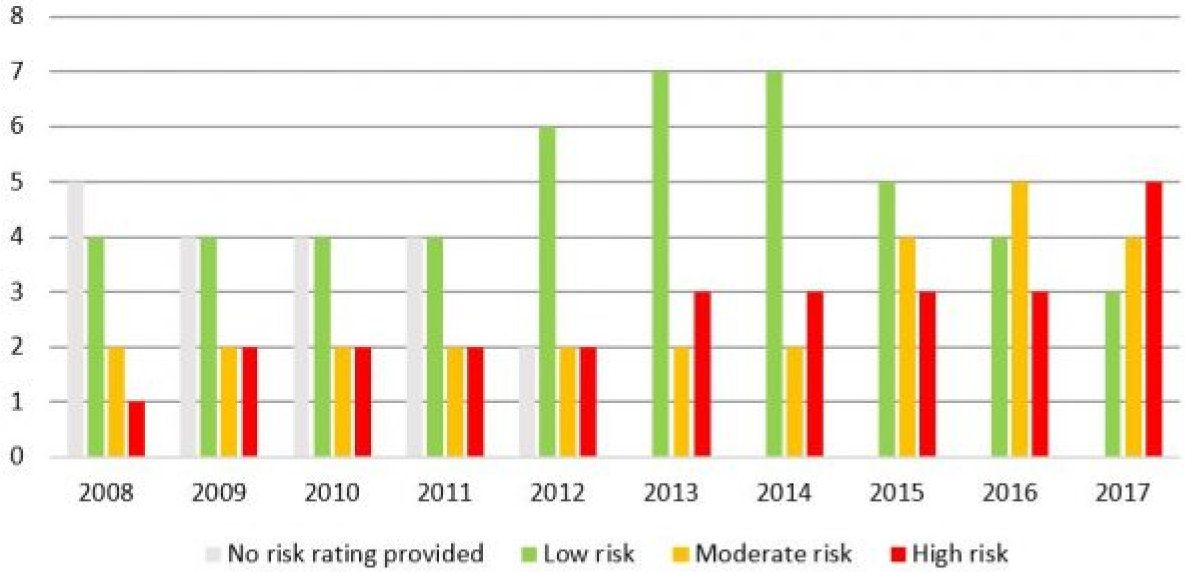
Political discussion in Australia seems to have shifted up a gear in response. As Foreign Minister, Julie Bishop made clear that she wanted Australia to continue to be the region's "partner of choice". And just last week, Labor leader Bill Shorten announced that a Labor government would set up an Australian Pacific infrastructure investment bank – an announcement he also framed in terms of Australia's status as "partner of choice".

But is it fair to claim that China is engaged in "debt-trap diplomacy" in the Pacific?

Most advocates of this argument have pointed to anecdotal evidence – high debt levels in Tonga, the case of the Hambantota port in Sri Lanka – rather than to hard data. In this piece, we look at international debt data to explore: (i) whether Pacific island countries are in debt distress, and (ii) whether this is the result of lending from China.

One issue we consider is whether Pacific island countries are at greater risk of debt distress than in the past. Using IMF and Asian Development Bank (ADB) risk ratings, we do see a rise in debt distress over the last five years (see Figure 1). We also see that over 40% of Pacific island countries are now classified as being at high risk of debt distress (see Figure 2, with countries singled out). So debt certainly appears to be a problem in the region.

Figure 1: IMF/ADB debt distress ratings 2008-2017 for Pacific island countries and Timor-Leste



Note: IMF article IV's are not conducted every year – for these years we code the risk rating as the same in the most recent article IV report. All countries use IMF ratings except for Cook Islands, which uses ADB. Countries included are Fiji, Palau, Papua New Guinea, Solomon Islands, Timor-Leste, Vanuatu, Kiribati, Marshall Islands, Micronesia, Samoa, Tonga and Tuvalu. Tuvalu and Nauru are excluded as they were not IMF members in 2008 (they joined in 2010 and 2017 respectively), and no ADB risk ratings were found.

Figure 2: Debt distress rating by country (using most recent data)

Cook Islands (2017)	Low
Fiji (2016)	Low
Nauru (2017)	Low
Palau (2016)	Low
PNG (2017)	Moderate
Solomon Islands (2017)	Moderate
Timor-Leste (2017)	Moderate
Vanuatu (2018)	Moderate
Kiribati (2017)	High
Marshall Islands (2018)	High
Micronesia (2017)	High
Samoa (2018)	High
Tonga (2017)	High
Tuvalu (2018)	High

Now for the second question: is this debt distress the result of lending by China?

The short answer is "no".

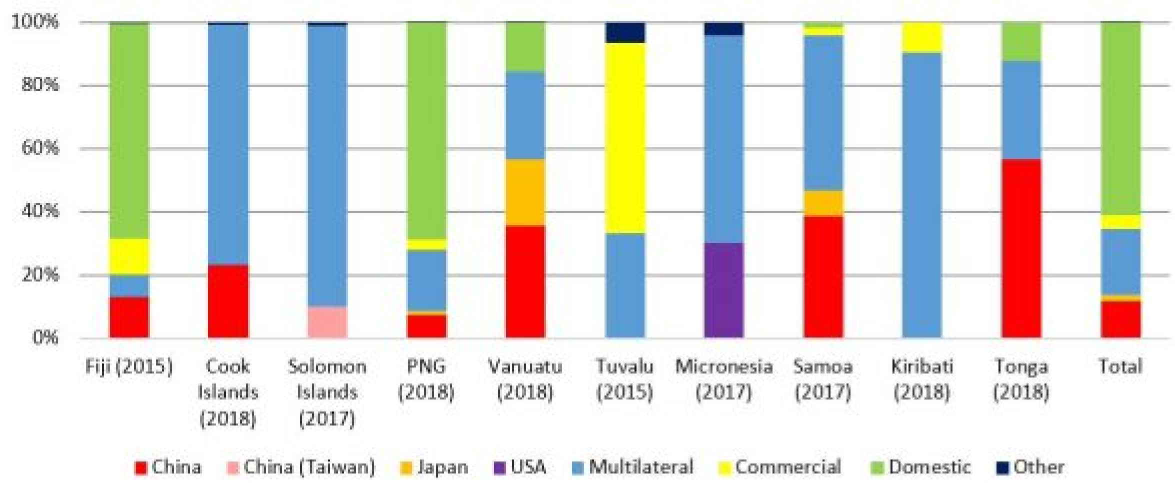
Although it is the largest bilateral lender, Chinese lending comprises less than half of lending in any single country, with the exception of Tonga. In fact, half of those countries in the "high risk" category do not even recognise China (PRC), meaning they have no access to Chinese concessional finance (they instead have a relationship with Taiwan). China has also provided significant sums to countries where debt is not an issue (i.e. to countries classified as being at "low risk" of debt distress).

Let's look at lending to the region in more detail.

China holds around 12% of the total debt owed by Pacific nations, or US $1.3 billion out of US $11.2 billion in debt in the years in question (see Figure 3). Australia does not feature in this graph, as currently all its aid is given as grants rather than concessional loans – though it does contribute to multilateral funds that are lent to the region (e.g. by the World Bank).

Aggregate figures for the region are driven by Papua New Guinea and Fiji, the economies of which dwarf the rest of the Pacific. Borrowing by these two countries alone makes up 88% of the region's total debt. However, in both countries, domestic debt dominates government borrowing – something that is explained in part by the activities of domestic pension funds.

Figure 3: Break up of national debt owed, by lender



Note: Timor-Leste, Nauru and Palau have been excluded from the graph as no information was found on the break down of their debt. Timor has signed up to China's Belt and Road Initiative (BRI), and has committed to receiving loans for projects, but these have not yet commenced and Timor-Leste currently does not *owe money to China. The total figure was calculated by converting all sums into US dollars and converting into 2018 prices using US CPI data.*

It is only in Tonga, Samoa and Vanuatu that Chinese lending comprises over one-third of total debt. In Samoa, lending by the multilateral development banks has been greater than lending by China. In Vanuatu, which is not at high risk of debt distress, the rise in debt to China is a recent phenomenon – and if government statements are anything to go by, appears to have come to an end.

That leaves Tonga as the only country where the "debt-trap diplomacy" narrative has some basis. Tonga is in a high level of debt distress, and Chinese lending dominates – the result of two large concessional loans provided by China Eximbank in 2008 and 2010.

However, anyone with knowledge of how those loans came about would argue that the Chinese state-centric "debt-trap diplomacy" narrative is a far stretch (see a 2014 article by Matt Dornan and Philippa Brant for a detailed description). The first loan came about in exceptional circumstances: the 2006 Nuku'alofa riots had destroyed a good portion of the CBD, and the government wanted to fund rapid reconstruction. The second loan for road re-development was driven by political machinations: MPs from outside of Nuku'alofa sought to attract loan-financed spending in their electorates outside of the CBD. In the background, (for-profit) Chinese construction firms which would implement the projects sought to ensure that both loans went ahead. In other words, the Chinese state did not drive either loan. In fact, given current tensions resulting from their repayment (the Tongan PM has made various contradictory remarks on the subject), it would be fair to argue that the loans have come to pose a headache for Chinese engagement with Tonga.

What can we conclude? Our analysis of debt in the Pacific strongly suggests that the "debt-trap diplomacy" argument is without foundation. Debt is a problem in the region, and one that appears to be increasing in importance. But for most countries it is not debt to China that is of concern. Keep that in mind next time you hear that the Pacific is drowning in Chinese debt.

For more on China's engagement with the Pacific, see Matthew Dornan and Sachini Muller's blog on the China shift in Pacific trade.

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