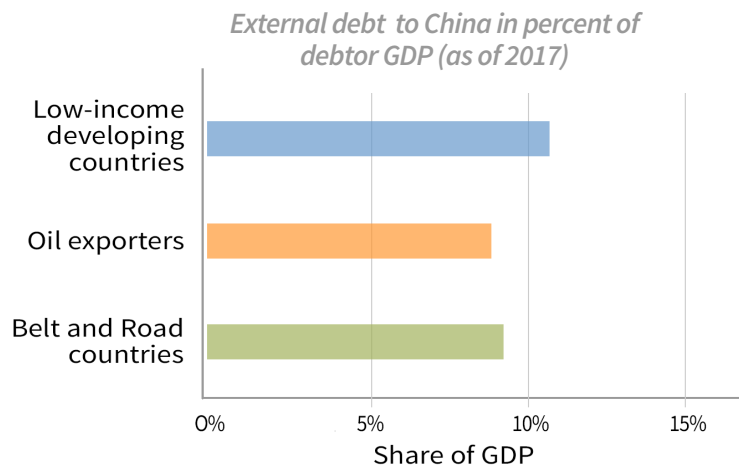


Political Effects of China's International Lending on Recipient Countries



Source: Sebastian Horn et al. (2021). China's Overseas Lending, *Journal of International Economics*, p.12

China is a major player in international finance, serving as official creditor to nearly 80% of the world's countries. It plays an outsized role as creditor to low-income developing countries (LIDCs) with China's lending flows now exceeding that of multilateral creditors like the International Monetary Fund (IMF) or the World Bank.

China's lending practices differ significantly from those of multilateral banks and OECD governments (as further explained below). This leads many observers to debate the impact of China's lending on the political institutions of debtor countries. Does China's lending erode democratic governance and empower autocrats?

The data. To analyze the political effects of China's development lending on recipient countries, the author utilized a uniquely comprehensive database of loan-level lendings to emerging or developing countries gathered by Horn et al. (2021). The data collection is based on a wide range of sources, such as publicly available databases, country-specific debt reports, debt contracts, and annual reports of recipient and implementing entities. The database includes "hidden" China aid up to USD 200 billion not found in conventional official debt statistics. The author specifically analyzed longitudinal data covering 104 developing countries that received China's aid from 2002 to 2017.

INSIGHTS

■ China's overseas lending to low-income developing countries exceeds that of multilateral creditors like the International Monetary Fund or the World Bank.

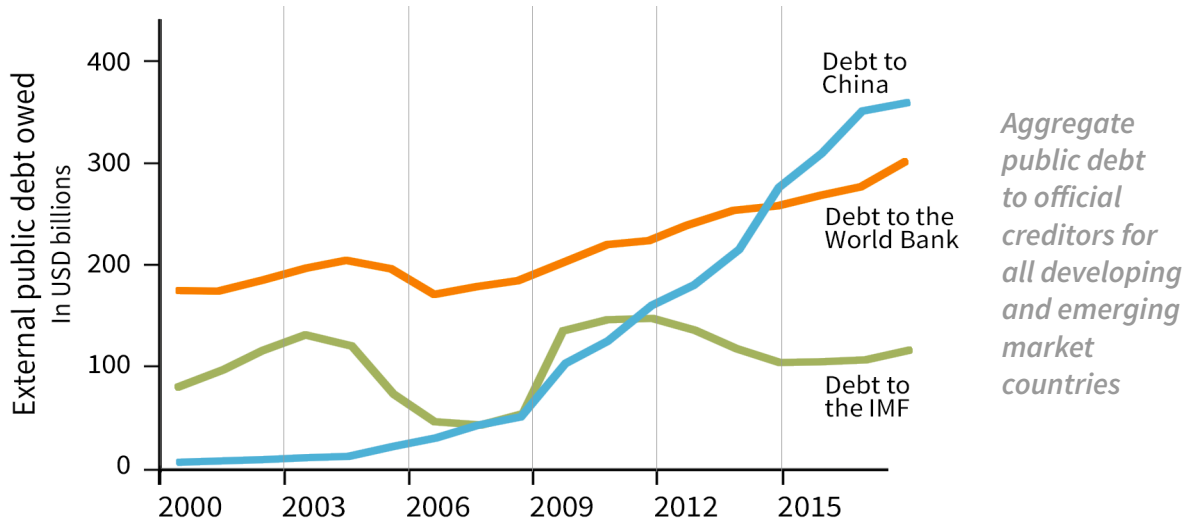
■ China's development loans are largely negotiated on a bilateral basis between its state entities and recipients abroad, contributing to their opaque nature.

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To gauge changes in political orientation over time, the author also used the Polity V Project, which tracks trends in political regime characteristics for 167 countries from 1800 to 2017, as well as data from the Varieties of Democracy (V-Dem) Institute.

To isolate the impact of China's development lending on political institutions of recipient countries over time, the author held constant a series of control variables like other foreign aid received, GDP per capita, population measures, regime stability, and regime age, among other factors.

Lack of data on China's international lending. Unlike other major economies, much of China's development lending is undertaken by China's state-owned policy banks and China's Ministry of Commerce, as well as other state-owned commercial banks and state-owned enterprises. Likewise, China's government does not report its official international lending and does not publish data on outstanding overseas debt claims. As such, about 50% of China's overseas lending goes unreported in publicly available debt statistics compiled by, for example, the IMF, the World Bank, or the Bank of International Settlements. Thus, data on the true extent and scope of China's lending is scarce, and its lending practices remain highly opaque.



... INSIGHTS

■ China's development lending "amplifies" political institutions in recipient countries: it makes democracies more democratic and autocracies more autocratic.

■ The amplification effect is stronger among autocratic recipients because China's opaque lending practices disproportionately benefit autocratic regimes with fewer checks on power.

Unconventional lending practices. China's development lending differs significantly from lending activities undertaken by traditional multilateral institutions and OECD creditor nations. First, China's official loans typically involve prevailing market interest rates and shorter maturities compared to the mainly concessional terms (i.e., below market interest rates) of other official lenders. Second, China's development finance differs from conventional development lending in that most of its loan agreements are bilateral, as opposed to multilateral, in nature. Debtor governments, in other words, often deal directly with the Chinese state rather than with multilateral creditors like the IMF or the World Bank. Finally, China's lending strategy involves "closed circle" or "circular lending": instead of disbursing funds to accounts controlled by debtor governments, China's state-owned lenders disburse funds directly to China's state-owned enterprises contracted to complete the projects abroad by debtor governments. Already described as highly opaque, these practices further obscure the overall picture of China's official lending activity.

Impacts of China's lending: amplifying existing political institutions. This analysis concludes that China's foreign lending does not change the orientation of political institutions in recipient countries (from democratic to autocratic, for instance, or vice-versa), but it does amplify their existing political institutions. In other words, development lending from the P.R.C. makes democratic countries marginally more democratic and autocratic countries more autocratic as measured by the Polity V Project and V-Dem datasets. These data measurements convey the relative presence (or absence) of institutions that allow citizens to express their political preferences, constrain the use of executive power, and guarantee civil liberties to all citizens.

Heightened impact of China's lending on autocratic countries. External lending by the P.R.C., however, has a relatively stronger amplification effect on autocratic recipients as autocracies become more autocratic relative to democracies becoming more democratic.

China's foreign lending more likely serves autocratic ends. The author suggests that China's development lending further amplifies autocracies relative to democracies because the opaque and closed nature of the lending places fewer constraints on the actions of autocratic regimes. This makes it easier for autocrats to deploy lending to serve autocratic projects that, for instance, benefit political elites over ordinary citizens. The opaque nature of China's lending does not confer the same degree of convenience for democratic states where the exercise of power is more constrained.

SOURCE PUBLICATION

Gregory W. Caskey (2022).
**Chinese Development
Lending and the
Amplification Effect.**
Working paper.

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