CHINA RESEARCH GROUP

Transcript

Banking on the Belt and Road: Insights from a New Global Dataset of 13,427 Chinese Development Projects

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Tom Tugendhat
I'll just give it a second more before we start broadcasting as I can see people that are joining us, the participants sort of rolling in, as happens. While people are just arriving, I'll just say thank you very much for joining today's China Research Group session, it's an enormous pleasure to have with us two fantastic speakers who are going to be speaking about the new global data set and the insights that's given on the Banking on the Belt and Road. This is an area of particular interest to me, as many of you will have heard me talking about BRI financing in various different ways. And what's important in today's session is we have from William and Mary College, the AidData team.

What they've done is they've taken effectively research from around the world and they regularly publish datasets and analytical papers on various topics, with China being one of their major focuses. They recently released a report analyzing - I think I'm right in saying this - 13,427 Chinese development projects, worth 843 billion US dollars. Now those are development projects overseas, this report covers loans, not just from government institutes, but also state-owned enterprises, to 165 countries in every region, from 2000 to 2017, allowing a comparison to Chinese investment between pre and post the Belt and Road initiative, the One Belt One Road programme, as the Chinese call it.

Their work represents the first systematic analysis of the legal terms of China's foreign lending, raising new questions for international creditors, and debt relief projects. Look, this is clearly incredibly topical, as we're going into various different conversations about development and of course, about real issues and COP. So for the enormous pleasure that I'm just going to introduce and then hand over to Bradley Parks, who's the executive director of AidData and to Ammar Malik, who is the senior research scientist at AidData. Gentleman, thank you very much indeed, for joining us this afternoon, or this morning for you. Thank you very much for coping with the time zones. And over to you.

Dr Ammar Malik
Thank you very much, Tom, I really appreciate you taking the time to host us today. I just briefly introduce myself. My name is Ammar Malik, I'm a senior research scientist at AidData as Tom said, we've been working on this research project for quite a few years. And I will get us started. And our plan is to spend about 15 minutes, first sharing a little bit about who we are and what we do and how we do it. And then really get into some of the findings that Brad will be sharing. So if you allow me I'm

going to share my screen. We have some slides prepared today. So to get us started, you know, the first question you might be wondering about is, you know, who are we and why are we doing this research.

So as you all know, China has become the lender of first resort in developing countries for a few years now. But unlike G7 countries, China does not systematically report its development finance activities, in any open and transparent way. So the objective of our research programme, which has been going on for close to a decade now is to facilitate rigorous research and analysis and support evidence based decision making by basically providing comprehensive, reliable, and really granular, detailed data on Chinese development, finance activities. And we think of ourselves more as a platform that provides a basis on which other researchers around the world can build on and do more research. And I think it's critically important for governments in the Western Hemisphere, but around the world who are the recipients of this financing, to really understand the full picture of what's happening.

So just to give you an overview of the scope of our project, we basically cover all official sector financial flows from China, that aligned with the OECD criteria for ODA (official development assistance) and OOF (other official flows), which means that we cover grants, technical assistance, loans, export credits, debt forgiveness and rescheduling. In other words, both aid and lending that the Chinese are doing is all covered. And then it is also systematically reported on OECD criteria in OECD definitions so you can do apples to apples comparisons with what the US, the United Kingdom and other countries are doing.

As Tom mentioned, we have 1000s of projects worth over 843 billion dollars across all major regions in the world, we cover 165 countries. The unique feature of our data set, which sets us apart from many others that try to do this kind of tracking is that we have a very comprehensive scope. We cover all of the sectors that are listed in by the OECD. In this area, we cover all low income, lower middle income and upper middle income countries. And we cover financing that comes both through the Chinese government itself and state-owned financial institutions. Now all of this means that we have information covering more than 5,000 recipients or borrowers and implementation institutions. And we categorize each one of them by the different types, such as government agency, state-owned enterprise, special purpose vehicle, and so on. We do this by reporting on 70 variables, which includes a whole lot of information for each of these 13,427 projects. The big categories of this include the commitment amount, the sector they're in, the status whether they're completed or not. When did it start? When did implementation start? When did it end? Where is the project located, including their precise locations and geospatial information, interest rates, maturity, grace period, and so on.

Now, one other thing I wanted to mention was, you know, we do all of this on the basis of AidData's tracking underreported financial flows methodology. You know, you might be thinking, how do we get all of this information? And how do we piece it all together?

So basically, the way we do it is through four big sources or four big chunks of information. And we all piece it together, mostly from documents that are publicly available. But sometimes we have to make special requests to host governments or international institutions to give us these documents. So the

first big category is the actual grant agreements that are in government registers and gazettes. For grants, loans, credit, exports, and so on. The second is that we extract official records from aid and debt management information systems from most countries, a lot of countries put this on their website or do reporting to institutions like the World Bank. We also scour through details in annual reports that are published by Chinese state-owned banks, who are the lenders in this case, the Chinese Embassy put out a lot of information, as does the Chinese government's website. We also rely a lot on parliamentary oversight institutions and host countries which put out a lot of information. And increasingly, we are also using unofficial sources such as media outlets, CSO, NGO reports, and so on. So all in all, our data set that Brad is going to discuss findings from now includes over 91,000 sources.

On average, we have 6.8 sources per project. And we're very proud to say that at least one official source is included in 89% of the projects. Because we are a research entity, research group at William and Mary, a university where students from all over the world come we are lucky that we are able to use data from different parts of the world and many different languages. Besides Chinese and English, we have sources in Spanish, French, Portuguese, Russian, and Arabic, as well. And the last thing I'll say is that you can all if you have in front of your phones or computers, log on to our website, aiddata.org. and download a copy of this data set because all of our data and all of the 91(thousand) sources that we've used, and all of the the assumptions that have gone into putting this data set together are all freely available on the web, for you to download, engage with and make your own conclusions or do your own research on them. So with that, I'll stop myself and hand over to Brad who's going to walk you through some of the key findings.

Bradley Parks
Thanks Ammar. So Ammar kind of emphasized that a unique feature of this data set is the use of OECD DAC measurement criteria and measurement standards. And one of the things that that allows us to do is to see how much China is spending vis-a-vis its peers and competitors. So one of the big takeaways from our latest report Banking on the Belt and Road is that whereas before BRI was introduced, China and the US were overseas spending rivals, we now see that during the BRI era, China has eclipsed the US. It's now out spending it on more than a two to one basis. It's outspending the UK on a more than seven to one basis - about 7.6 to 1, to be precise.

So in an average year, since the BRI, was introduced, China's spending about $85 billion on overseas development projects. But the color of that money really matters a lot. So whereas the vast majority of the development finance coming from the US and the UK comes via official development assistance or aid in the strict sense of the term, and primarily grants, China is kind of forging its own path. So it maintains a loan-to-grants ratio of 31 to 1, it's for those of you who are familiar with these OECD classifications, to translate that into other official flows, or OOF and then official development assistance, ODA, it's a it's a nine to one ratio. No matter how you cut it, China is out spending Western powers with debt rather than with aid. And much of that debt is provided on commercial or close to commercial terms, as opposed to the concessional orientation of Western and multilateral development finance institutions.

So just as a point of reference, we find that a typical overseas loan from China has a 4.2% interest. But if you as a developing country, are going to borrow from an OECD lender, let's say, Germany, France, Japan, you know, you're looking at something closer to a 1% interest rate. There's also a big difference in the repayment periods, the average repayment period on a loan from China is less than 10 years. The loans that are issued by OECD lenders tend to fall somewhere between 20 to 30 years, so you're talking about two times or three times as long a tenure or maturity length.

Another finding from our report is that a key characteristic of the Belt and Road era is the approval of mega projects, these are projects that are being financed with loans that are worth $500 million or more. So we see just a huge increase in the percentage of or the sheer number of these, these mega projects being greenlit and with these larger projects has come greater credit risk, right, the state-owned lenders in Beijing, you know, are facing a higher risk of not being repaid.

And so the response to that risk that we document in this report is an increase in the use of so called credit enhancements, which are basically repayment safeguards. So any state owned lender has three primary tools at its disposal to cover its debts. One is collateral that can be seized in the event of default. Another is getting your borrower to buy credit insurance from a third party or asking the borrower to secure a third party repayment guarantee, meaning if we can't repay the loan, you know, this other person over here, this other entity is going to step into the breach and make sure that you know the bad debt is recovered.

And so what we find is that, during the 21st century, there has been a huge increase, a doubling of the percentage of China's overseas lending portfolio, that benefits from one of these three repayment safeguards, either collateral, or credit insurance or a third party repayment guarantee. It's gone from about 30% of the portfolio to just about 60%. And we'll come back to this but there's a clear preference among those three safeguards for collateral. There's a specific reason why that that's the case, which I'm sure we'll talk about.

Another important finding from the study is that these Chinese state-owned lenders have a fundamentally different orientation than some of their peers and competitors. They are yield maximising surrogates of the state. The primary focus is on hunting for profitable revenue generating projects and this is because of domestic economic frailties, which we'll come back to in a moment. Ammar, can you go to the next slide? So one of the areas of the Belt and Road Initiative that I think is perhaps least well understood is its domestic economic rationale. You know, the way that the BRI is typically characterised is that it's part of some sort of grand strategy, right, a foreign policy strategy to build alliances to reshape the international order in a way that is more Sinocentric. And I think what oftentimes gets lost is that the BRI is a thinly veiled extension and expansion of the going out or going global strategy that was first adopted in 1999. So, you know, China's got a couple of different domestic problems that it is trying to solve through external lending.

The first is its domestic industrial input overproduction problem, it produces too much steel and cement, glass and aluminum. And so one of the ways that it's using its overseas lending program is by contractually, obligating its overseas borrowers to buy those oversupplied industrial inputs when

infrastructure projects are being implemented. So, if you think of the standard gauge Railway, that China ExIm Bank is financed in Kenya requires a massive amount of steel and other oversupplied industrial inputs in China, and so the borrower is bound within the four corners of its loan contract to source that those oversupplied inputs from Chinese state-owned enterprises that don't have enough domestic customers in China. So that's the first internal problem.

The second internal problem is because of recurring trade surpluses, they have a surplus of dollars and euros and other foreign currencies, it's primarily dollars, and so they're not getting sufficiently attractive returns on those excess dollars. Also, if they keep those dollars at home, they may face some macroeconomic stability problems. So they have elected to denominate their overseas loans in these foreign currencies, and then price those loans at or near commercial rates, so they can earn a more favorable return on those dollars in euros than they would otherwise get if they say park those dollars in US Treasuries or invested them elsewhere.

So I think you know, when you understand the supply side factors that are kind of influencing the overall size, and scope of the BRI, it kind of turns things on its head when you think of who is subsidising whom, right, typically think of BRI as a subsidy to the developing world. But, in many ways, the developing world is helping China solve pretty thorny domestic economic problems that relate to inefficient and bloated state-owned enterprises that have not found a way to get their get their house in order. Alright, next slide. Another important finding from the study is that we see evidence of China pursuing what we call a high risk, high reward credit allocation strategy.

And to understand the strategy, you have to go back to the 2008 global financial crisis. So the single biggest year on year increase in overseas lending from China occurred between 2008 and 2009. Why did that happen? That happens because China decided after quantitative easing took place in the in the US that they were not receiving a sufficiently attractive return on their surplus dollars. So the state administration on foreign exchange in China signed a very consequential entrust agreement with China Development Bank, what they did was they entrusted their surplus dollars to CDB. And they said, go get us a better rate of return than what we could otherwise get by having these dollars parked in US Treasuries. And that's the moment at which CDB is deputized to go and look for these higher rates of return. And at that time, the president of CDB is interviewed by the Financial Times. And he says, look, everybody's telling me to go to Wall Street, that you know, now this is the time to buy low and sell high and he says, I'm not going to do that I'm going into international commodity markets. So what happened? Commodity prices, international commodity prices plummeted during the 2008 global financial crisis, and China saw an opportunity to kill two birds with one stone.

First of all, they realized, look, we can come in and buy up these commodities at record low prices. These are kind of undervalued, potentially high return assets. But we also have this surplus of dollars. So here's what we're going to do. We're going to ramp up our overseas lending to resource rich countries like the Equatorial Guineas and Angolas and Venezuelas in Turkmenistans of the world, that no one else is lending to where very few Western creditors are lending to. And what we're going to do is we're going to denominate those loans in in our oversupplied dollars, we're going to price those loans above our average interest rate, it's going to be closer to 6%. So we're going to ask for a king's ransom,

because we're lending to countries that are generally not considered to be credit worthy. And then what we're going to do is we're going to allow these borrowers to repay us with the proceeds from their commodity sales. So we're going to simultaneously sign two agreements with them: a loan agreement, and a commodity sales agreement. And these agreements are going to be linked and what will happen is that the commodity providers, when they sell us oil, let's say, we're not going to remit dollars to their Treasury, there won't be a cross border financial flow, we're going to deposit the proceeds from those oil sales or commodity sales into an offshore bank account, typically in Beijing that is controlled by the lender. And we're going to require that they maintain a minimum cash balance in that offshore lender control bank account. And that's going to be used for two purposes, it's going to be used as a source of collateral. And it's going to be used to facilitate repayment of the loan, so we're not going to take any chances on repayment, because the money's not really going to ever leave China. So we refer to this as a grab and go source of collateral despite the kind of media myths of debt trap diplomacy that China likes to collateralise on physical assets, like a port or an electricity grid, we find no evidence for that. We find that they collateralise on cash, they want collateral that they can put in their backpack and walk out the front door with so that they don't ever have to dawn the doorstep of a judge to try to recover an overdue debt, they're way savvier than what the media is giving them credit for. Next slide.

Another section of our report kind of looks at the consequences of all of this overseas lending to developing countries. And what we find is that public debt exposure to China is substantially higher than anyone previously understood. There are now 42 low income and middle income countries that hold Chinese debt, worth 10% of their GDP or more. In some countries, it's much, much higher than 10%. Some countries that's as high as 50% of GDP. We also document the fall of sovereign debt and the rise of hidden debt. So China faced a major problem in the run up to BRI. And that problem was they had already issued a huge amount of debt. And so their government borrowers overseas said, look, we can't take more debt on our balance sheets. And so that put Xi Jinping and his colleagues in a difficult position. It put the Chinese state owned banks in a different position; they had to go search for new borrowers. And so they got creative. And what they decided to do is not lending to central governments, but lend to state-owned enterprises, state-owned banks, they would set up shell companies, these so called special purpose vehicles or joint ventures and then lend to them. And so now we see that 70% of China's overseas lending does not go to sovereigns. It's going around sovereigns, which at face value, you might say so what, right? Why does this matter for folks in the public sector?

Well, it actually matters a lot because most of these off government balance sheet transactions benefit from an explicit or an implicit form of liability protection from the host government that could come in the form of a sovereign guarantee, or it could be an implicit form of liability protection, like if this shell company that we establish goes belly up, and the company was established to run a public infrastructure asset while the host government might have to intervene to repay that overdue debt.

We're just gonna wrap up here, Ammar. Next slide. I won't go too much into this, but we also document in the report that governments are systematically under reporting their debts to the principal international reporting system for public debt, which is the World Bank's Debtor Reporting System. We estimate that there's $385 billion that should be reported to the World Bank's DRS that is not being

reported, works out to, for the average country to be about 5.8% of GDP, that's under reported or I guess, more precisely, unreported debt to official creditors in China. And we find that the problem is getting worse, not better over time.

So in a typical year, before BRI you know, there would be $13 billion of unreported Chinese debt worldwide. It's now soared to $40 billion a year during the BRI era, and we think about this hidden, hidden public debt challenge as a kind of a 'phantom menace'. And the reason why we use that term 'phantom menace' is because if you if you put yourself in the shoes of a finance ministry official in a low income or middle income country, the challenge is not so much about knowing that there's a specific monetary amount, that you're going to have a debt, that you know exists that you're going to have to service. And it's more about not knowing the full monetary value of the debts to China that you may or may not have to service in the future.

So if you think about this, imagine we set up a shell company to implement the China Laos Railway. We - the Laotian government - have a 30% ownership stake in that shell company. if the shell company is well managed, the public infrastructure asset generates enough revenue. It's no skin off anyone's back, the loan is paid on time. And it's not a public sector liability. But if that railway doesn't generate enough revenue, who's going to repay the lender? It might end up being the Laotian government, it might be that liability may be partially borne by the Chinese government, they don't exactly know how much they're on the hook to repay in the event of default. So that is really the nature of the challenge. That's kind of rattling credit rating agencies, when they look at a country like Laos and say: look on paper, they owe 60% of their GDP and public debt, but it might actually be as high as 95% because of these hidden public debts.

And then I'll just finally say that, there's a final section of the report that really focuses on implementation of BRI projects. And some of the top line findings from that section of the study are first of all that over a third of the portfolio's run into major implementation problems, like corruption scandals, labour violations, various environmental problems and public protests. We find that these projects, the BRI projects are also running into major implementation delays, we're seeing an increase in project suspensions and cancellations more so in the BRI era, than in the pre-BRI era. And we're seeing this interesting dynamic that we refer to as BRI buyer's remorse, where host country policymakers that were previously kind of eager to jump on the BRI bandwagon are now starting to create some distance from their Chinese patrons, because of public concerns about corruption and overpricing that are making close relations with China a political liability, right, for governing elites.

And then just last slide, Ammar, I'll land the plane here. You know, looking forward, if we try to think about how Beijing might address this rising tide of public antipathy towards BRI projects, we foresee three paths that they could take, which are probably not mutually exclusive. One path would be to go to the root of the problem, which is waning support with the general public in BRI participant countries - try to win them over, in the hopes that those efforts will result in the electoral success of pro-Beijing political parties. Or they could fall back on an old playbook that they've been using for decades, which is not to try to win over the general public, but to try to curry favor with incumbent leaders, the political leaders in BRI participant countries and bank on their loyalty to Beijing, as well as their political survival.

And then the last, you know, potential path that they could take is the multilateralisation path. They've made some noise about this in the, in the past, you know, showing interest in co-financing and co-implementing infrastructure projects with Western powers and multilateral institutions. But, to date, it's been more rhetoric than action. So, you know, we're just gonna have to wait and see if that, if that takes shape. So with that, I think we'll stop.

Tom Tugendhat
Well, thank you very much, indeed, for that extraordinary detailed presentation, where I think we're going to drop the slides and come back. It's very nice to see you back. Thank you very much indeed, for that presentation. I have to say I found much that extraordinarily revealing.

The first bit that I found pretty staggering, was the 70% figure that you quoted - the 70% of Chinese lending to non-sovereigns, that is effectively to one degree or another sovereign backed, or at least backed by some form of contractual agreement that ties the government in.

The second thing that I found completely fascinating, was the way in which you described the deliberate strategy to take monies that would otherwise have gone into US Treasuries and divert them into other areas and other areas deliberately in order to look for returns. Because, of course, the third bit and perhaps the most important element of this that I found fascinating is this is not an aid strategy. This is a profit strategy. And it, I have to say it, it reminded me of many of the other supposedly 'aid' projects that we've seen from some countries at various points being masked, but this one, rather successfully.

So I was wondering if I may, I'm going to kick off with questions and answers - but I'm now going to also say please, to any participants, if you would like to ask a question, please do the usual question in the question and answer box, or get in touch on the chat.

My question, however, is what can we do to make sure that governments around the world price and report these loans correctly. Because, as you say, if they're going into special delivery vehicles that are going to different businesses that are so connected to the state entity, how can we, without waiting for you guys to report, make sure that these are properly identified for global rules?

Bradley Parks
I think that the most obvious way is to invest more resources in the World Bank's Debtor Reporting System. That system has been in place since the early 1950s. And its principal purpose is to provide visibility to policymakers and international organisations, as well as in developing countries on sovereign debt exposure to creditors of all types. This is not even specific to China. And so that system, I think what our report reveals is in is in need of rehabilitation, there are just yawning gaps in the reporting to this system. And the World Bank should be credited that the DRS was not made public until just a few years ago. And so, now, it's been revealed, because of their admirable decision to make the system public that there are real weaknesses.

I'll just give you two quick examples. You know, the government of Montenegro, its single largest repayment liability right now is a $940 million loan from China Exim Bank for a highway project, that loan is nowhere to be found in the World Bank's Debtor Reporting System. AidData has published the unredacted loan contract. It's publicly available, and so we have a situation where the international reporting system for recording public debt cannot capture the single largest repayment obligation of a sovereign government. And yet, a research institution like ours is able to retrieve and publish the loan contract itself. That just shows the severity of the problem that is a sovereign debt, but the problem is also acute with respect to government guaranteed debt.

So when governments are asked to voluntarily disclose their debts to this international reporting system, they're supposed to report two things. They're supposed to report debts that were directly contracted by the finance ministry or the central government, and then any loans that benefit from an explicit sovereign guarantee. So the loan is issued to a private entity, and the government says if you go belly up, we're on the hook to repay that debt. The government is supposed to disclose that to the World Bank. And our analysis in this report shows that that is not happening.

Look no farther than Bosnia and Herzegovina; they guaranteed, there was a shell company created to implement $600 million Tuzla thermal power plant project. AidData again has obtained the loan contract in its entirety. We've published it online, and it's not disclosed by the authorities to the World Bank. This is just unsustainable and frankly, unacceptable state of affairs. And so I think it's just time to really invest more time and attention and resources into building that system up so that it is credible and useful for all parties. It's a public good, right especially as we enter into the debt rescheduling situations, where kind of the first step to an orderly collective restructuring is being transparent about who owes what to whom. And you can't do that without this type of information.

Tom Tugendhat
Okay, well, this is this is absolutely fascinating study. There are a whole series of questions coming in, and I could easily monopolize you for a lot longer. But I'm gonna start turning to the questions if i may. Jacob Mardell, are you able to speak? Or do you want me to read out your question?

Jacob Mardell
I am able to speak if you.

Tom Tugendhat
Great, go for it.

Jacob Mardell
So first of all, thank you for doing all this research it's really fantastic. I'm yet to dig into the data but I've read the report. My question is really on incentives on the host country side for engaging in these bills for taking these loans from China. And it's not necessarily captured in the data, but I wondered whether you could offer any thoughts on this? And then also, if I may have two questions just about competition with the BRI and the influence China might wield through this financing. What is there that the US, UK

and EU can do to compete for influence - assuming that we don't want to be financing dodgy projects in risk areas?

Bradley Parks
Maybe I'll take the first question and Ammar, would you like to take the second? Alright, so on the first question, you know, I think it's important to think about this problem over time. So prior to the announcement of the B3W (Build Back Better) initiative that the G7 announced in June, prior to the EU's announcement of the Global Gateway initiative, there just was not very much competition in the in the official in the infrastructure, financing markets, right. So, you know, to some extent, if you are a developing, if you were a developing country looking to obtain credit for a big ticket infrastructure project that could not plausibly be financed with grants. You had limited choice, there was limited competition in that market. And so many of these borrowers kind of flocked to China, that also had a need, right to kind of invest these surplus dollars and euros. Now that's changing, right? Competition and choice in the infrastructure financing market is, is increasing. So perhaps, we'll see, the demand from the borrower side, may evolve in the coming years, that's gonna be something to keep a very close eye on.

But I think the other part of this, another part of the answer to this question is thinking about credit worthy versus un credit worthy countries. So by enlarge, you know, after the experience of the highly indebted poor countries initiative in the late 1990s, and early 2000s, Western powers, kind of started to take a very strong interest in helping poor countries get on sustainable, get their public finances on sustainable footing. So they wrote down, you know, a lot of overdue debts. And then there was a big shift towards grants or very low interest loans. And they avoided extending credit to countries that don't have good credit histories. Right.

And so I think China kind of innovated around the global financial crisis when they ramped up lending to these resource rich borrowers like Venezuela and Angola, Russia, Equatorial Guinea, those types of countries, many of them could not obtain credit because they have, you know, bad credit histories. And so, you know, China found a tool in this collateralisation mechanism, specifically collateralising on the cash proceeds from the sale of commodity exports, as a way that they could still transact with these borrowers that other official creditors didn't want to touch with a 10 foot pole while protecting their own interests well, namely ensuring that they get repaid on time and with interest and the way that they did that is, you know, by ask, requiring that borrowers, you know, maintain this minimum cash balance and the offshore lender control bank accounts. That has effectively positioned China as a senior creditor; a creditor that's more important to repay than other creditors, if you encounter a cash crunch, I don't know Ammar, if you want to piggyback on the second question.

Dr Ammar Malik
Yeah, I just will add something really quickly on in terms of the G7's response, I think the dollar strategy, that retailer dollar dollar match, we're trying to compete dollar for dollar across all the sectors is clearly not a smart strategy. I think first thing we need to do is to understand where are some of the areas in which there might be competitive advantage. And our data set is, I think, a first attempt in trying to understand it, because now you can look for a country to country sector to sector, where are

projects going? Well, where are they not going? Well, what's missing? What are the missing pieces? And what do we need?

So one quick thought that comes to mind is that, you know, the, there is a lot of hardware infrastructure being funded by Chinese entity very quickly, very efficiently, apparently. But there are so many other elements for economic growth and development, including capacity building, you know, human rights, women's rights, and so on, that are not addressed through this kind of hardware spending. So perhaps those are some areas where there is still quite a bit of work to be done in the developing world.

Tom Tugendhat
Thank you. Thank you very much. There's an excellent question from somebody earlier from Lawrence J., which I will ask very briefly, if I may, because we only have a few minutes left, he very kindly agreed to speak with us 4:45. So it's very good to be here. But how can smaller countries extricate themselves? Is there a mechanism? Is there any way in which Western countries multinational organisaions can help to get them out? Clearly, if we're offering lower interest rates and longer terms, it is in their interests to get out? But is there? Are there? How can I put this politely personal reasons why some leaders may not wish to withdraw themselves? And are there other obstacles to withdrawing?

Bradley Parks
Yeah, it's a it's a great question. I mean, the the dirty little secret about Chinese lending is that, you know, the, the original sin is not in the loan contract, it's in the underlying commercial contract that is financed with the proceeds of the loan. So those commercial contracts are oftentimes intentionally inflated, there's artificial price inflation. And the reason why those commercial contracts are inflated, it's because there are collusive deals being struck between Chinese state owned enterprises and host country politicians or their relatives and allies. So typically, the way that this works is you increase the commercial contract by let's say, 20%, or 30%. And then you split the super profits between the Chinese state owned enterprise that is your counterparty and then the politician who's going to submit the submit the loan application. So China runs a demand driven loan application system, they don't just approve loans on their own, they have to receive a request, typically from the Office of the President, or the Office of the Prime Minister in the host country. So that is a crucial vulnerability, an institutional vulnerability that the head of state or the head of government is the entity submitting the loan applications. And Chinese state owned enterprises have figured out how to game the system, they figured out that you can't get a loan application approved unless you already have a commercial contract in place. So if you can inflate the cost of the commercial contract and make it be in the interest of the person submitting the loan application, and the company that will implement the project to have that artificially inflated cost, well, now you have kind of a lock-in mechanism, no one has an incentive to reveal that collusive deal.

So yeah, that's not easy to unwind. I mean, one thing that I would say is, in democratically elected governments and governments with reasonable institutions of democratic accountability, when there are government transitions of power, this is a unique moment to sort of rein in some of these excesses and we're seeing in the BRI buyer's remorse countries, that many times what happens is a new government comes to power and they immediately go back and review these commercial contracts with

an eye towards value for money, asking, you know, whether it is in the public's interest to continue with the these projects. So I think when, when new governments come in and they review existing contracts, that's an important time. You know, for countries that are contemplating the possibility of unwinding relationships that, you know, were previously established.

Tom Tugendhat
Thank you very much indeed, Look, you've been extremely generous with your time. And I know there's many other people who would like to come in. So I will, I'm afraid. Tragically, you have to call it a day there. Because you've been very, very generous already. Before we go, may I just remind everybody that on the usual terms, all of this will go on our website very soon, there is a podcast that will be made out of this, which is simply a recording of it. So it's not afraid it's not worth much cleverer than that. But it'll give you a chance to hear all those details. Again, AidData have got all their information online, and the links will be on the website as well. So please do feel free to go through their data and look more carefully. On the 25th of October, so next Monday at three o'clock, we have another session we're going to have, we're going to be talking about climate change in the run up to COP, and I'm delighted that Amber Rudd, who many of you will remember will be speaking as well, Alex Wang and Isabel Hilton, as environmental and China experts. So please do join us Monday 25th, October at three o'clock, for the next session of the China Research Group. And please check out online for everything you heard today. Thank you.