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Ain't No Sunshine when Xi's Gone: What's behind China's Declining Aid to the Pacific?

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The much-awaited update to the Pacific Aid Map showed a sharp drop in China's 2019 aid spend in the Pacific, despite the pressing development needs presented by COVID-19. While eight of the Pacific's ten major donors also saw falls in their aid spends from 2018 levels, China Aid dropped the most, falling 31 per cent to just 6 per cent of overseas development assistance (ODA) in the Pacific, a far cry from 2018 reports that the People's Republic of China (PRC) was set to become the region's leading donor based on committed aid funds. This In Brief strongly concurs with the map's authors about the reasons for the relative decline. However, it's doubtful that 2018 represents a 'high-water mark' for China's aid to the region (Pryke and Dayant 30/9/2021), or indeed any sort of roll back in China's presence. The nature of China's engagement with the region is changing — in line with global trends — as China's state-owned enterprises (SOEs) and policy banks get more creative about how they fund their operations.

Xi's sugar hit

As Pryke and Dayant (30/9/2021) note, Xi Jinping's 2018 attendance at the APEC summit in Papua New Guinea led to a sudden surge in China's aid, which jumped by a quarter on 2017 levels. The recent decline reflects a return to pre-APEC levels, rather than Chinese aid having reached a high-water mark. This is not the first time official visits to the Pacific have led to greater aid spend, as they did when Premier Wen Jiabao (2006) and Xi Jinping (2014) visited Suva. Short spurts of government interest in the Pacific are a well-known effect inside China — back in 2018, Chinese colleagues in Pacific studies were joking that they had to get their Chinese journal articles in before the end of the year, otherwise they had no hope of publication.

With longer-lasting importance for the Pacific, official visits lead to a great intensity of activity by China's SOEs. A recent study showed that in the year around the APEC summit, the number of Chinese SOEs in Papua New Guinea increased from 21 to 39 (Connolly 2020:53–54). Given the increased ambition of the PRC leadership to direct its companies at home and abroad — a generalisation that could not be made before Xi took power in 2012 — this effect will be more lasting than the sugar hit of ODA. These companies are agnostic and creative about funding sources for their projects — PRC construction company executives our team interviewed expressed a strong preference for multilateral lenders such as the Asian Development Bank and other countries' bilateral aid programs, citing the onerous nature of China Exim Bank's monthly reporting requirements.

A recent global comparison of Chinese SOE behaviour argues we should treat PRC investment in the same way as we treat tied aid, noting, 'China is unusually well positioned to employ FDI [foreign direct investment] as a policy tool because Chinese firms are subject to extraordinary state influence, and many of the most important firms are state owned. Indeed, we find patterns consistent with the interpretation that China deploys its FDI for political purposes in a way that is analogous to foreign aid' (Stone et al. 2021:2) and 'investments by firms that are not state owned and that do not have foreign affiliates do not respond to state visits or to Taiwan recognition' (ibid.:19).

China's policy banks: The tip of the spear?

The decline in China's aid is a global trend. Since mid-2015 when China's foreign reserves contracted abruptly, the policy banks (led by China Exim Bank in the Pacific) that were meant to be the 'tip of the spear' in the Belt and Road Initiative (BRI) have been short of funds for concessional loan projects (Connolly 2021:56). China simply doesn't have spare US dollars to fund infrastructure projects abroad. If loans were denominated in yuan, the equation would be different, but internationalisation of the Chinese currency hasn't proceeded at the pace Xi might have hoped.

Just as importantly, China's policy banks are changing the way they finance projects, making it less likely that they will appear as aid. A full review of AidData's recent survey of the global impacts of BRI projects is beyond the scope of this In Brief, and there

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are limitations — its data only goes up to 2017 and the reported amounts cover commitments rather than what has actually been spent — but Tonga (35.4% of GDP) and Samoa (29.9%) make the top ten countries in terms of debt exposure to the PRC (Malik et al. 2021:44–58, 163–64). Tonga in particular is worrying. The kingdom has high levels of sovereign debt to the PRC, but its 'hidden' debt levels (20.8%) are bested only by Laos and Turkmenistan, in line with the findings of a 2019 Lowy report into debt sustainability (Rajah et al. 2019).

The same companies and the same banks are involved in China's ODA and outbound direct investment, and they are increasingly responsive to state direction. Policy lending is policy lending, whether it proceeds through a state-owned policy bank, an SOE, a city government agency or a country-to-country loan. The BRI has supercharged the blurring between whether a project counts as aid or investment.

This blurring has long been apparent in South-East Asia and Africa. Recent projects in the Pacific suggest a more complex engagement led by China's SOEs and subnational actors is already with us. A recent example is the Kumul Submarine Cable Network, which is 85% funded by US$270 million from China Exim Bank in the form of a preferential buyer's credit, channelled directly to a local SOE, PNG DataCo Ltd, a wholesale subsidiary of Kumul Telikom Holdings, with work contracted to Huawei Technology Co Ltd. Concerns have been raised about the pricing (Malik et al. 2021:67) as well as the commercial and technical viability of the project (Suwamaru 2020).

Buying the debt trap narrative

This In Brief strongly concurs with the Pacific Aid Map authors that reticence by Pacific Island countries to take on new concessional loans (only Papua New Guinea and Vanuatu have done so since 2016) in part reflects widespread concern about China setting a debt trap that might affect their future sovereignty. While this thesis is not entirely well founded, as multilateral lenders hold the largest share of Pacific debt (Fox and Dornan 8/11/2018; Rajah et al. 2019), in countries with weak governance settings and subject to natural disasters fuelled by climate change, even moderate levels of debt can impact the ability of Pacific governments to provide education and health care.

As Solomon Islands MP Peter Kenilorea Jr explained in 2019: 'We don't want to be tied into debt. Particularly to one country. We can all go crazy with our infrastructure needs and those needs are clear … our governance structures need to be strengthened and there are certain capacities that we need to have in order to deal with this kind of powerful partner, knowing full well that the China of today is not the China of three years ago or even two years ago, definitely not 20 years ago when most of the Pacific were recognising them.'

Australian policymakers would do well to heed Kenilorea Jr's advice — the nature of China's engagement with the Pacific is changing in a way that is not captured by the aid data — something the aid map's authors readily acknowledge. In parallel with strong moves on the part of the PRC central state, such as the appointment of defence attachés to Papua New Guinea and Fiji (which also gained a police liaison officer last month), China's SOEs like China Civil Engineering Construction Co are showing more inclination (or feeling greater pressure) to front China's diplomacy in the region (Smith 12/9/2019). With the blurring of aid and investment, it now perhaps makes sense to map the operations of PRC companies and attempt to draw distinctions at the project level based on the type and source of funding. We are also going to see more PRC subnational actors, whose initial enthusiasm for the BRI was lukewarm at best (Manuel 2019). Time for us all to read up on China's 'paradiplomacy'.

Author notes

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