Saturday December 14, 2013

“Tis' the season of jolly Santa”

T.K JAYARAMAN
Professor
Fiji National University
Nasinu,
Fiji Islands

Santa is now travelling. He is making a list of “who is naughty and who is nice”.

Santa will favour everyone, no exception. That is the faith, which has inspired several generations of kids.

In the case of China, which is emerging as Santa for Pacific island countries (PICs), the experience does not span generations. However, the experience of two decades has been one of generosity.

An Asian Santa

China gives loans to developing countries in all regions. Their loans do not carry any belt tightening measures of the kind imposed by international funding agencies, which earned the epithet: IMF (infinite misery forever).

China also forgives loans after a while. They are treated as grants. Details on China’s assistance to developing countries are not readily forthcoming. Being a communist state, China is secretive. Most of the data used by researchers, including the Sydney based Lowy Institute, are collected from the aid recipient countries, some cooperative and some not so cooperative.

China embraced capitalistic steps just about two decades ago. It has been exploiting the access to world markets to the hilt, using the liberalised trading environment. Over more than decade, China has built a huge trade surplus.

With cheap labour, China has been manufacturing consumer goods of all kinds, with foreign investment, for exports. By an export-led growth approach, China has established itself, as the world's second largest economy, beating Japan to third place.

One of the famous quotations of Deng Xiao Ping goes like this:

"I don't care if it's a white cat or a black cat, so long it catches mice".

He brushed aside his critics opposed to his capitalistic approach to development.

Why China gives aid?

The "capitalistic" economic theory says balance of payments has to balance, regardless of the system, communist or free market.

If a country builds a current account surplus (trade in goods and services; remittances and other positive inflows), it has to experience capital outflows: buying overseas bonds, investment abroad, aid and loans.

If there is no matching outflow, capital inflows get transformed into domestic money under fixed exchange rate regime. The result will be inflationary.

China has a fixed exchange rate regime. Under the fixed exchange rate system, the adjustment is on output. Under the flexible exchange rate system, the adjustment falls on exchange rate. The advanced countries have been persuading China to up-value its currency and adopt a freely flexible exchange rate policy, instead of a fixed exchange rate, which is artificially kept low to promote exports.

Until adopting a flexible exchange rate regime, one way out is: liberal use of the cheque book diplomacy to "win friends and influence people".

China's aid

An independent think tank, the Lowy Institute of Australia, tried to document Chinese aid over time, relying more on anecdotal evidence. It says over last five years, China has provided US $800 million. In the latest year of study (2009), about $270 million in loans and aid grants were provided to PICs.

Most of the loans and grants are for infrastructure such as water supply and roads. Some recipient countries diverted aid money for purposes other than the original ones. Since monitoring of aid utilisation by China is not as rigorous compared to that of international funding agencies, the recipient countries are more relaxed.

If the funds are not properly utilized, the lending program fails. Countries find themselves unable to meet repaying obligations since expected returns from investments funded by debt do not materialise. So, countries are forced to request for rescheduling payments of interest and instalments or extension of grace period.

Rising expectations

In September, Tonga was about to default in regard to a loan of US$ 50 million. China accepted the Tongan request to extend the grace period for some indefinite period.

The Lowy Institute study says in the past China forgave loans after some efflux of time.

In 2006, China converted US$11.5 million debt owed by Samoa into a grant. There are two other country instances where the requests for similar conversion were temporarily rejected. Indications are that they would be considered at an appropriate time.

In mid November 2013, eight PICs attended Second China-Pacific Islands Countries Economic Development and Cooperation Forum in China. The first one was held seven years ago years in Nadi.

The difference is, this time PICs made efforts to convert past loans into grants. China did not readily agree, but it announced aid of US$1 billion on concessional terms over next four years.

In the meanwhile, two reports by ADB and ANZ on PICs' economic trends are of concern. Specifically referring to Tonga's debt, they indicate that "burden of paying the debts to China's EXIM Bank is likely to post a drag on overall growth despite the postponement of the first tranche of repayments in September".

Tonga's public debt is around 43 percent of GDP. About 90 percent of the debt is owed to external creditors and much of it is to China.

Samoa's debt, which is mostly external, is 45 percent of GDP and is likely to reach 54 percent by next year. The high level of debt has led Samoa's debt distress classification from moderate to high.

Last week, the government and opposition in Tonga made a united appeal to China expressing hopes for conversion of US$ 50 million into a grant. Indeed, it was one of the rare occasions when opposition is seen joining hands with government.

As the jingle goes, when mommies are kissing Santa Claus, daddies would not mind. After all, Santa is a grand old father figure!

The reason put forward by opposition's finance spokesperson is that conversion into grant will allow "further foreign borrowing, which is much needed".

It is not clear who would be the new creditors, ADB or IMF; or China again!

Santa is watching. He has not smiled so far.