

The Negative Externalities of China's Development Finance: How National Governance Capacity of Recipient Countries Made a Difference in Aid Results

Yanxing Zhou

Duke Kunshan University, Suzhou, Jiangsu, China

Keywords: Global South, Development Finance, International Relations, Foreign Aid, China's Aid Method.

Abstract: As China has been engaged in deeper international cooperation, it advocates its preposition on globalization and multilateralism, providing aid to developing countries. With the deepening of international cooperation, China's aid programs are also questioned by the international society, which seems to be the mainstream in academic discussion. This research compares how Tanzania and Sri Lanka respond differently to exploit China's development finance. Tanzania took some more effective measures to deal with risks during the cooperation. However, Sri Lanka didn't well exploit the freedom of China's aid method. It takes less effective measures. China's aid method is like an amplifier expanding the effect of recipient countries' governance capacity. To some extent, it exposes some issues of recipient countries' dependence on debt and misjudgment in decision-making. China should not be mainly responsible for some less-than-ideal international aid. The conditions of the recipient countries also make differences in the final result.

1 INTRODUCTION

Since the establishment of the People's Republic of China, China, as one of the most powerful emerging donor countries, has played a role in foreign aid careers, even during its hardest times. Traditional ways of aid are regarded as ways to promote the democratization of recipient countries, so the aid is usually through certain conditionality. However, China's aid method seems more attractive and accessible to recipient countries because it doesn't have a lot of attached political limits (Li, 2017). What's more, many recipient countries think the aid offered by emerging donors like China is more useful and appropriate to their needs than the aid offered by established donors (Woods, 2008). During the process of aid, one principle that China's aid follows is non-interference (Ahmed, 2022). China doesn't advocate that democracy should be forced to take place with "conditional aid". The international community should give more time for recipient countries to carry out their problems. The recipient countries need to realize the internal balance of reform, stability, and development. It provides opportunities to many countries that are rejected or brushed off by established donors. The main form of development finance that China offers to the recipient

countries is through debt. China's assistance has had positive effects on the local development of the recipient countries. For example, the finish of the TAZARA railway "formed the backbone of a new spatial orientation for agrarian production and rural commerce. (Dreher et al., 2022)" However, due to the unbalanced results after getting the aid, some Western countries came up with their questioning about the reasonability of China's aid mechanism. They argue that China's aid program "creates new options for dictators who were previously dependent on those who insisted on human rights progress (Brautigam, 2011)". In addition, they argue that China's aid through flexible loans is likely to entrap the recipient countries with a debt trap so that China can get strategic benefits, decreasing the recipient countries' agency. It is undeniable that China's aid program has generated some controversial results while bringing local development to host countries, but that doesn't mean that China should be treated as the dominant force in an aid program. For some recipient countries, China's aid method is relatively successful, and many African countries have started to embrace the "Beijing consensus." Even though many experts and scholars have pointed out that China's aid method might need a process to adapt to the local situation (Li, 2017). It can show that the local condition plays

a role in affecting the final results. If the local condition can be organically combined with China's aid method, the result can be good. Many researchers emphasize the systemic shortcomings of China's aid mechanism but ignore the effect of different capacities of governance in different recipient countries on the aid results, shaping China an image of selfishness and irresponsibility. China's aid method works like an "amplifier." It amplifies the good. The article aims to discuss the different outcomes of China's foreign aid from the aspect of recipient countries' governance capacities, which can help the public to have a more rational view of China's aid mechanism.

2 SAMPLE SELECTION

This research takes the cases of Tanzania and Sri Lanka to analyze how the aid results of these countries are different.

Tanzania, as the most important country for China to deepen the international cooperation in the East Africa area, has great political, economic, and diplomatic significance. Its relationship with China the strongest and longest-running on the African continent (Lammich, 2024).

Sri Lanka is a typical failed case of debt diplomacy. Its percentage of external debt to GDP is generally getting higher over 10 years. In addition, it is located at a key location of the geopolitical competition which is mainly dominated by China, the United States, and India, in the Indian Ocean Region. Under the context of international powers competing with each other and fighting against each other, international public opinion deliberately downplays the fact that Sri Lanka owes many agents but can't make ends meet, and the main debtors are Western private creditors. According to the report launched by Sri Lanka in 2024, it shows that Sri Lanka owes almost twice as much to Western private creditors than it does to China (Ministry of Finance, Economic Stabilization, and National Policies, 2024). The data shows that the general argument regarding China as its biggest creditor is worth discussing.

Finally, the two cases are exactly aligned with the research topic. Tanzania's governance method is more fit for its national needs and it is national-benefit-oriented. Sri Lanka's method is more aligned with the president's interest instead of the country's. Scholars used to discuss how African countries' agency plays a role in shaping Sino-African relationships. It reveals that the agency of every African country should not be ignored or denied even

if the agency appears to be regionally uneven and the relations can be shaped by the purpose of the agency (Mohan & Lampert, 2013). The conclusion inspires the research that different levels and purposes of agency can have an impact on the inter-engagement of the activities between China and recipient countries. The distinctions between their national orientation determine that the measures the two countries are taking are different.

3 TANZANIA

Tanzania has always set a national development plan since it declared its dependence in 1961, for which nature is to boost national development. The Julius Nyerere administration hoped the donor community could finance an ambitious project, which is a key part of its five-year national development plan: a 1,860-kilometer railway (the TAZARA railway) running from Kapiri Mposhi in Zambia to the port of Tanzania's largest city, Dar es Salaam (Dreher et al., 2022). However, the economic viability is questioned by many countries and multilateral institutions. China stepped out and offered to finance the construction of 415 million dollars. After 3-year construction, the TAZARA railway was finally finished, and this railroad played a significant role in promoting the economic development along the railway. It brought a large-scale population redistribution along the rail line and strengthened the connections between rural and urban areas, improving the employment and industrial development alongside the railway (Dreher et al., 2022).

Tanzanian government intentionally takes measures to decrease the negative effect of the shortcomings of China's aid mechanism. After the first cooperation with China in the 1970s, China and Tanzania agreed to their second cooperation in the 2010s. China's reputation for getting things done quickly is an attractive factor to the Tanzanian government during this period. However, reasons for getting things done quickly is that (1) Beijing's policy bank could approve the loan with the Tanzanian government without a competitive bidding process for the contractor sector, which aroused suspicions of corruption; (2) China's policy banks is that they did not insist that the contractors or Tanzanian government counterparts follow the environmental standards of Western aid agencies and multilateral institutions, but follow the rules set up by the host countries, which could result in different outcomes due to the differences among regional environmental policies (Dreher et al., 2022). However, the

investigation conducted by the public prosecutors has shown that the Tanzanian government took measures to prevent the irregular cooperation between Chinese state-owned enterprises and local collaborators. In addition, Tanzania set up its own environmental policies, so China's high-risk behavior to the forest had little or no effect on deforestation.

4 SRI LANKA

The aid program in Sri Lanka focuses more on unnecessary "White Elephant" project construction, which is for building up the Rajapaksa family's image but barely has any positive effect on local development. Hambantota, as the hometown of President Rajapaksa, has been favored, and he wanted to make it the "second capital" of Sri Lanka (Dreher et al., 2022). The Rajapaksa administration proposed to construct a deep seaport in Hambantota with 1.5 million dollars, a nearby airport with 200 million dollars, a road from the seaport to the airport with 412 million dollars, an expressway connecting Hambantota and Colombo, the capital city, with 180 million dollars, and in addition, some constructions like an international convention center, cricket stadi (Dreher et al., 2022). It's undeniable that China-financed projects have driven the rapid economic growth of Sri Lanka in the short term, especially Hambantota, during the first seven years of the Rajapaksa administration (Dreher et al., 2022). However, a scary fact was that the Mattala Rajapaksa International Airport was the "world's emptiest international airport," which only earned 123 dollars in revenue in a single month in 2014 (Dreher et al., 2022). The revenue it earned is apparently barely able to cover the loan it borrowed from China. Improving transportation and construction is definitely important to economic growth, however, in Hambantota, these projects and constructions might not fit its true need.

The cost overrun and corruption issue attracted some attention. A former chair of the country's National Transport Commission noticed that the cost of the road was 55% higher than those bid competitively; What's worse, the most expensive projects were financed with loans priced at market or close-to-market rates instead of grants. As the loan is much higher than the market price, it means that there will be a great amount of profit. Whether the profit is really got by the country or the profit goes to private wallets of Sri Lanka officials can definitely arouse the public's concern and suspicion. In addition, at the end of the Rajapaksa administration, a debt of 8 billion

dollars was accumulated in China. To avoid severe debt burden, they granted China "a major ownership stake in and a 99-year-old lease to operate Hambantota's deep water port in exchange for 1.1 billion dollars of debt forgiveness (Dreher et al., 2022). However, looking back to the case of Tanzania, under the same vulnerability of China's aid mechanism, Tanzania avoided and prevented the occurrence of exceeding cooperation between national officials and China's enterprises to the greatest extent (Dreher et al., 2022). The nature of Rajapaksa's request for aid is different from the Tanzania government's. Sri Lanka's goal is based on the wish of the government (or the president) instead of what the country really needs.

5 ISSUES

The research finds that the undeveloped governance capacity might entrap recipient countries into the following challenges (1) dependence on debt, (2) misjudgment about the national need.

5.1 Dependence on Debt

Over the past decades, Sri Lanka has increasingly depended on external debt to support its infrastructure construction. Long-lasting debt made Sri Lanka involved in the fiscal deficit. A dataset collected by CEIC reported that, in Sri Lanka, the tax revenue percentage of GDP was 12.9% in Jun 2024, and the average value from Mar 2014 to Jun 2024 was 10.6% (CEIC, 2024). The Central Bank of Sri Lanka's annual report for 2022 shows that the foreign debt to the central government is 51.6% of GDP. The overall fiscal balance has been negative since 2016 (Central Bank of Sri Lanka, 2023). The heavy debt burden has brought a great economic burden to the government of Sri Lanka. Its state revenue can not support normal national development, let alone clearing all the debt. The proportion of Sri Lanka's external debt is increasing, and the country is almost running on an accumulation of debt, entrapping itself in a vicious cycle.

Sri Lanka doesn't establish a sustainable economic development method. Sri Lanka's continued loan has brought it short-term and visible economic benefits, but its internal economic growth momentum is inadequate. It doesn't have a well-established industry to generate and sustain revenue, and it doesn't have a stable and adequate national tax revenue.

5.2 Misjudgment About The National Need

One reason for the failure of China's development finance in Sri Lanka is that the Rajapaksa administration failed to make reasonable goals for Sri Lanka. The proposed projects mainly aimed at winning the support from Rajapaksa's hometown, Hambantota. It prioritized some large-scale and costly projects but failed to balance the short-term economic increase and long-term development sustainability. Developing transportation and urban construction is definitely one important way to promote local development, but it is not what Hambantota needs. Sri Lanka's government borrowed about 800 million dollars from China to support its white elephant projects. Low commercial activities result in that there is not enough revenue to cover Sri Lanka's cost to finish the construction. As a result, the revenue can not cover the debt. By contrast, Tanzania's decision seems to be more reasonable and feasible.

Additionally, the government ignored the importance of developing domestic production capacity, like domestic industries, national taxation...The national taxation is always at a low level, limiting the development of public sectors like healthcare, and infrastructure. Instead, all social resources are used to pursue short-term economic benefits, worsening the economic vulnerabilities of Sri Lanka.

6 SOLUTIONS

To decrease the harm of the challenges, recipient countries are encouraged to enhance debt management, fiscal transparency, and sustainable development.

First, it's very important to enhance the debt management, and the supervision of the fiscal policy. A transparent and supervised borrowing can guarantee the reasonability and sustainability of borrowing. Additionally, negotiation with creditors and diversifying financing sources are also important. Negotiation with creditors can help recipient countries to have less debt burden. Diversifying the financing resources can improve the situation in which is trapped in debt.

Second, the countries should re-evaluate what are the highly efficient projects that can long-term benefit the countries. The recipient countries should spare more effort on enhancing some public welfare careers like public health, education, employment, and so on,

instead of some potentially impractical projects. The government should be cautious in particular in avoiding unnecessary exceeding investment. Improving economic resilience is also important. The government can promote resilience by developing different industries, and diversifying the economic sources, decreasing the dependence on external financing. Debt exceeding national capacity can involve countries in debt traps. Debt is one way to get the financing but it should not be the main way to support development projects. When debt accumulates to a certain extent, it will become a heavy burden for a country.

Third, improving governance capacity is necessary. With a stronger governance capacity, it is more likely to make decisions that are best for national development. Reasonable development loans can provide opportunities to recipient countries to work on constructions that are beneficial to national development and match what the citizens are asking for, but the government must have a clear acknowledgment of the country's capacity. A sound governance system is able to guarantee the efficient and fair use of funds. In addition, citizens have the rights to supervise and know the process of decision-making.

Finally, promoting international cooperation can help the recipient countries utilize the governance system with professional and advanced social resources and knowledge, realizing long-term sustainable development. Only when the national governance capacity is comprehensively improved can every aspect of national decision-making can run well and supervised.

7 CONCLUSION

The research found that the governance capacity of the host country is significant for the result of aid. Through reading different literature, the research finds that many researchers criticize and question China's aid method, shaping the recipient countries as complete victims. China's aid method emphasizes non-interference. It can explain China's position in international aid. China might be criticized for cooperating with countries with not good humanitarian records but that is not what China means to. The "no interference" lowers the condition to get aid, so some countries get the chance. China's method is more like an amplifier of existing issues, the effect of host countries' governance capacity itself is unignorable. China's method offers opportunities for good leadership to develop the country but also

lets the bad leadership have the chance to realize their individual desire. At the end of the research, it found some issues that the recipient countries are facing. One is the dependence on debt, the other is the misjudgment about the national need. The research suggests recipient countries realize long-term sustainability by enhancing debt management, project re-evaluation, governance capacity, and international cooperation. The research analyzes how the governance capacity of the host countries can have an effect on the ultimate result of Chinese development finance aid. It can help the researchers and the public to have a more comprehensive and objective view of China's aid method. The research can be improved if more perspectives are accessible to the researchers. Because the research cases are mainly accessed from Western research articles. The research may be limited by the research aspect from one side, and the observation from multiple sides is good for the research's objectivity.

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