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Vietnam's Hidden Debts to China Expose its Political Risks

Although Vietnam's Chinese debt burden is low compared to some of its neighbors, it is still a worry for the Communist Party mandarins in Hanoi.

By Zachary Abuza and Phuong Vu

Vietnam has famously eschewed China's Belt and Road Initiative (BRI), but it has been the recipient of over $16.3 billion in Chinese project financing from 2000-2017. A new report on Chinese economic assistance programs sheds some light on Vietnam and suggests that the country is increasing its debt burden to China far beyond what is commonly thought; creating political risk and impacting Vietnam's potential policies toward its neighbor to the north, which is already prone to bullying and intimidation.

$385 Billion in Hidden Debt

The recent report by AidData on China's overseas lending and assistance portfolio found a collective total of $385 billion in un- and under-reported debts. The dataset looks at 13,000 Chinese-funded projects worth $843 billion in 165 countries, from 2000-2017. While the data includes many non-BRI projects, it is fair to say that Chinese lending and grants went up dramatically after the BRI commenced in 2013. The report found that the average government "is under-reporting its actual and potential repayment obligations to China by an amount that is equivalent to 5.8 percent of its GDP."

So how did the debt burden get so big? What AidData found is that China gives very little in the way of grants, and that even its lending is not between sovereign states. Instead, "nearly 70 percent of China's overseas lending is now directed to state-owned companies, state-owned banks, special purpose vehicles, joint ventures, and private sector institutions in recipient countries," rather than sovereign borrowers: i.e. central government institutions.

Why does this matter? First, Chinese lending is not cheap. Indeed, the average Chinese loan bears an interest rate of over 4 percent, nearly four times the rate of financing from Japan or the European Union.

Second, China has demanded high degrees of collateralization, either assets or money in escrow accounts that China controls. As such, we have already seen debt-for-equity swaps in Sri Lanka and Laos. While even China might not want to move against a sovereign government if they cannot service their debt, Beijing has no qualms about its state-owned enterprises seizing assets from their partners overseas. For instance a Chinese SOE took over part of the Lao power grid when a Lao SOE could not service its debts for hydroelectric dam construction.

And indebtedness to China is enormous: 42 developing countries, including four in Southeast Asia (Laos, Brunei, Cambodia, and Myanmar), have "public debt exposure to China in excess of 10 percent of GDP."

Where is Vietnam?

The situation is particularly acute for Vietnam, as it is the eighth-largest recipient of Chinese Official Other Flows (OOF) lending from 2000-2017. In all, Vietnam has borrowed $16.35 billion, second only to Indonesia in Southeast Asia. Vietnam was the 20th largest recipient of Chinese concessionary ODA, a mere $1.37 billion. Notwithstanding, Vietnam has long been suspicious of the BRI and to date no new infrastructure project in Vietnam has been officially labelled as part of the BRI in the public domain.

Vietnam's recent economic growth has been stellar, with positive growth every quarter from 2000 to mid-2021, when COVID-19 shut down Ho Chi Minh City, the economic hub of the country. As Vietnam moves to absorb production as firms and countries seek to decouple from China, infrastructure is its greatest impediment.

According to the Global Infrastructure Hub, Vietnam's demand for infrastructure investment is an estimated $605 billion between 2016 and 2040. As Vietnam gets wealthier, development assistance and bilateral and multilateral concessionary lending has peaked. Demand is so huge that Vietnam has to mobilize foreign financing sources, amidst growing difficulties in public-private-partnership and build-operate-transfer projects, and limited state budgets.

The BRI has the potential to help Vietnam relieve its capital thirst, and Hanoi has publicly endorsed it. In November 2015, the two sides agreed to expand bilateral trade, especially border trade, as northern Vietnam became part of China's supply chain. The two sides have also agreed to promote, though not link, China's BRI and Vietnam's 2004 Two Corridors and One Economic Belt development strategy. In November 2017, Vietnam and China signed a MOU on the joint implementation of the China's BRI and Two Corridors and One Economic Belt, in addition to creating an infrastructure cooperation working group and a finance and currency cooperation working group. Vietnam's top leadership attended both BRI forums in 2017 and 2019.

But privately the leadership and policy advisors have expressed grave doubts. The 2017 MOU has gone mostly un-implemented for several reasons.

First, as mentioned above, Chinese loans are not cheap. For example, Chinese ODA loans carry very high interest rates, on average 3 percent annually. This is significantly more than Japan (0.4-1.2 percent), South Korea (0-2 percent), or India (1.75 percent).

Preferential credit loans from China are similar to export credit, which is conditional on the recipient country adhering to a number of project-related demands regarding the use of Chinese contractors, among other stipulations, coupled with less attractive loan terms compared to other donors. In many cases, this makes the actual cost of the loan much higher than it would be in the event of an open and competitive bidding process. Moreover, Chinese loans are subject to a 0.5 percent commitment fee and 0.5 percent administration fee. The loan duration and grace period are shorter than those from other lenders, by 15 and five years, respectively.

Second, Chinese loans come with a lot of additional conditions, including the project design and management by Chinese SOEs, the purchase of Chinese technology, and the use of Chinese laborers, many of whom never return to China, causing local resentment.

Third, Chinese firms have an awful track record for delays, lack of transparency, cost overruns, environmental damage, poor construction quality, and high maintenance costs. The Cat Linh-Ha Dong railway in Hanoi, a $866 million project, is the latest example of a Chinese infrastructure project gone sour, and the source of considerable public animus.

Indeed, in the AidData report, Vietnam was the fifth-slowest country for the completion of Chinese-funded projects, with an average of 1,783 days (4.9 years) for each project. Of the top 10 countries with BRI infrastructure projects that have been publicly linked to "scandals, controversies, or alleged violations," Vietnam is ranked fourth, with five projects worth $2.75 billion.

Political Will

So why does Hanoi continue to seek Chinese lending? In part it is a political calculation, hoping that being tied more closely to China will limit Beijing's bullying and aggression.

Hanoi has not expressed any public concern about being caught in a "debt trap" with China. Its debt load remains manageable and the economy is growing sufficiently to service the debts. Unlike Laos, Vietnam has plenty of sources of capital.

But Vietnam's concerns are clearly warranted. Hanoi has limited its sovereign debts to China. It has encouraged non-sovereign engagements, through commercial banks, state-owned enterprises, and even private companies, in order to reduce its political risk. Together sovereign debt and OOF loans to China come to 6 percent of GDP, according to AidData.

Although Indonesia in absolute terms has received the most Chinese loans in Southeast Asia, the situation of Vietnam appears more concerning in relative terms. While low, Vietnam's sovereign debts and OOF as a proportion of GDP is lower only than Laos, Cambodia, Brunei, and Myanmar.

As long as Vietnam can service Chinese lending, even at extremely high interest rates, the repo man won't come knocking. But if and when he does, the leadership in Hanoi should expect an enormous backlash from its nationalist citizens, who have high levels of mistrust of China.

That's Hanoi's real political risk.

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