



China's Foreign Debt

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<http://www.ck-wong.ca/china/chinas%20foreign%20debt%2020051022.pdf>

Introduction

There is a veil on the inner operation of China economy. We know, at the international level, she continues to purchase the US T-bill. She also has another 9+% GDP grow quarter. However, how do her entrepreneurs raise foreign capital? With a rare chance, some data has been reported: there is U\$148.3B foreign debt for first half of 2005, an increase of 77%

Where is the debt coming from?

China's low cost labor market has driven the international commodity prices towards deflation. The trade surplus is well known. It is interesting to see where is this U\$148.3B foreign debt come from.

When the order of Wal-Mart hit China, the payment of the work is not a debt. It is a debit trade because the Wal-Mart has to pay the Chinese manufacturer. The money is an inflow.

There is no systematic report on the foreign borrow. The following is a few observations.

The debt could come in a few situations. The most obvious one is loan. Loan from outside China is the financial assistance. Most of the times these loan are investment.

Others are trade credit which is about 53%.

Strong FX Control

Unlike the American, China is still a state planned and controlled country. The proactive control of the trade to ensure trade surplus is a very important role to guarantee the continuous growth of China without uncontrolled foreign debt.

The most effective way is through foreign exchange control. By doing so the country could monitor the inflow and outflow of the money.

The State Administration of Foreign Exchange (SAFE) considers a continued up trend in foreign debt may threaten the nation's stable economy growth. I would say the real threat is losing the majority control to foreigner.

Under the current regulation, foreign ownership could not exceed 20% but may be increase as China wants to draw more foreign investment in China.

The combination of ownership and close monitoring the inflow of money through foreign exchange could prevent the lost of majority control of the fast growing companies. This could be seen as a backward, non-free trade, and unpalatable policy but China has too much bad experience. Protectionism is needed to ensure history does not repeat itself as often.

This also reflects the level of maturity of entrepreneurs are not self-sufficient enough to maintain the Chinese ownership. In time, this policy may further relax but it would not before China has tried out all the economic policies and find them satisfactory. It should also important to avoid any speculative forex activities to be gained during the China exchange revaluation.

Compulsory forex sell

When the companies received the forex, they are obligated to sell a large portion to designated banks. China needs the forex to create its reserve to back up the RMB. She would continue to do so in a much more eager way. With the basket of money to represent the value of RMB, China needs a considerable amount of forex to stabilize the exchange rate.

On top of this, China needs the foreign exchange to continue the T-bill purchase and to offer the required forex for state owned companies to purchase foreign assets.

New form of debts

There is also a very interesting ruling starting in December in China that import payments of no less than US\$200,000 that are delayed 180 days or longer after delivery will be treated as foreign debt. This new regulation is significant in two ways. We could watch the going up or down of the amount to observe the size of the trade. Second it could also a barometer to measure the government's confidence on Chinese entrepreneurs' business skills.

Resources

[1] "Measures to contain increase in foreign debt" by Feng Jie, China Daily, 2005.10.22
http://www.chinadaily.com.cn/english/doc/2005-10/22/content_486990.htm