Research on China's Foreign Debt Risk Analysis and Evasion Countermeasures

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Abstract: Foreign debt plays an important role in making up for the lack of state construction funds and promoting the rapid development of the national economy. However, since the 1990s, China's external debt has grown in size and has become a world debtor. How to manage this huge amount of assets and safeguard national interests has become a major problem facing our authorities. Based on this, this paper analyzes the risk of my foreign debt and gives the countermeasures. Firstly, it outlines the external debt, introduces its definition, role and negative impact, then clarifies the current situation of China's external debt, and then analyzes the risk of holding huge US treasury bonds in China, and then elaborates on the causes of China foreign debt risk. Finally, based on this, the evasive countermeasures are proposed, which is of great significance for the prevention of foreign debt risks.

1. Introduction

Since the reform of the exchange rate system in China in 1994, with the rapid growth of foreign trade, China's foreign exchange reserves have also increased, becoming the country with the largest foreign exchange reserves, and foreign exchange reserve assets are mainly concentrated on US treasury bonds [1]. In recent years, the global financial crisis, the outbreak of the debt crisis, the quantitative easing monetary policy of the United States, the downgrade of the US bond sovereign credit rating, and the debt ceiling crisis have all contributed to the decline in the credibility of US bonds, and the prospects are worrying [2]. As the biggest holder of the bond, China is particularly important to avoid and control the risk of US treasury bonds.

2. External Debt Overview

2.1 Definition of External Debt

External debt refers to the existing, but not contingent, of all residents of an economy at a certain point in time, and the unpaid portion of the interest and or the principal amount of the debt to be paid at a certain point in the future. The creditor is a non-resident of the economy. The Chinese government defines foreign debt as a debt that has a contractual repayment obligation for domestic institutions (hereinafter referred to as “borrowers”) to foreign institutions, individuals and non-residents in China [3]. “Domestic institutions” here refers to permanent establishments established in China within the law, including but not limited to government agencies, financial institutions, enterprises, institutions and social groups. “Non-residents” here refers to institutions outside China, natural persons and their non-established institutions established in China within the law.

2.2 The Role of External Debt

2.2.1 Raising financial funds and balancing income and expenditure

With the development of a country's economy and the expansion of the state's fiscal functions, it is inevitable that there will be insufficient financial funds in a certain period. The borrowing of foreign debts can make up for the lack of construction funds [4]. The timely borrowing of a certain amount of foreign debt can not only make up for the fiscal deficit, but also avoid the method of overdrafting to the bank to make up for the additional currency and inflation caused by the deficit. For example, in a certain period of time, the national key projects such as energy and transportation require a large amount of funds. It is difficult to meet the budgetary funds alone, and it is necessary to introduce foreign capital to make up for it. If the foreign capital introduced is in line with the external debt conditions, it constitutes an external debt.

2.2.2 Regulating the domestic industrial structure

Foreign debts generally specify investment projects, such as the World Bank energy and transportation projects to eliminate the "bottleneck" phenomenon of the national economy, and poverty alleviation projects are specifically used to develop economically backward areas [5]. This is beneficial to regulating the industrial structure of a country, promoting mutual support among the various industries of the national economy, and achieving sound development. Moreover, the development of backward areas is conducive to further balancing regional economic development, preventing widening gaps between regions and contributing to social stability. In addition, the borrowing of foreign debt into the national economic development plan and the strict monitoring of foreign debts are conducive to the state's macroeconomic regulation and control, reducing blind investment and redundant construction, and optimizing the industrial structure. Therefore, external debt is an important means for the state to carry out macroeconomic regulation and control.

2.2.3 Improve the liquidity in international payments

Borrowing foreign debt can directly increase the income of a country's international balance of payments. These foreign exchange earnings will help to improve the country's external payment capacity and international liquidity, while using external debt for productive investment, developing bottlenecks and exporting foreign exchange earning industries, can promote the adjustment of domestic industrial structure, increase the production of imported substitute products, and reduce Imports, saving foreign exchange, can also produce export products, improve the ability to earn foreign exchange through exports, and improve international payment capabilities.

External debt is a double-edged sword. It has both positive and negative aspects. The foreign debts are not as good as possible. The scale of foreign debt must maintain a certain ratio with foreign exchange reserves and the level of development of the national economy. Borrowing foreign debts must not only consider repayment ability, but also consider whether foreign debt can be used effectively and play its active role. Therefore, the borrowing, use and repayment of external debt must be effectively managed. Poor management will inevitably have a negative impact on the country and should be avoided as much as possible.

2.3 The Negative Impact of External Debt

2.3.1 Increase the cost and risk of debt service

The external debts vary in form, with medium- and long-term external debts, short-term external debts, low-interest, ancillary government or international organization external debt, and high-interest commercial external debt [6]. In order to improve the utilization efficiency of foreign debts, we should minimize short-term external debts, increase medium- and long-term external debts, and strive for low-interest aid loans. For commercial foreign debts with higher interest rates, we should maintain an appropriate scale. And as far as possible, the foreign debt is less affected by the loss of interest rates and exchange rates. Optimizing the external debt structure is conducive to increasing the income of external debt and reducing the cost of debt service.

2.3.2 Leading the external debt crisis

The borrowing of external debt should be done according to the state's economic development and economic affordability. A moderate external debt scale is conducive to promoting economic development. If the scale is too large, the long-term borrowing will increase the net balance of the external debt. If the borrower fails to meet or is unable to repay the foreign debt, the ultimate debt service burden will ultimately be borne by the state [7]. If the economic strength of external debt is unbearable, it will lead to a debt repayment crisis, which will not only affect the country's external reputation, but also have a devastating impact on economic stability. The history and lessons of the debt crisis caused by the out-of-control and mismanagement of external debt in many developing countries deserve to be taken as a warning.

2.3.3 Affecting foreign exchange balance

The external debt should be mainly used in the infrastructure and construction with weak national economic development, or in industries that can earn foreign exchange through exports and indirectly promote foreign exchange earnings through exports, so as to be able to achieve self-sufficiency in debt-servicing foreign exchange. If a large amount of external debt is not invested in basic industries and sectors, and overall promotes economic development and structural upgrading, and cannot directly or indirectly form foreign exchange earning capacity, then debt repayment needs to be supplemented from other foreign exchange earnings by the state.

3. China's Foreign Debt Status

The data shows that as of the end of December 2018, the balance of China's full-caliber (including local and foreign currency) foreign debt was 1,348.7 billion yuan (equivalent to US$195.2 billion, excluding external liabilities of the Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan, the same below), compared with 2017. At the end of the year, it increased by 207.3 billion US dollars, an increase of 12%.

The National Chief Economist said that in 2018, the scale of our foreign debt continued to grow, and the growth rate generally slowed down. Among them, in the first four quarters of 2018, the quarter-on-quarter changes in foreign debt scale were 7.5%, 1.5%, 2.7% and -0.2%, respectively. Among them, the growth rate was the fastest in the first quarter, and the growth rate in the second and third quarters was obviously slowed down. At the same time, the external debt structure continued to be optimized. From the perspective of currency structure, the foreign currency of the local currency increased by 16% year-on-year, which is higher than the foreign currency foreign debt of 10%. From the perspective of the term structure, the medium- and long-term foreign debt growth rate was 13%, slightly faster than the 11% growth of short-term foreign debt; Debt instruments are mainly due to the increase in debt securities, currency and deposits, trade credits and advance payments, which accounted for 44%, 23% and 20% of the growth in external debt, respectively.

The data shows that from the institutional sector, the general government debt balance is 1,514.1 billion yuan (equivalent to 232.3 billion US dollars), accounting for 12%; The central bank debt balance is 203 billion yuan (equal value of 29.6 billion US dollars), accounting for 1%; The bank debt balance was 6.1683 billion yuan (equivalent to 888.7 billion US dollars), accounting for 46%; The other department's debt balance was 406.49 billion yuan (equal value of 592.3 billion US dollars), accounting for 30%; Direct investment: intercompany loan debt balance is 1,457.4 billion yuan (equivalent to 212.3 billion US dollars), accounting for 11%.

At the end of 2018, China foreign debt debt ratio was 14.4%, the debt ratio was 74.1%, the debt service ratio was 5.5%, and the ratio of short-term foreign debt to foreign exchange reserves was 41.4%. The State Administration of Foreign Exchange believes that the above indicators are all within the internationally recognized safety line, and the risk of foreign debt is generally controllable.

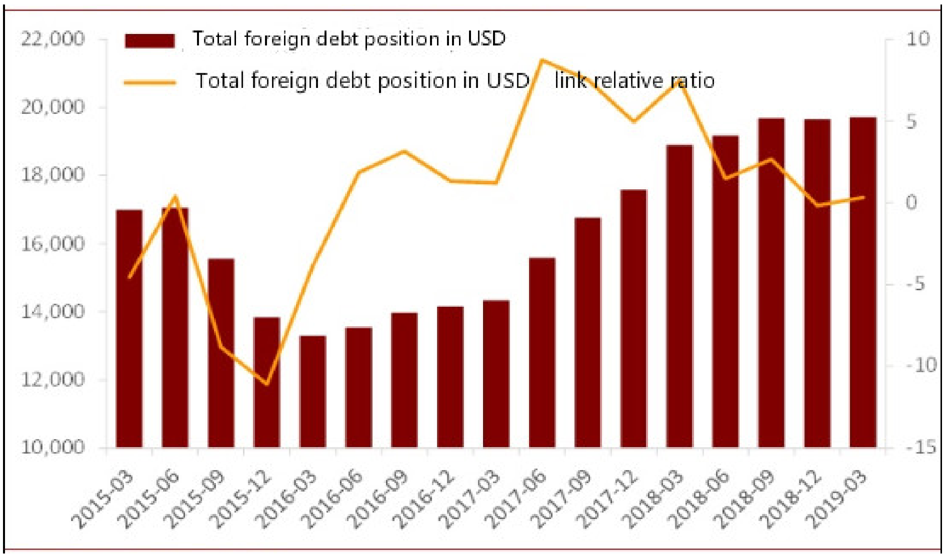

Figure 1. Total foreign debt of China

4. The Risk of Holding Huge Amounts of Us Treasury Bonds In China

4.1 USD Depreciation Risk

In order to solve the "double deficit" problem of finance and trade, one of the methods adopted by the United States is to increase the issuance of the US dollar and depreciate the US dollar. This will reduce the actual debt of the United States and the nominal debt of its creditor countries will not changes, while creditor countries will lose some assets in the process. Since there is no such policy in the world today to protect debts from actual value, China will undoubtedly face the risk of depreciation of the US dollar as the first largest country [8]. In addition, in 2016, Standard & Poor's downgraded the US bond sovereign credit rating from AAA to AA+, indicating that the US national credit declines and the security of US debt is questioned, which will inevitably affect the enthusiasm of global investors to purchase US treasury bonds. A large-scale depreciation of US treasury bonds is a major loss for China.

4.2 USD Inflation Risk

Inflation of the US dollar has both internal internalities in the United States and externalities in areas outside the United States. The US government does not need to take any responsibility for US dollar inflation outside the homeland. This means that the US government will not mind the massive export of dollars and will not care about dollar inflation in other regions outside the homeland. The United States has gradually realized the transfer of wealth by using the time difference and speed difference of inflation. China has purchased a large amount of US treasury bonds, and its dependence on the United States has gradually increased. Therefore, China has become the main target of US export of US dollar inflation without knowing it.

4.3 Risk of Debt Repayment

Because of its strong comprehensive national strength, the United States has long been the most important world currency. Many sovereign countries in the world, including China, have made US treasury bonds an important part of foreign exchange reserves [9]. The US government also relies on a large number of issued government bonds to make up for the huge funding gap, making it more and more external debt. In recent years, the economic growth of the United States has been slow, and it is difficult to support the huge demand for debt repayment. The current economic adjustment and policy reform prospects are not clear. With the decline of the US's own net assets and the increasing debt, the US debt repayment risk will continue to increase.

4.4 Risk of Realizing Foreign Exchange Reserves

The investment of foreign investors, China's foreign debt, trade surplus, and income from international tourism are counted as China's foreign exchange reserves. Foreign investors and domestic investors will undergo frequent exchanges. In order to maintain a normal economic order, China will certainly allow foreign exchange reserves to meet the needs of exchange. The reason why the liquidity of China's foreign exchange reserves is relatively low is because US treasury bonds occupy a very high proportion in our foreign exchange reserves, and our foreign exchange reserves are relatively single. When foreign investors suddenly withdraw from China, we will be forced to sell a large number of US debts, which will lead to a sharp drop in the price of US debt, and China will therefore bear a high cost of realizing.

4.5 China's Monetary Policy Implementation Risk

For a large amount of US treasury bonds, it is necessary to put a corresponding amount of RMB in the value of the US dollar. The depreciation of the US dollar in a short period of time will inevitably affect the smooth implementation of China's monetary policy. If the dollar depreciates, the excess RMB that China has put into the market before will trigger inflation. In addition, in order to cope with the RMB issuance caused by huge US Treasury bonds, the People's Bank of China needs to adopt a tight monetary policy to control domestic excess liquidity, but the increase in interest rates will trigger the international society to arbitrage the RMB, thus affecting the implementation of tightening monetary policy [10].

5. The Cause Of China's External Debt Risk

5.1 Risk Prevention Awareness Is Weak

Since China’s external financing for medium and long-term external debt has been implemented in a window system, it is mainly financed by the Ministry of Finance and financial institutions, and then transferred to enterprises. This model is easy to weaken the responsibility of the company's external debt, and the awareness of preventing risks is relatively weak. According to authoritative surveys, the risk management status of foreign debt enterprises is divided into three categories: 55% without risk management; 27.5% for risk management, but not for single mode; 17.5% for relatively complete management.

In this survey, about 12% of enterprises rarely consider foreign debt risk when borrowing foreign debt; 88% of enterprises consider external debt risk when borrowing, but only 50% of enterprises have special departments and personnel responsible for external debt risk management work. The main reasons are reflected in:

1) The enterprise's awareness of external debt risk management is weakened and insufficiently valued. Foreign debt risk management is not an important part of enterprise management. The awareness of active management of external debt is not strong, and the responsibility is poor. It is not sensitive enough to changes in international capital markets.

2) The measures for external debt risk management are single, lacking overall planning, systematic and comprehensive management. Failure to comprehensively consider the exchange rate, interest rate, currency and foreign debt and whether the foreign exchange earnings of enterprises match, cannot achieve the purpose of optimizing the external debt structure.

3) External debt risk management is a professional and technically difficult task, and is closely related to the trend of international financial markets. Most enterprises lack talents who are familiar with the operation of international finance and international capital markets, and the relevant professional knowledge of corporate finance personnel is insufficient.

4) The financial management level of the enterprise is not high. Due to the fact that the financial management model of the enterprise formed under the planned economy has not yet fundamentally changed, the financial management of many enterprises still stays in simple capital transactions and accounting treatment, and the efficiency and risk of using funds. It is more intuitive to use the

method of “low borrowing and higher” to reduce the cost of external debt, and it is easier to get support from the decision-making level of enterprises. However, the application and effect of foreign debt hedging instruments such as cross currency swaps are more difficult to understand and evaluate.

5.2 Unreasonable External Debt Structure

Among the sources of borrowing foreign debt in China, mainly foreign government loans, international financial organization loans and international commercial loans, the first two types of loans are generally of an aid nature. The characteristics of loans are that the interest rates are more favorable and the use period is longer. International commercial loans are general international credits. The interest rate is determined by the market and is usually high. The loan term is mainly in the short and medium term. Therefore, if the proportion of international commercial loans is too large, it will inevitably increase the cost of debt and increase the risk. Since the 1990s, although the Chinese government has strictly controlled the growth of commercial loans, in the foreign debts, the proportion of foreign government loans has not changed significantly, and the proportion of international commercial loans still dominates.

5.3 Unsatisfactory Use of External Debt

The effective and full use of external debt can not only promote economic growth, but also enhance its solvency. The efficiency of the use of foreign debt can be measured by the growth rate of external debt and the growth rate of GDP. If GDP grows faster than the growth rate of foreign debt, it indicates that the external debt utilization efficiency is high and the solvency is enhanced. Conversely, if the growth rate of GDP is lower than the growth rate of foreign debt, it indicates that the utilization efficiency of external debt is not high and the solvency is weakened. Comparing the growth rate of China's foreign debt and GDP, we can see that the overall efficiency of my foreign debt utilization is not high, and the potential solvency is weak.

5.4 Fluctuations in International Financial Markets

In the international financial market, fluctuations in basic financial variables such as interest rates and exchange rates will cause units that borrow foreign debt in China to face exchange rate risk and interest rate risk, and increase financial costs. This mainly includes exchange rate risk and interest rate risk. The exchange rate risk of external debt refers to the loss caused by foreign exchange fluctuations due to exchange rate fluctuations. Exchange rate risk is transmitted through the structure of the external debt currency. Since there is a period of time between the external debts from borrowing to debt repayment, the exchange rate in the international financial market is unpredictable, so the exchange rate risk is objective. According to the exchange rate risk theory, countries or regions with a single foreign currency structure have a greater exchange rate risk. China's external debt is mainly concentrated in the US dollar and the Japanese yen. The risk dispersion of the debt burden does not reflect the principle of diversification. The exchange rate changes between the US dollar and the Japanese yen may cause debt risks and increase China's debt burden. In particular, the yen debt, due to its high proportion, is low in China's export settlement. In recent years, the yen exchange rate has been fluctuating and rising, and the uncertainty has increased, which has caused my foreign debt to bear greater exchange rate risk. Interest rate risk refers to the increase in financial costs or loss of profit opportunities by borrowing foreign debt units due to fluctuations in market interest rates. For units borrowing foreign debt, if the interest rate rises when the debt is repaid, the interest cost of the floating-rate debt will rise correspondingly, exceeding the cost budget when borrowing; on the contrary, if the interest rate falls, the fixed-rate debt cannot enjoy the interest rate drop. The benefits of reduced interest rates have lost profit opportunities.

5.5 The Debt Fund Allocation Mechanism Is Unreasonable

Due to the multi-channel and multi-sector management of the external debt management system, the establishment, approval, introduction and use of foreign debts are carried out in a long way. The rights, responsibilities and profits of various departments are not clear, and there is a lack of communication and information exchange between various departments. And the lack of proper supervision in management has created a chaotic phenomenon in the use and management of external debt funds. First of all, the foreign debt declaration and examination and approval department only pays attention to the project of the higher-level branch control department, and runs the approval documents. However, the use of funds is rarely questioned, and thus it is impossible to talk about supervision and management. Secondly, the introduction of foreign debt projects, according to different departments scattered in different local professional banks and functional trust investment companies, the number of foreign investment and the direction of the use of funds cannot be unified management and effective supervision, and some places introduced to local foreign investment. There is no clear statistics on the number and projects, let alone effective supervision. Once again, there is a lack of supervision over the allocation and use of external debt funds for constructive and non-constructive funds, especially the lack of understanding of the quality and price of external debt fund procurement equipment, and there is no effective supervision.

6. China's Foreign Debt Risk Aversion Countermeasures

From the perspective of foreign financial risk prevention practice, the risk management of external debt must implement double-layer risk control, that is, the government and foreign debt enterprises coordinate and cooperate, and the two-pronged, flexible coordination of external borrowing, use and repayment, to achieve "the lowest cost, moderate external debt risk management objectives of scale, risk minimum, best benefit, returning and maintaining credit on time".

6.1 Strengthening the Risk Supervision of Foreign Debt Enterprises

The security of corporate external debt is the basis for the country's overall external debt security. For a long time, in order to ensure external repayment, the Chinese government has been implementing a window system for external financing of medium and long-term external debts. It is mainly financed by the Ministry of Finance and financial institutions, and then transferred to enterprises. Although the external debtor is the Ministry of Finance or a financial institution, in fact, the real main body of loan and loan repayment is the enterprise. Among China's medium and long-term foreign debts, government departments, Chinese-funded financial institutions, and Chinese-funded enterprises have undertaken more than 80%. Among the debts borne by government departments and Chinese-funded financial institutions, except for the foreign debts issued by the Ministry of Finance and the small amount of external debts adjusted by the banks, most of them were transferred to state-owned large and medium-sized enterprises for capital construction and technological transformation. Once a company has difficulties in repaying debts, it will inevitably be passed on to banks and finances, affecting the country's overall external debt security. Therefore, the management of foreign debt risk of state-owned large and medium-sized enterprises is the focus of China's external debt risk management.

6.2 Establishing an External Debt Management and Management Organization

At present, China's foreign debt management still has the drawbacks of long-term management. Therefore, macro-foreign debt control must be strengthened from the establishment of organizational structure. The formation of an external debt management system is a top priority. In the management of foreign debt lenders, the remaining debts of bankrupt financial institutions should be properly handled and the changes in the international financial market should be closely monitored, the debt structure should be actively adjusted, and various financial instruments should be used to avoid exchange rate and interest rate risks. On the other hand, we should try our best to reduce the cost of borrowing funds from the international market. According to the overall ratio of assets and liabilities and risk management, we should choose financial institutions with good asset quality and high international credit rating as our external financing window and reduce our country overall external funding costs.

6.3 Strengthening the Use and Benefit Management of Borrowing External Debt

Under the current system of China, the four links of “borrowing, using, earning, and returning” of foreign debt are sometimes out of touch. "Borrowing," "using," and "returning" are certain, but the benefits are not assessed. In the future, while strengthening the statistics and monitoring of external debt, we should strengthen the management of the use of external debts and establish a set of assessment management system for the use of foreign debts to assess the effectiveness of external debt. In the management of foreign debts, a unified loan-to-loan approach should be established to regulate the transfer of foreign preferential loans, to limit the spread of interest rates, to arbitrarily shorten the loan-to-deposit period, to prevent and reduce the arbitrariness of transfer loans, and to provide preferential conditions for foreign loans.

6.4 Controlling the Scale and Structure of External Debt

The introduction of external debt is mainly to alleviate the shortage of domestic funds. The leading role in investment activities should always be domestic capital. Therefore, China should fully investigate and predict the current supply and future supply of domestic capital, and may under the premise of making the most accurate estimates of economic benefits and costs, determine the scale of short-term and long-term external debts. In addition, the control of the scale of external debts should be carried out through indicators such as debt service ratio, debt ratio to scientifically determine external debt scale and total. China's financial market is still an emerging market, and systemic risks are large. Therefore, the government has always implemented strict external debt program management, encouraging FDI's capital inflow form, and rapidly expanding the scale of foreign debt. In terms of the structure of foreign debt, China The government should maintain a relatively reasonable proportion of short-term liabilities in the control of short-term external debt, and ensure the stability and healthy development of the economy.

6.5 Promote Diversification of Borrowing Entities

Although China does not have a global debt repayment risk, local debt repayment risks and potential debt repayment risks exist. China should further improve the external debt repayment fund. In addition, China should optimize the main structure of borrowing and develop borrowing from non-state entities. Foreign loans to domestic enterprises should be gradually deregulated. Borrowings below a certain limit can be freely handled, but the state does not assume responsibility for repayment .On this basis, the state-to-business foreign debt management gradually shifted from prior planning approval to post-event dynamic analysis.

7. Conclusion

Since the reform and opening up, with the development of the national economy, the state's fiscal functions have been expanding, and to some extent, there have been insufficient financial resources. Although the fundamental solution to this problem is to develop productivity and improve economic efficiency, development of production requires more investment. The construction funds can make up for the insufficient funds of the national key construction projects by borrowing foreign debts, and can also introduce foreign advanced technology, advanced equipment and management experience. Foreign debt can also make up for the fiscal deficit and avoid or delay inflation. Foreign debt is a better financing method when international capital is abundant, the international political environment is good, and borrowing conditions are favorable. However, at present, there are still many problems in the risk management of foreign debts in China. In the future, we must strengthen the assessment and avoidance of risks, so as to better promote China's economic development.

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