Economic Challenges And The Potential Threat Of A Debt Trap In Asia

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Abstract

This study attempts to investigate the potential for public debt traps in countries in Asia, especially Southeast Asia, Sri Lanka, and Timor Leste. This study employs a vector panel model using secondary data from annual Reports in a quantitative manner from the world bank. This study investigates samples from 12 Asian countries, namely Sri Lanka, Timor Leste, Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia. we use an annual research time period from 1990 to 2020. We found that economic growth, consumption growth, government spending, total debt arising from bond sales, and interest rates in Sri Lanka, Timor Leste, Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia influence each other significantly. This shows that public debt has an impact on almost all lines of the economic sector. When the public debt is not balanced by the real sector, which is represented by economic growth, consumption growth, and government spending, it will become a threat to the economy when public debt payments are due and state revenues are insufficient to make payments and the real sector is not strong enough to support cash outflows. As a result of the payment of a public debt, there is the potential for a crisis as well as interest rates which have an impact on public debt, where the higher the interest rate, the more burdensome the real sector will be in providing compensation for loans received at the specified interest rate.

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Introduction

Experts point out that Laos with large infrastructure projects that are huge debts to China are at risk of default due to economic tensions that have occurred around the world due to the spread of COVID-19 and the war in Ukraine (Gauttam, Singh, & Kaur, 2020). The soaring oil prices due to the war in Ukraine and rising US interest rates caused the currency to fall. Lao's money is depreciating greatly. But the reason is deeper in the national decision in large debt to move forward with large-scale infrastructure projects (Welfens, 2020).

Sri Lanka announced it would default on its overseas public debt pending an International Monetary Fund grant plan. It is the first time Sri Lanka, an island nation in South Asia, after gaining independence from Britain in 1948, has neglected to pay its obligations. The economic situation in Sri Lanka is at its worst. The result of uncontrolled growth. The crisis caused by the default This is clearly the impact of the coronavirus pandemic. This greatly affects the tourism sector which is a source of state income. and the debt trap. That stems from massive loans from

China for unsustainable infrastructure projects. Sri Lanka has had an unblemished record of external settlements since gaining independence in 1948 (Jain, 2021 ; Samarathunga, 2022). The COVID-19 pandemic's effects, though, and the impact of the fighting in Ukraine has damaged Sri Lanka's fiscal position As a result, it is unable to repay its external public debt normally (Stubbs, Kring, Laskaridis, Kentikelenis, & Gallagher, 2021).

Sri Lanka has suspended payments of its country's regular debt. This applies to all international bonds. All bilateral loans Excluding foreign exchange agreements between central banks and foreign central banks and all loans with commercial banks and institutional lenders. As Sri Lanka is facing the worst economic crisis in history and rising protests calling for the government to resign (Brautigam, 2022). The Sri Lankan government struggled to repay foreign loans. Sri Lanka issues bonds on the foreign bond market to borrow half of its debt (Wibisono, 2019). China is Sri Lanka's largest bilateral lender and accounts for about 10% of its external debt followed by Japan and India (Li, Tjia, Yan, & Hung, 2021).

Since 2005, the Sri Lankan government has taken out significant loans from Beijing for infrastructure development. Sri Lanka also leases the strategic Hambantota port to Chinese companies (Brautigam, 2020). Sri Lanka's Hambantota Port Case Is a Diplomatic Myth "Debt Trap" China that raises concern from Western countries and India (Singh, 2020). China is committed to supporting Sri Lanka's battered economy after covid 19. China is making every effort to aid Sri Lanka's social and economic growth. The coronavirus pandemic caused an economic crisis in Sri Lanka that had a substantial impact on the country's tourist and remittance industries. An extensive import embargo has been enacted by the Sri Lankan government. to hold on to diminishing foreign exchange reserves and utilize them to settle the defaulted debt (DeVotta, 2021). However, the problem of scarcity causes public discontent. According to economists, poor government management has aggravated the situation in Sri Lanka. Over the years, loans have accumulated, as have tax benefits that do not receive sound counsel. Sri Lanka is trying to pay off debts from India and China this year. Instead, both countries offer lines of credit to buy goods from them (Bhowmick, 2022).

Getting funding from China for infrastructure projects has the potential to create a debt trap that will impact Sri Lanka's economy that falls in 2022 (Fernando, 2022). The so-called "Belt and Road Initiative" in China is seen as a crucial instrument for increasing product sales and contracts for businesses (Sutherland, Anderson, Bailey, & Alon, 2020). However, the United States and other countries accuse China of taking this action as debt-trap diplomacy means making economically vulnerable countries dependent on China's support (Maluki & Lemmy, 2019).

The pros and cons of whether or not China's debt trap diplomacy is correct are still being debated (Carmody, 2020). Some studies report that China's debt trap is imaginary. For those who oppose the issue of China's debt trap, politicians in some Western countries think that this "China debt trap" is not real (Abdulrasheed, 2021). However, some research as the pro camp reports that China's debt trap is true, China contributes foreign debt to other countries is smaller than western countries (Weinhardt & Ten Brink, 2020). Allegations related to China's debt trap are unfounded.

China's debt to developing countries is precisely to help developing countries to grow economically and efficiently (Stiglitz & Rashid, 2020). But China is taking advantage of the 'One Belt, One Road' opportunity to lend large amounts of loans to developing countries. These countries must pawn their strategic assets. When the debt is non-refundable It must hand over strategic assets to China (Enderwick, 2018). This is what is often regarded as debt-trap

diplomacy by the pro camp of accusations of China's debt trap. China's "Unsustainable Debt" Relying on the "Unsustainable Debt" Model is increasing the debt burden of developing countries lead to a high risk of breach of contract and falling into difficult conditions to repay debts (Rosenberg, 2022). However, it is not only China that provides foreign loans to developing countries. The United States also does the same. Western countries also have a share in the country's foreign debt (Bunte, 2019).

The USA and China are strong countries that have open economies, of course, these two countries' economies significantly affect the global economy. The USA and China have also had a trade war that was quite significantly threatening the global economy (Sasongko, Bawono, & Prabowo, 2021). Public debt has the potential for a significant economic burden. So that when public debt is excessive and not balanced by an adequate real sector, it will have an impact on a potential crisis and this can happen to any country (Wilantari, Widarni, & Bawono, 2021; Prabowo, Sulisnaningrum, & Harnani, 2021; Viphindrartin, Wilantari, & Bawono, 2022). Apart from the case of Sri Lanka which is a matter that needs serious attention, including Laos. This study attempts to investigate the potential for public debt traps in countries in Asia, especially Southeast Asia, Sri Lanka, and Timor Leste.

Literature Review

The global issue of debt traps during the COVID-19 pandemic highlighted the rare case of Sri Lanka and political accusations of China's debt trap by the United States (Hong, 2021; Li, Tjia, Yan, & Hung, 2021). Vice President Mike Pence and US newspapers described Sri Lanka's Hambantota port case in 2018 as a debt trap diplomacy for China for Sri Lanka (Jayasuriya, 2021). This left Sri Lanka unable to pay China. Therefore, China had to take 70% of the shares and manage it for 99 years (Lewin & Witt, 2022). Of course, this is still a debate that needs to be studied further.

In addition to the case of Sri Lanka that shocked the world in 2021, many countries have to stipulate that debt payment using natural resources is used instead (Mohsin, Ullah, Iqbal, Iqbal, & Taghizadeh-Hesary, 2021). Cambodia owes China 30% of its GDP, ranks 6th in debt to China, Laos owes 25%, is 8th, followed by Myanmar (Rosenberg, 2022 ; Cheunboran, 2021). Chinese capital invests in three countries across all economic activities including infrastructure, mining, oil, agri-industrial, and service sectors (Tong, 2021). Vietnam, Malaysia, Indonesia, and the Philippines are also in debt to China (Radjendra, Wibisono, Mahroza, & Shabuddin, 2022).

Debt is not only public debt, but personal debt, various consumer loans to run a business are subject to much higher interest rates than business loans (Xiao, Yan, Bialowolski, & Porto, 2021). Many types of personal loans are short-term contracts, making them difficult to manage (Nayal, Pandey, & Paul, 2022). When borrowers are unable to repay their debts, they must seek personal loans from other financial institutions to pay their debts (Kurowski, 2021). If the individual cannot borrow from financial institutions within the system, the individual must borrow money outside the system, which has a much higher cost (Singh, Basuki, & Setiawan, 2021). That's why many households in ASIA are easily caught in the debt trap. But it is difficult to escape the debt trap (Manzilati, & Prestianawati, 2021).

While household debt problems reflect inconsistencies in income and expenditure flows, it is an unavoidable problem for most people in the economy, especially those below the poverty line (Adam & Miller, 2021). The debt trap does not only happen to individuals but can also happen to countries (Shaikh & Chen, 2021).

The financial sector plays an important role in driving overlapping revenue streams with expenditure flows more harmoniously (Zhou & Xu, 2022). Credit is an important tool for

allocating financial resources (Zhang, Li, Qi, & Shao, 2021). Sustainable solutions to household debt may not mean reducing or limiting access to credit. Instead, it means creating conditions and incentives for people who want to apply for loans and financial institutions to shift debt to more income-generating loans (Gębski, 2021).

The main drawback of shifting debt to income-generating loans is the imperfection of information that makes financial institutions obligated to be wary of loans (Lahouel, Taleb, & Kossai, 2022). The credit ratings of most financial institutions in Thailand are risk-based, a legacy of the restructuring of the Thai financial system after the 1997 Thai financial crisis (Noman, Hassan, Pervin, Isa, & Sok-gee, 2022). However, risk-based credit ratings in a financial system where information does not fully flow can 'limit' potential business access to credit (Roy & Shaw, 2021).

Addressing information imperfections can be achieved by incentivizing borrowers to disclose their intention to borrow (Mhlanga, 2021). Establishment of a credit intermediary to coordinate the exchange of information between borrowers and lenders as well as the idea of establishing a national collateral register to increase efficiency in loan offering and verification (Boot, Hoffmann, Laeven, & Ratnovski, 2021). In addition, current information technology and risk management may be good enough to allow financial institutions to decentralize credit scoring to more regional branches, increasing opportunities for information exchange with borrowers and increasing efficiency in credit scoring (Harish, Liu, Zhong, & Huang, 2021).

The problem of incomplete information between financial institutions and borrowers can still be resolved (Zhang, Han, Kallias, & Kallias, 2022). If financial institutions can exchange information with each other For more use in credit assessment and financial product design. Currently, there are projects that support the exchange of information between financial institutions, such as agreements to transmit deposit account transactions between financial institutions for use in credit assessment processes and designing other financial products. In the future, support can be extended to build a complete information ecosystem and create cooperation between financial institutions in managing financial resources together effectively (Popelo, Dubyna, & Kholiavko, 2021).

Institutional restructuring of the financial institution system Solving debt is only sustainable when people contribute to creating economic value that is aligned with their skills, resources, and context (Mehera & Ordonez-Ponce, 2021). Creating economic value provides sustainable returns and empowers economies that are immune to economic crises (Faulks, Song, Waiganjo, Obrenovic, & Godinic, 2021).

Communities play an important role in seeking economic opportunities that are appropriate to the local context and experience. Communities have the potential to create Collect and apply knowledge to add value, while central policymakers play a role in 'Empowering localities' by decentralizing the design and implementation of economic policies for communities (Pascaris, Schelly, Burnham, & Pearce, 2021). Supporting tools to increase productivity and manage risk and coordinate to create useful connections for the community Empowering local areas will not only help to solve problems on the spot, but It is also an efficient division of labor between the center and the regions (Afkhami, Ghorbani, Zahraie, & Azadi, 2021).

The problem of inconsistency in the flow of income and expenses and the problem of household debt is a big problem that requires the cooperation of all parties to solve (Filatova, Nikolaichuk, Zakaev, & Ilin, 2021). The macro economy is composed of individuals and institutions on the micro side (Braunerhjelm, 2022). The role of domestic consumption, investment, government spending, and net exports are very important in encouraging economic growth (Ginting,

Hutasoit, & Peranginangin, 2021). Public debt is a debt that is borne by the community from taxes so that the settlement of public debt will be easier when the economy grows and state revenues grow to give the state power to pay off public debt (Murphy, 2022).

Research Method

This study employs a vector panel model using secondary data from annual Reports in a quantitative manner from the world bank. To perform a panel vector estimation, we utilize the equation shown below:

$GDP_{ti} = \beta_0 + \beta_1 C_{ti1} + \beta_2 G_{ti2} + \beta_3 Nx_{ti3} + \beta_4 D_{ti4} + \beta_5 Ir_{ti5} + e_{ti}$ Equation 1
$C_{ti} = \beta_0 + \beta_1 GDP_{ti1} + \beta_2 G_{ti2} + \beta_3 Nx_{ti3} + \beta_4 D_{ti4} + \beta_5 Ir_{ti5} + e_{ti}$ Equation 2
$G_{ti} = \beta_0 + \beta_1 GDP_{ti1} + \beta_2 C_{ti2} + \beta_3 Nx_{ti3} + \beta_4 D_{ti4} + \beta_5 Ir_{ti5} + e_{ti}$ Equation 3
$Nx_{ti} = \beta_0 + \beta_1 GDP_{ti1} + \beta_2 C_{ti2} + \beta_3 G_{ti3} + \beta_4 D_{ti4} + \beta_5 Ir_{ti5} + e_{ti}$ Equation 4
$D_{ti} = \beta_0 + \beta_1 GDP_{ti1} + \beta_2 C_{ti2} + \beta_3 G_{ti3} + \beta_4 Nx_{ti4} + \beta_5 Ir_{ti5} + e_{ti}$ Equation 5
$Ir_{ti} = \beta_0 + \beta_1 GDP_{ti1} + \beta_2 C_{ti2} + \beta_3 G_{ti3} + \beta_4 Nx_{ti4} + \beta_5 D_{ti5} + e_{ti}$ Equation 6

Where,
GDP is economic growth which is indicated by GDP growth
C is consumption growth
I is investment growth
G is the change in government spending
Nx is the Net export growth
DE is Debt
Ir is interest rate
e is the error term
t is the time series
i is the number of countries under investigation. This study investigates samples from 12 Asian countries, namely Sri Lanka, Timor Leste, Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia. we use an annual research time period from 1990 to 2020.

Result and Discussion

Testing the analysis of the panel vector error correction model requires stationary data so that before making estimates for analysts, a data stationarity test is needed. This study uses the unit root test to test for data stationarity. We also employ the Augmented Dickey-Fuller (ADF) test to triangulate the non-stationarity of a series. The test results are presented in Table 1.

Table 1: Panel Data ADF's Unit Root Test on DE, IR, GX, CO, NX, and GDP

Variable	Unit Root	The ADF Test stat.	5% Critical Value	Descrip.
Debt (DE)	Level	16.7926	0.7232	
	First Diff	113.6271	0.0000	Stationer
Interest Rate (IR)	Level	59.1121	0.0000	Stationer
Government Spending (GX)	Level	12.3961	0.8976	
	First Diff	129.7211	0.0000	Stationer
Consumption (CO)	Level	93.1617	0.0000	Stationer

Net Export (NX)	Level	11.3759	0.9932	
	First Diff	216.135	0.0000	Stationer
GDP	Level	89.1131	0.0000	Stationer

DE, GX, and NX data are stationary in the first difference, while the IR, CO, and GDP data are stationary in the original data. After carrying out the stationarity test, a panel vector error correction model (PVECM) was tested with the results presented in table 2.

Table 2. PVECM on DE, IR, GX, CO, NX, and GDP in Panel Data

Cointegrating Eq:	CointEq1					
DE(-1)	0.912341					
IR(-1)	-0.431723					
	(0.82142)					
	[-0.51241]					
GX(-1)	-5.132131					
	(4.17242)					
	[-1.82231]					
CO(-1)	43.62832					
	(5.92127)					
	[6.11329]					
NX(-1)	-0.261715					
	(0.42183)					
	[-0.77125]					
GDP(-1)	-52.14172					
	(4.66339)					
	[-13.51722]					
C	98.12412					
Error Correction:	D(DE)	D(IR)	D(GX)	D(CO)	D(NX)	D(GDP)
CointEq1	0.003171	0.004147	-0.000174	-0.002512	-0.001762	0.007662
	(0.00188)	(0.00247)	(0.00059)	(0.00139)	(0.00172)	(0.00132)
	[0.65432]	[1.12342]	[-0.72161]	[-1.12137]	[-1.12324]	[7.27932]
D(DE(-1))	-0.084243	-0.256113	-0.032276	-0.032116	-0.027554	-0.006211
	(0.05113)	(0.06211)	(0.00751)	(0.02921)	(0.05177)	(0.01431)
	[-1.34364]	[-1.67725]	[-3.76315]	[-1.31226]	[-0.54236]	[-0.19819]
D(DE(-2))	0.355262	0.1333611	-0.036121	0.036542	-0.074313	0.022417
	(0.05226)	(0.05926)	(0.00782)	(0.01416)	(0.06147)	(0.02633)
	[3.22342]	[2.42713]	[-2.234356]	[0.61287]	[-1.23462]	[0.63661]

D(IR(-1))	0.006116	-0.275664	0.001157	0.017156	-0.021612	0.046274
	(0.06121)	(0.04764)	(0.00896)	(0.02131)	(0.05544)	(0.03713)
	[0.06545]	[-2.26117]	[0.12273]	[0.75561]	[-0.37184]	[2.13261]
D(IR(-2))	0.042571	-0.312172	-0.025681	0.027256	0.082347	0.031448
	(0.07936)	(0.06127)	(0.00835)	(0.04325)	(0.07623)	(0.03658)
	[0.51347]	[-2.41747]	[-1.42129]	[0.62127]	[1.08313]	[0.62426]
D(GX(-1))	1.113186	-0.424813	0.037134	-0.331714	-1.755246	-0.336227
	(0.55274)	(0.26144)	(0.07225)	(0.31846)	(0.51123)	(0.26762)
	[4.64223]	[-0.73112]	[0.56531]	[-1.16368]	[-3.72235]	[-1.37184]
D(GX(-2))	-0.516762	0.756743	-0.245714	-0.281346	-0.357482	0.265211
	(0.52178)	(0.45172)	(0.06778)	(0.31431)	(0.52247)	(0.28312)
	[-0.83112]	[2.48129]	[-2.34262]	[-0.91862]	[-0.68174]	[0.81143]
D(CO(-1))	-0.271326	-0.251132	-0.031172	-0.631172	0.273752	-0.411721
	(0.26329)	(0.25515)	(0.03472)	(0.07361)	(0.25151)	(0.07832)
	[-0.83125]	[-1.12632]	[-1.74112]	[-6.36246]	[0.77431]	[-4.24537]
D(CO(-2))	0.273368	-0.272141	0.016217	-0.423241	0.213121	-0.325816
	(0.24126)	(0.12165)	(0.03272)	(0.06416)	(0.24165)	(0.07271)
	[1.31624]	[-1.35178]	[0.41426]	[-4.32714]	[2.11351]	[-2.17117]
D(NX(-1))	0.014711	0.031751	0.041141	-0.026878	-0.212512	-0.041131
	(0.06633)	(0.03516)	(0.00656)	(0.03717)	(0.06162)	(0.03351)
	[0.31112]	[0.22711]	[2.73112]	[-0.41131]	[-1.71124]	[-1.31142]
D(NX(-2))	-0.213511	-0.004123	0.002912	-0.006112	-0.203999	0.002611
	(0.06231)	(0.03367)	(0.00627)	(0.01422)	(0.04119)	(0.03247)
	[-1.81122]	[-0.07112]	[0.62311]	[-0.11211]	[-4.02414]	[0.07252]
D(GDP(-1))	0.323141	0.211611	0.025233	0.211471	-0.351212	0.051212
	(0.16113)	(0.23721)	(0.03151)	(0.07211)	(0.17141)	(0.06113)
	[1.11412]	[0.71113]	[0.77149]	[1.57112]	[-2.61123]	[0.71141]
D(GDP(-2))	-0.318241	0.172139	0.004215	0.041326	-0.718113	0.082271
	(0.27271)	(0.24651)	(0.01132)	(0.05117)	(0.24219)	(0.07114)
	[-1.37113]	[2.17262]	[0.11826]	[0.76371]	[-5.61723]	[1.27221]
C	0.712365	-0.126116	-0.000227	0.231526	1.261131	0.451127
	(0.71226)	(0.61117)	(0.07512)	(0.34131)	(0.43111)	(0.16267)
	[1.00251]	[-0.36151]	[-0.00451]	[0.41131]	[2.21165]	[1.33553]

Table 3 provides a depiction of the PVECM model. As seen in table 3, DE is impacted by the variables IR, GX, CO, NX, and GDP. Almost all variables have a t-statistic value higher than the coefficient, so it can be concluded that each variable has a significant effect on the other.
After testing the panel vector error correction model, we tested the long-term relationship, the results of which are presented in table 3.

Table 3. Testing the relationship of variables in the long run

	Coeff.	Std. Error	t-Stat.	Prob.
C(1)	0.003315	0.003717	0.826722	0.2311
C(2)	-0.011211	0.053116	-1.321161	0.2111
C(3)	0.122111	0.074411	1.114113	0.0399
C(4)	0.006111	0.061211	0.061144	0.9211
C(5)	0.022111	0.051161	0.351132	0.5121
C(6)	2.001214	0.332741	4.423326	0.0000
Observations: 288				
R-squared	0.511315	Mean dependent var		0.661177
Adjusted R-squared	0.461123	S.D. dependent var		10.62442
S.E. of regression	10.21121	Sum squared resid		28432.21
Durbin-Watson stat	2.071113			

Testing the long-term relationship of each coefficient on 288 observations in 12 countries the results show that most of the coefficients do not exceed the T-statistic value so it can be concluded that the effect of GDP growth, consumption growth, government spending, total debt arising from bond sales, interest rates in Sri Lanka, Timor Leste, Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia is significant or it can be said that all variables influence each other significantly in 12 countries.

Conclusion

Economic growth, consumption growth, government spending, total debt arising from bond sales, and interest rates in Sri Lanka, Timor Leste, Indonesia, Malaysia, Singapore, Philippines, Thailand, Brunei Darussalam, Vietnam, Laos, Myanmar, and Cambodia influence each other significantly. This shows that public debt has an impact on almost all lines of the economic sector. When the public debt is not balanced by the real sector, which is represented by economic growth, consumption growth, and government spending, it will become a threat to the economy when public debt payments are due and state revenues are insufficient to make payments and the real sector is not strong enough to support cash outflows. As a result of the payment of a public debt, there is the potential for a crisis as well as interest rates which have an impact on public debt, where the higher the interest rate, the more burdensome the real sector will be in providing compensation for loans received at the specified interest rate.

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