

# Dependence, Power, and Relationships: The U.S.-China Relationship on China's Sovereignty Debt Crisis

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## Abstract

In the world today, as changes unseen in a century are accelerating, the trade dispute between China and the United States has become one of the main forms of strategic competition between the two countries. The world has hit a low point in economic development since the COVID-19 pandemic, and with the declaration of national bankruptcy of Sri Lanka in 2022, the sovereign debt crisis trend seems to be on the rise. China was not seriously affected by the financial crisis in 2008, to explore the reasons, this paper introduces the political factors to construct a new theoretical model of "dependence-power-relationship", and divides countries into two categories: dependent and non-dependent. In the process of analysis, this paper mainly focuses on China-US relations, specifically analyzing how the changes in China-US political relations impact on China's sovereign debt crisis and national economic security, which provides lessons for today's China on the future layout of its economic development, as well as a reference for a wide range of countries facing sovereign debt crises.

## Keywords

Sovereign Debt Crisis; U.S.-China Relations; National Strength.

## 1. Introduction

Since 1800, there have been nearly 230 national bankruptcies worldwide. This century has also seen the bankruptcy of a handful of countries, from the Americas to Europe. National insolvency, a concept introduced by the International Monetary Fund in 2002, refers to a situation in which a country's external assets are less than its external liabilities, which is commonly interpreted as insolvency.

The international economic situation outside Iceland and Sri Lanka in 2008 and 2022 was characterized by high stagflation. the financial crisis in the United States of America in 2008 affected the whole world, and a downward trend in the international economy in 2022 was inevitable under the impact of the New Crown Disease. However, if the international economic situation is the determining factor that leads to the bankruptcy of a country, then all countries should suffer from a sovereign debt crisis in the context of this economic downturn and not just the localized countries such as Iceland and Sri Lanka. Thus, economic factors were not the fundamental factor that led countries into sovereign debt crises; perhaps political factors were the root cause of national bankruptcy.

## 2. Research Background and Research significance

### 2.1. Research Background

The United States issues national debt to the world, forming a huge scale of external debt. Still, due to the international currency status of the dollar, the United States does not break out in a sovereign debt crisis. The U.S. national debt is denominated in the local currency, which allows

the U.S. to have a shallow risk of exchange rate fluctuations and to successfully pass on the debt crisis by printing more dollars to dilute the cost of its debt. Due to international responsibility, international morality, practical considerations, and the non-international currency status of their currencies, other countries and economies are not willing to print their currency, but also unable to transfer the debt crisis. As a result, the sovereign debt crisis happens from time to time, and "national bankruptcy" has become a familiar term in the international community. In recent years, Latin America and Europe have been the hardest hit by sovereign debt crises and "national bankruptcies", presenting serious national debt risks.

The Latin American debt crisis erupted in August 1982 with Mexico's declaration of its inability to repay its external debt as the trigger. Subsequently, Brazil, Venezuela, Argentina, Peru, and Chile had difficulties in repaying their debts and announced the termination or postponement of external debt repayment. The debt crisis put an end to the "Latin American miracle", which had been formed by 35 years of stable development of Latin American countries, and the Latin American economy was plunged into the "lost decade".

In 2008, Iceland became the first country to be described as bankrupt. A year later, the debt crisis in Dubai triggered a domino effect, dragging down the global economy. After Dubai, in December 2009, the trumpet of the debt problem was blown into full swing in Greece. After the Greek government announced that its fiscal deficit and the ratio of public debt to gross domestic product (GDP) had far exceeded the standards stipulated in the European Union's Stability and Growth Pact, the three major global rating companies downgraded the sovereign rating of Greece, and the debt crisis in Greece then intensified, pulling off the prelude to the sovereign debt crisis in Europe. Subsequently, in Ireland, Portugal, Spain, Italy, and other countries the sovereign debt crisis also erupted. Although the debt crisis countries, the European Union and the International Monetary Fund have taken various measures to prevent the further spread and escalation of the crisis, the deteriorating trend of the sovereign debt crisis in Europe has not been effectively curbed, instead, the development of the crisis has a worrying prospect.

## 2.2. Research Significance

At a time of economic globalization and deepening economic interdependence among countries, the sensitivity and vulnerability of interdependence have led to thoughts and concerns about whether the fallout from the worsening of the sovereign debt crisis in Europe will spread to the rest of the world. The sovereign debt crises of the 1980s and 1990s are behind us, but a new round of sovereign debt crises is still occurring, brewing, and developing in this century. This state of affairs has prompted academics to think deeply about the causes, impacts and measures to deal with the current round of crises, and at the same time to conduct in-depth research on the patterns of crisis events, early warning and prevention. However, the current research on the causes of sovereign debt crises remains to be improved.

For a long time, researchers' studies on sovereign debt have focused more on bailout policies after the outbreak of a crisis, such as recommendations on national bankruptcy laws and the improvement of rescue measures by various countries and international organizations. The analysis of the causes of the sovereign debt crisis is also more often attributed to the subprime mortgage crisis in the United States or the structural defects of the system and economy within the crisis. The reasons for sovereign debt crises are analyzed from the economic point of view both inside and outside the country, while seldom analyzed from the foreign political point of view, such as the point of view of international relations.

Although a sovereign debt crisis has not yet erupted in our country, our current potential financial and economic risks are still relatively high. The country's financial and economic development started late, and there are still many unstable and unhealthy factors. The operation of the capital market is not yet standardized, the financial regulatory system needs to be improved, and a systematic protection mechanism has still not been established.

Especially after proposing the Belt and Road initiative, the economic development of China and other Asian, African and Latin American countries are closely linked. Once China falls into a sovereign debt crisis, it will bring a serious economic crisis to the world economy.

Therefore, it is an urgent task for us to explore the causes of the outbreak of sovereign debt crises from the perspective of world politics, so as to better learn the lessons from the countries that have been hard hit by sovereign debt crises, to take appropriate measures to make up for and stop the damage appropriately after the crises have occurred. Therefore, this paper chooses the topic of "Dependence, Power and Relationship: The Impact of Sino-US Relations on China's Sovereign Debt Crisis", which is of great theoretical and practical significance.

### 3. Literature References

What kind of logic is followed and what kind of characteristics are exhibited behind national bankruptcy? The exploration of this important issue, mainly in economics, has long developed a logic of inquiry based on sovereign debt crises. Therefore the literature review in this paper will focus on the main findings of economists and financiers on the definition of national bankruptcy and sovereign debt crises and the causes of their outbreak. Since the theoretical discussion in this paper will also use part of the knowledge about economic interdependence, this paper will also organize the theories about economic interdependence in order to have a better understanding of national bankruptcy.

#### 3.1. Definition of Sovereign Debt Crisis

Before defining the concept of sovereign debt crisis, an overview of the concept of "sovereign debt" is needed. The International Monetary Fund (2022) suggests that "sovereign debt" refers to the process by which a government borrows domestically and from abroad to finance expenditures that are not covered by its general tax revenues, and that "sovereign debt" is formed when the government borrows too much or for other reasons, such as accidents, the sovereign may have difficulty in repaying the debt. Eaton, J., & Fernandez, R. (1995) emphasize the difference between sovereign debt and private debt, arguing that sovereign debt is borrowing without collateral and with unclear default penalty procedures.

Rating agencies usually focus more on defaults, and therefore the definition of "sovereign debt crisis" by rating agencies is more inclusive of defaults. The world's three major rating agencies have suggested that a country is in sovereign default if it fails to make payments on one or more of its debts, or if a country's devalued bond swaps result in a reduction of interest or principal or an extension of maturity. Sovereign debt crises are constituted when sovereign debt defaults erupt in a concentrated and frequent manner and have a significant negative impact on debtor countries and creditors. Moody's Investors Service (2003) defines a "sovereign debt crisis" as the liability consequences of a default by a sovereign issuer.

The International Monetary Fund (2002) introduced the concept of "national insolvency" to rationalize the extension of the debt of a country in a sovereign debt crisis and to give a country a respite from debt servicing. The definition of "sovereign debt crisis" in this paper is equivalent to "national bankruptcy". When a country does not need to declare bankruptcy to apply internationally for sovereign bankruptcy protection, then the country's sovereign debt may not be in a real crisis. Sovereigns can borrow both domestically and abroad, but since available domestic funds tend to be more limited and repayment terms tend to be shorter, Governments tend to favor borrowing on international capital markets, which are larger and usually of longer duration. Thus, sovereigns tend to default on their external debt, and defaults on domestic borrowing can be characterized by stagflation in the domestic economy and bank failures, but they do not fall into a debt default crisis. Therefore, this paper simply defines a "sovereign debt crisis" as a situation in which a country's external assets are less than its external liabilities,

which is commonly interpreted as insolvency, for the subsequent the subsequent content analysis.

### 3.2. Studies related to the causes of Sovereign Debt Crises

Since the outbreak of the debt crisis in Latin America in the 1980s, economists have been studying the causes of sovereign debt crises. Sachs and Larrain (2002) summarize the causes of the outbreak of sovereign debt crises as fiscal policy, external factors (mainly the surge in international bank lending), capital flight, and adjustments in trade policy. Paolo Manasse and Nouriel Roubini (2009) argue that most sovereign debt crises are due to the government's inability to pay off, illiquidity and the risk of macroeconomic changes. Graciela L. Kaminsky (2006) argues that economic crises occur for different reasons because the actual situation in the crisis countries is different. Reinhart, Rogoff (2008), on the other hand, cuts through the historical perspective and argues that the risk of a sovereign debt crisis is always much higher after a financial crisis. Cottarelli, and Schaechter argued that higher sovereign debt should not be attributed to the financial crisis alone, but rather to unsustainable fiscal policies accumulated over a long period.

In conclusion, current analyses of the causes of sovereign debt crises revolve solely around economic perspectives, whether it is fiscal policy from a domestic perspective or the financial crisis from an international perspective, ignoring the role of political factors. Economic sanctions, as an effective tool used today by many Western countries, especially the United States, to confront, threaten and even retaliate against hostile countries with unfriendly political relations, can sometimes be the cause of a country's bankruptcy. Most of the current analyses on the causes of sovereign debt crises are based on the current situation of insolvency in the eurozone countries, which has strong geographical limitations.

### 3.3. Relevant Studies on Economic Interdependence

The theory of "interdependence" has its roots in the liberal tradition and is a response to realism's exclusive focus on inter-state relations. The first application of the concept of "economic interdependence" in economics can be found in the American economist W. A. Brown Jr.'s *The International Gold Standard Reinterpreted*. Richard N. Cooper (1968) introduced this concept into international economics, arguing that economic interdependence is the degree to which a country's international economic transactions are sensitive to the state of economic development abroad. Robert O. Keohane and Joseph S. Nye (1977) elaborated on the concept of interdependence in greater depth, proposing the "Complex Interdependence Theory", which points out that interdependence between countries is characterized by asymmetry, sensitivity and vulnerability.

## 4. Thesis Ideas and Research Methodology

Since the existing micro-fiscal policy perspective and the meso-financial crisis perspective cannot well explain the reasons why sovereign countries fall into debt crises, this paper will construct a new theoretical analytical model by introducing "economic interdependence", which is an important concept in international economic politics. According to the theory of economic interdependence, the closer the political relations between two countries, the more frequent the economic exchanges will be, which in turn will lead to interdependence. However, due to the unequal resources of the two parties, an asymmetric type of interdependence may be formed in the process of interdependence, meaning there is a stronger party among the interdependent parties. The stronger party can constrain the development of the weaker party by changing its economic policy or imposing an economic blockade, thereby plunging the other party into a sovereign debt crisis. When and how the stronger party changes its economic policy

relative to the weaker one depends overwhelmingly on the political relationship between the two parties and on future political trends.

The US-China relationship is a hot issue in current international relations, and a third round of sovereign debt crisis seems to be brewing after the COVID-19 pandemic. Therefore, at a time of tension between the United States and China, the impact of the political relationship between the two countries on China's sovereign debt crisis has become the focus of this study.

#### 4.1. Research Hypothesis

First of all, according to the political relations with other countries and the degree of connection with the economy of other countries, sovereign states can be categorized into two types externally dependent states and non-dependent states. On this basis, national bankruptcies can be categorized into dependent and non-dependent bankruptcies, with non-dependent bankruptcies referring mainly to sovereign debt crises in non-dependent countries. When a country does not have external dependence, regardless of political relations with other countries, it is difficult to be affected by the economic fluctuations of other countries, and more often falls into sovereign debt crises out of its fiscal policy, financial vulnerability, instability, etc. Therefore, the main study in this paper targets externally dependent countries for analysis. Most countries in the twenty-first century are externally dependent, and with the development of the economy and the deepening of globalization, the coefficient of the country's external dependence is growing and the degree of external dependence is becoming deeper and deeper. In the new era, most countries have strengthened and improved their domestic financial systems, drawing on the lessons and experiences of crisis countries and globalized economic interactions. For externally dependent countries, micro-domestic factors had long since ceased to be a major cause of national bankruptcy. Therefore, it is feasible to study the sovereign debt crisis in the new period from the perspective of the externally dependent state subject and the international political causes.

#### 4.2. Methods of Analysis

The main research methods adopted in this paper are literature research and qualitative analysis. The current research status is summarized, and the framework and research basis of this paper are constructed by combining the current interaction between China and the United States as well as the economic development trend.

### 5. Reconstructing the Analytical Framework for Sovereign debt crises

Existing analyses of the causes of sovereign debt at home and abroad have explored the causes of national insolvency at the micro (domestic economic level) and meso (regional institutional level) levels, giving strong explanatory power and practical relevance at the economic level. However, as mentioned earlier, each of these research theories has its problems in terms of explanatory scope and explanatory power, which leads to varying degrees of bias in their understanding of sovereign debt crises. To this end, this paper is committed to constructing a new framework based on the above studies to achieve the doctrinal goal of reinterpreting the causes of sovereign debt crises.

Based on the theory of "economic interdependence", this paper introduces the political variable, further splits the political variable itself with the theoretical kernel of interdependence, and separates the two more specific independent variables of "dependence" and "power" to form a new "dependence-power-relationship" trinity analytical framework.

#### 5.1. Dependence

After splitting, the dependency variable refers to the country's external dependency on the international system. Changes in dependence fundamentally determine the main source of

threat that plunges the country into a sovereign debt crisis. When the country is externally dependent, the main source of the sovereign debt crisis is the political relationship with other countries; when the country is non-dependent, domestic factors, especially fiscal policy and economic policy, become the key factors that lead the country into a sovereign debt crisis.

The dependency variable is influenced by domestic economic development. The faster the country's economy develops, the more the country will tend to become an externally dependent country. When the country's economy reaches a certain stage of development, the non-dependent country may even transform into a dependent country.

## 5.2. Power

The strength variable is the sum of a country's own hard and soft power. For dependent countries, asymmetric advantages of interdependence can be gained when they are the more powerful party. In the event of a deterioration of political relations with other countries, it can withstand the pressure of sovereign debt imposed by other countries through economic sanctions, termination of economic cooperation, and so on. When the country is the weaker party, it is vulnerable to economic policy shocks in the context of changes in political relations with other countries, thus increasing the risk of falling into a sovereign debt crisis.

## 5.3. Relationship

Relationship refers to the degree of friendliness in the country's bilateral relations and is the focus of this study. When a country's economy is growing rapidly, the country's economic environment tends to be open and is highly likely to be an externally dependent country. At this point, the country's political relations with other countries will become the main source of threat affecting its slide into a sovereign debt crisis, and the country's strength becomes a key variable affecting the evolution of the sovereign debt crisis. Interstate relations are manifested by interstate events.

## 6. China's Sovereign Debt Crisis and U.S.-China Relations

Undoubtedly, China is an externally dependent country. Based on the events of political interactions between China and the United States in the past decade, it is evident that the relationship between China and the United States has been deteriorating, while the level of interdependence between China and the United States is rising. As there is still a gap between China and the United States in some areas of strength, the closer the U.S. and China get, the more likely it is that our country will fall into a sovereign debt crisis.

So what are the reasons why China did not go "bankrupt" like other countries with which the United States had friendly relations when the economic crisis broke out in the United States in 2008?

### 6.1. Different Economic Systems and National Systems

China's late entry into the international market. In 2008, China's market economy was immature, and the special socialist system had a macro-control regulatory role. At that time, China's external dependence was low, and thus it was not hit very hard even though it was on friendly terms with the United States. The vast majority of European countries that have declared national bankruptcy have long been integrated into the international economic system of European integration and economic globalization, and are highly dependent on the outside world.

### 6.2. Different Power

China's overall strength is stronger than that of countries such as Greece and Iceland, which declared bankruptcy after the 2008 financial crisis. Strong power allows China to hedge its

sensitivities against the consequences of changes in economic policy or economic sanctions of the United States while maintaining good relations with it.

## 7. The Weakness of China's Dependence on the U.S.

At present, Sino-U.S. relations are in a tense state, and the U.S. continues to issue economic policies and propositions of restrictions on China. Although China has developed rapidly in the fields of food, infrastructure, and some high-tech areas, it is still unable to confront the United States in some areas and shows weakness in dependence.

Our trade dependence and the U.S. weight in grain foreign dependence is high, which means that the real industries of China's domestic economy and its strategic resources are closely linked to U.S. strategy toward China. When a powerful party adopts sanctions or "decoupling", the weaker party will be hit and fall into a sovereign debt crisis. Meanwhile, the non-international nature of China's currency makes it extremely risky for foreign investment development.

China has now put forward the Belt and Road Initiative, which is closely linked to the destiny of the vast number of developing countries. Developing countries, in turn, are the main borrowers at the international level. Once China fell into a sovereign debt crisis, it could easily lead to the wholesale bankruptcy of a large number of developing countries, thus creating a vicious circle. Therefore, in the future direction of development, China how to make an effort to keep the cooperation with other countries while safeguarding its national security is a topic we should pay attention to.

## 8. Conclusion

The U.S.-China relationship is positively correlated with China's sovereign debt crisis, and China's interdependence on the U.S. is more fragile and sensitive than the U.S.'s. So the closer the ties between the U.S. and China are, the more likely China is to fall into a sovereign debt crisis. How to maintain China's economic security while keeping cooperation in the U.S.-China relationship and preventing China from falling into a sovereign debt crisis at the onset of the third trend of national bankruptcy has become an important issue we are currently facing.

Under the new circumstances of the deterioration of relations between China and the United States and the economic decoupling practiced by the United States, we need to think more calmly. By the logic of decoupling and the corresponding sequence, we should turn our weaknesses into strengths, so that we can gain a greater say in the great power game and thus better protect our national interests. From now on, our country should look further ahead, develop science and technology, adjust our industrial structure, and maintain our foreign dependence at a stable level. Within the dollar system, maximize asymmetry, engage in flexible confrontation, and outside the dollar system, construct its own self-recycling and explore new avenues. In order to safeguard China's economic security, we must make changes from the inside out.

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