Emerging analysis

China's lending landscape and approach to debt relief

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October 2021

 This report has been funded by the UK Foreign, Commonwealth and Development Office (FCDO). Views expressed do not necessarily reflect FCDO's official policies.

How to cite: Rudyak, M. and Chen, Y. (2021) China's lending landscape, approach to debt and the Common Framework. ODI emerging analysis. London: ODI (www.odi.org/en/publications/chinas-lending-landscape-and-approach-to-debt-relief)

Contents

1 Introduction

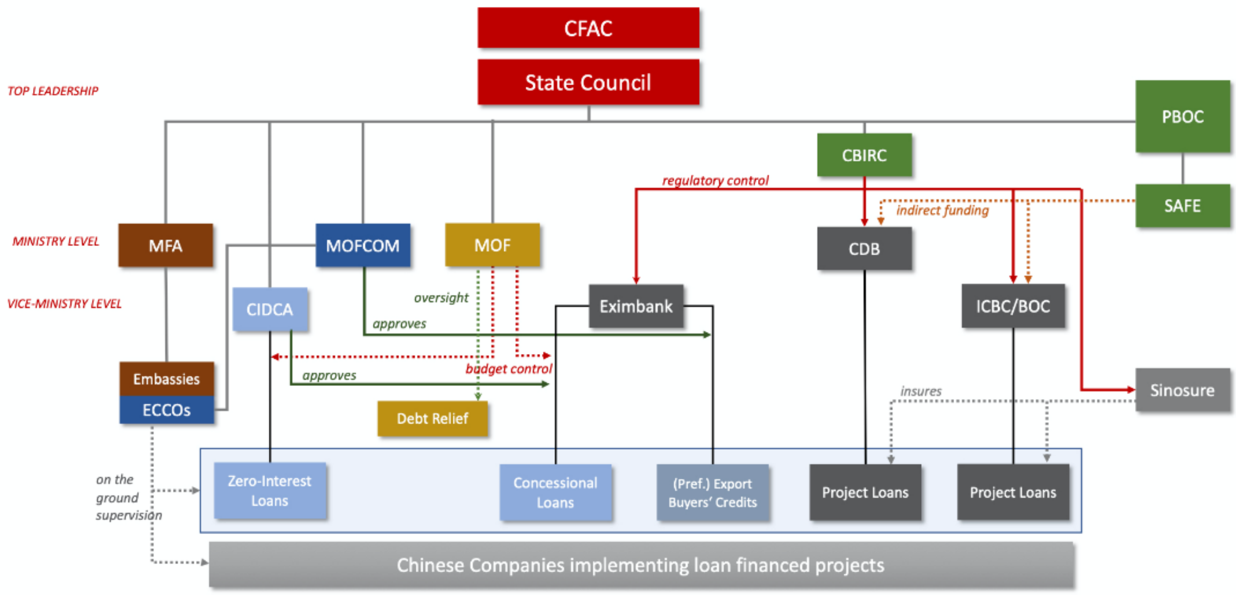
This briefing note reviews the institutional landscape of Chinese financial and lending institutions, and its approach to overseas debt relief. Part 2 of this briefing maps out the key institutions and agencies within China’s overseas development finance architecture. Part 3 disaggregates between different lending institutions, highlighting differing incentive structures and approaches to debt relief.

We highlight the disparate and fragmented ministries and institutions involved in different aspects of China’s overseas development finance, and outline the different incentive structures at work within institutions which condition potential debt restructuring outcomes. This research was conducted for a rapid response briefing, and draws from primary data and eight informant interviews, which took place in March 2021. We hope this briefing note will be instructive to policy audiences in donor countries and to audiences in borrowing countries, in shedding light on China’s lending structures and practices.

2 The institutional landscape of China’s development finance

This section outlines the political and financial institutions involved in China’s overseas lending and development finance. Figure 1 maps out the institutional landscape and their positioning within China’s internal bureaucracy.

Figure 1 Institutional mapping of China's overseas finance architecture



Source: author's elaboration[1]

2.1 Policy banks and lending institutions

China Development Bank (CDB)

- Established in 1994, CDB is the world's largest national development bank and China's largest institution for overseas investment, with total assets of USD 2.4 trillion in 2019. CDB sources its capital largely through bond issuances (71% in 2014), corporate deposits (24%), borrowing from the People's Bank of China (PBOC) and government organs (5%), and through limited foreign currency bonds. CDB enjoys a competitive rate of borrowing from government sources, at

[1] See: Marina Rudyak, *Who Is Who in the Chinese Lending Institutional Landscape* (Sassenberg: Urgewald, October 2020), p. 7.

approximately 2-3%. It can also raise funds cheaply through bonds, due to its state backing, meaning it can offer the same rate as government bonds.[2]

- The CDB provides USD or EUR-denominated **medium and long-term market rate loans** to government institutions and companies. The base interest rate is typically set to the (floating) LIBOR rate with an additional margin incorporated to account for borrower-specific risk and repayment capacity (see Table 1). The interest rate is usually higher than that of the World Bank, but in cases of political interest, CDB may offer a very low interest rate (Jakarta-Bandung High-Speed Rail was offered at interest of 2%).

- The CDB is a **ministry-level government agency** under the direct supervision of the State Council and under the regulation of the China Banking and Insurance Regulatory Commission (CBIRC). It has the status of a “development finance institution” (开发性金融机构) to support China’s national initiatives (e.g., China-Africa cooperation and the Belt and Road Initiative (BRI)) and should prioritise China’s political objectives over profits (though avoiding losses). Unlike Eximbank, CDB does not offer any kind of officially subsidised loans and over a series of reforms beginning in the late 1990s, the bank has enjoyed greater autonomy in decision-making around lending arrangements. Though it has played a key role in the BRI and China’s overseas finance and it has something of a hybrid status as a bank, the Chinese government insists that CDB is **not an official bilateral lender**, insisting on its status as a commercial bank in the DSSI.

- Despite its large role in China’s overseas lending, the CDB is seen in China’s development circles as **lacking international experience** and **weak on credit risk management**. In contrast to the PBOC, which recruits economists trained in the West, most of CDB’s senior management comes from the Agricultural Bank of China. It was also recently shaken by a significant corruption scandal with former CEO Hu Huaibang, who was forced to step down in 2018 and is now in jail for life. In this period, both policy banks were subject to external audits, which majorly impacted their overseas lending operations.

[2] Muyang Chen, ‘Beyond Donation: China’s Policy Banks and the Reshaping of Development Finance’, *Studies in Comparative International Development*, 55.4 (2020), 436–59 <https://doi.org/10.1007/s12116-020-09310-9>.

China Export-Import (Exim) Bank

- Established in 1994. With USD 610 billion of assets as of 2018, Eximbank's assets amount to only one quarter of CDB's. It is China's main lender to lower income countries and fulfils a dual function:
    1) **Official bilateral creditor,** providing RMB-denominated **concessional loans**, which are part of China's foreign aid. Concessional loans are granted to government institutions (normally Ministry of Finance (MOF)) on the basis of inter-governmental agreements and upon approval by the China International Development Cooperation Agency (CIDCA), and are used mainly in large-scale infrastructure construction, provision of large quantities of mechanical and electronic products and complete sets of equipment. The rate is below China's central bank's benchmark rate, usually a fixed interest rate of 2-3%; the margin is subsidised by the MOF (see Table 1 for typical terms).
    2) **Export credit agency**, providing USD-denominated **preferential export buyer's credits** to government institutions for the purchase of goods and services from Chinese companies. No intergovernmental agreements required. Generally, slightly more expensive than concessional loans (higher rates, shorter maturities, shorter grace periods); financed by Eximbank's own capital and not subsidised by the government; can support up to 85% of project costs, but 15% counterpart contribution is required.

- Eximbank is also a **vice-ministry-level government agency** under the direct supervision of the State Council and is under regulatory oversight of CBIRC. It has the status of a "policy-based finance institution" (政策性金融机构). Like the CDB, it should support China's national strategies. Unlike the CDB, it is not required to make a profit (though it should not operate at a loss).

The status of policy banks within China's bureaucratic system differs substantially from the setup in the UK and other major donor countries, where policy banks are typically subordinate to an authority (ministry or a government agency) that is politically responsible for development cooperation or development financing.[3] By contrast, Eximbank and CDB are independent ministry-level agencies that are not subordinate to China's MOF (which represents China in multilateral development finance negotiations), the Ministry of Foreign Affairs or CIDCA. As such, directives that influence their activities, including their approach to debt restructuring, must come from the State Council or higher.

Sinosure[4]

- Sinosure is an export credit agency that provides insurance services only and does not engage in direct lending. While a majority of its operations support Chinese firms in the trade and export sector, it is also the primary provider of credit risk insurance for China's overseas commercial lending and in the BRI, providing political and commercial risk insurance in event of loan non-repayment, mostly for CDB and commercial banks. Sinosure plays a critical role in approving loan agreements for loans that have credit insurance, and may be involved in loan restructuring negotiations in the event of a borrower default.

Other commercial lenders (ICBC[5] and Bank of China)

- Chinese state-owned commercial banks provide USD or EUR-denominated middle and long-term non-concessional loans to government institutions and companies, and act independently of China's foreign aid apparatus. Like CDB loans, the base interest rate is typically set to the (floating) LIBOR rate, with an additional margin added to account for borrower-specific risk and repayment capacity. Interest rates on average sit around 4.5-6%, maturities and grace periods vary widely. Only ICBC thus far has been involved in a debt restructuring case – that of Angola in 2020, where it acted alongside CDB.

[3] In the UK, the FCDO sets the investment policy for the CDC Group; in Germany, the KfW is an implementing agency of the BMZ; in Japan, the JBIC is supervised by the Ministry of Finance.

[4] for in-depth discussion of Sinosure's role, see Yunnan Chen, *Sinosure's Role in China's Overseas Lending and Debt Negotiations* (ODI, December 2020), p. 6.

[5] Industrial and Commercial Bank of China

2.2 Policy institutions and decision-makers

State Council

- The highest administrative authority of China. It decides on China's foreign aid and international development cooperation policies, approves the annual foreign aid budget, any grant above USD 1.5 million, projects costing more than USD 12.5 million, foreign aid to politically sensitive countries, and any request that exceeds the annual aid budget.

Chinese Communist Party's Central Foreign Affairs Commission

- Highest foreign policy decision-making organ in China's political system, chaired by the Chinese Communist Party's General Secretary and China's President Xi Jinping. The vice-chair is Premier Li Keqiang and other members comprise state councillors and relevant ministers. The current director of the Central Foreign Affairs Commission (CFAC) General Office is Yang Jiechi, who served as Foreign Minister 2007-2013, before heading the General Office of CFAC's predecessor, the Central Foreign Affairs Leading Small Group. CFAC directs China's foreign policy, including the major decisions on loans and China's foreign aid.

Ministry of Finance

- The MOF's role in **bilateral development finance** is limited to budgeting and approving foreign aid loans (interest-free loans and concession loans). Though it acts mostly as a rubberstamp ministry, it may intervene if it deems project costs too high. For Eximbank's concessional loans, it covers the margin between the commercial and concessional interest rate. It has no say in Eximbank's preferential buyer's credits or CDB loans, but it oversees all Chinese debt cancellations and debt rescheduling.

- In China's institutional landscape, the MOF can be considered more internationally minded. It is China's liaison agency for multilateral development finance, manages China's financial contributions to major MDBs (including ADB, World Bank, and the AIIB) and the UN system. It also seconds personnel to represent China in these institutions and recruits many internationally trained economists.

People's Bank of China

- The PBOC fulfils the role of China's central bank and is responsible for monetary policy, as well as regulation of financial institutions. It also represents China as non-borrowing shareholder in several regional and sub-regional MDBs. The PBOC plays a powerful role in holding China's foreign exchange reserves, management of which is delegated to the subordinate **State Administration of Foreign Exchange (SAFE)**. While the PBOC and SAFE do not appear to play an active role in overseas debt renegotiations or restructuring, it is important to note that SAFE, via China's sovereign wealth funds, has substantial shareholding in the major commercial banks, Sinosure, as well as CDB. This state ownership has some moral hazard effects for these banks' external lending, but may entail structural pressures to minimise potential losses that endanger China's foreign exchange reserves.

Ministry of Commerce (MOFCOM)

- The MOFCOM can be considered a fairly powerful player because it has to approve all Chinese companies' overseas activities. Its Economic and Commercial Counsellor Offices (ECCO) in Chinese embassies and consulates, rather than the embassies themselves, are the focal points for Chinese loans and companies in recipient countries.

- **Zero-interest and concessional loans (foreign aid)**: Although the MOFCOM is no longer in charge of the administration of China's foreign aid (which has fallen to CIDCA since March 2018), it retains all of its previous implementation responsibilities though its subordinate units:
  - *Department of Outward Investment and Economic Cooperation (DOIEC)* oversees the implementation of foreign aid zero-interest loan projects in coordination with CIDCA.
  - *Agency for International Economic Cooperation (AIECO)* oversees the implementation of turn-key projects (e.g. large-scale infrastructure construction) financed by **concessional loans**. It oversees the entire project cycle, including technical negotiations, selection of Chinese companies, project inspection and budget management. AIECO staff visit projects midterm and upon completion.
  - *Economic Cooperation Counsellors Office (ECCOs)*

are still responsible for the oversight of Chinese foreign aid loan projects on the ground, and occupy a similar status to foreign embassies. Unlike their counterparts at the embassies of OECD Development Assistance Committee (DAC) donor countries, ECCO representatives typically don't participate in donor coordination rounds in recipient countries, because they have no power to make decisions.

China International Development Cooperation Agency

- CIDCA is a vice-ministry level agency under the State Council in charge of political coordination of foreign aid. It was established in 2018 through a merger of MOFCOM's Department of Foreign Aid and the Ministry of Foreign Affairs (MFA) personnel in charge of foreign aid, and replaced MOFCOM as the lead coordinator of foreign aid. CIDCA is in charge of the overall foreign aid policy making and foreign aid country programming, conducts foreign aid negotiations on behalf of the Chinese government, signs international agreements and approves Eximbank's concessional loans and zero-interest loans.

- Formally, the reform has moved foreign aid (including concessional loans) closer to China's foreign policy, as CIDCA reports to the highest foreign policy cadres: Yang Jiechi, Director of the Communist Party's Foreign Affairs Office, and Wang Yi, State Councillor and Foreign Minister. This move was further highlighted in April 2021 when the Vice-Minister of Foreign Affairs, Luo Zhaohui, was appointed as the new chairman of CIDCA, succeeding Wang Xiaotao, who before he was appointed CIDCA's inaugural chairman had served as the Vice-Director of the NDRC. But CIDCA has no real influence over project implementation, **because as a vice-ministry it is outranked by those whom it is supposed to supervise**: MOFCOM and other line ministries in charge of the execution of foreign aid projects, and by the state-owned enterprises (SOEs) who implement concessional loan projects and also rank as ministries or vice-ministries. MOFCOM's ECCOs are officially in charge of overseeing foreign aid projects on the ground on behalf of CIDCA, but in practice, communication between ECCOs and CIDCA appears to be problematic.

China Banking and Insurance Regulatory Commission

- The CBIRC is a ministry level supervisory body under the State Council responsible for overseeing the banking and insurance sectors. In 2017, the CBIRC predecessor issued the Measures for the Supervision and Administration of the CDB and Eximbank – which included provisions on credit risk management regulations – who previously relied on the regulations for commercial banks as reference.

Ministry of Foreign Affairs

- The MFA had historically a rather weak role in Chinese lending, but its position appears to have become somewhat stronger under Xi Jinping, at least for foreign aid loans (zero-interest and Eximbank's concessional loans), as CIDCA reports to the State Councillor Wang Yi who is also the Foreign Minister.

- **Foreign aid**: MFA ensures that foreign aid and loan projects support China's overall foreign policy. It may suggest new aid projects to CIDCA. Chinese ambassadors can decide over discretionary funds (around USD 50,000) for small aid projects. Foreign aid reports drafted by ECCOs need to be signed by the ambassador and are sent to MOFCOM, MFA and CIDCA through Chinese embassies.

3 Debt renegotiation and decision-making structures

Table 1 Stylised facts on China's overseas loans and renegotiation outcomes

Type	Lending instrument	Lending institution	Renegotiation process	Likely outcomes
Foreign aid loans	Zero-interest loans (ZILs) RMB-denominated, typically 0% interest rate, 20-year maturity and 10-year grace period	CIDCA/ MOFCOM	Collective decision between MOFA, MOFCOM and CIDCA	Loan forgiveness/write-off
	Concessional Loans (CL) RMB-denominated, typical interest rate of 2-3%, 15-20-year maturity and 5-year grace period	Eximbank	Government-to-government agreement	Rescheduling, maturity extension
Non-foreign aid official loans	Export Buyer's Credits (EBCs); Preferential Export Buyer's Credits (PEBC) USD-denominated, loan terms vary. PEBCS have a slightly subsidised interest rate, maturity typically 15 years	Eximbank	Government-to-government agreement	Rescheduling, maturity extension, haircuts to interest rate in rare cases
	Middle-and long-term project loans USD or EUR-denominated, floating rate set to LIBOR at typical rate of 4.5-6%, varying maturity and grace periods	CDB	Internal to CDB, may be subject to political pressure	Rescheduling, rare cases of maturity extension
Commercial loans	Middle-and long-term project loans USD or EUR-denominated, floating rate set to LIBOR at typical rate of 4.5-6%, varying maturity and grace periods	ICBC, Bank of China, China Construction Bank, Agricultural Bank of China	Internal to bank	Rare cases of rescheduling (ICBC in Angola)

3.1 Debt negotiations and decision-making structures

- **Debt negotiations and decision-making structures vary by the type of loan and the creditor involved. In general, zero-interest loans (ZILs) are easily written off;** to date, they are the only loans that have been subject to loan forgiveness and only account for around 5% of Chinese loans.[6] Since ZILs come from the foreign aid budget, decisions can be made at the ministerial level through a collective decision-making process between MOFA, MOFCOM and CIDCA (as the implementing agency for foreign aid after 2016). For debt renegotiations regarding Eximbank and CDB loans, requests for debt relief are considered on a case-by-case basis.

  In the past, this was evaluated by a coordinating committee in Beijing, led by the MOF, along with MOFCOM, CIDCA, Eximbank and CDB, though it is not certain that this is still the case.[7] As yet, it is unclear if any structural mechanism for debt renegotiation exists above this level, nor does there seem to be much evidence for the existence of a leading group on this issue. However, the final decision on whether or not China participates in multilateral debt initiatives such as the DSSI and the Common Framework (CF) is taken at the level of the top leadership (State Council and/or the CFAC).

- **Negotiation processes differ between Eximbank and the commercial banks, including CDB.** As a pure policy bank, **Eximbank loan restructuring of concessional loans requires a government-to-government agreement, while CDB and commercial banks do not**. Whether a government agreement applies to Eximbank non-concessional loans is unclear, but likely. Since many infrastructure project loans have both concessional and commercial components, **both credit facilities have parallel processes for negotiation**, which may entail a more cumbersome process for borrowing governments. [8]

- **For CDB and other commercial banks, such as ICBC or Bank of China, decisions regarding loan term amendments and debt restructuring occurs within the bank.** This process may vary in terms of the tiers of decision-making involved. For example, CDB has regional branches, which may have greater autonomy in dealing with small

[6] With the exception of Cuba and Venezuela, which have been special cases. See: Development Reimagined and Oxford China Africa Consulting, 'China: Debt Cancellation', 2019 <https://2f62803c-d340-412c-803d-3d50e07aba88.filesusr.com/ugd/4f41e2_a51fccbbb8654033854fa4fc5e4549d8.pdf> [accessed 15 March 2021].

[7] Deborah Brautigam, 'Chinese Debt Relief: Fact and Fiction', *The Diplomat*, 15 April 2020 <https://thediplomat.com/2020/04/chinese-debt-relief-fact-and-fiction/> [accessed 15 March 2021].

[8] Interview 10/3/2021

defaults or technical defaults. If repayment issues extend to the loan principal, or involve restructuring, negotiations are likely to be escalated to central office. In the case of ICBC, for example, the lack of regional offices means any negotiations over loans are automatically directed to the central office in Beijing. This centralisation of expertise and decision-making means any renegotiation processes with ICBC may be more efficient.

- **For commercial loans, the credit committee within the bank plays an instrumental role in loan renegotiations.** Any request for changes in the loan agreement will be first escalated to the bank's credit committee, who may approve repayment deferrals. Refusals for deferrals appear rare, though the credit committee may make additional conditions for loan security. Finally, negotiations can be escalated to the Board, which has the final decision over any changes to loan agreement terms.

Debt relief for "special friends"

To date, only ZILs of borrowing countries have been subject to loan forgiveness – with two exceptions: Cuba and Venezuela. In 2011, China agreed to restructure Cuba's US$6 billion debt. Reports indicate that a part of the debt was forgiven.[9] China also did not pressure Venezuela when the country was unable to meet the debt repayments of its estimated US$20 billion debt to China. Both countries are considered "special friends"; the atypical debt restructuring cases are an example of relationality in China's foreign policy that, if necessary, puts maintaining stable political relations above all other interests. However, these cases are unlikely to set precedents for China's lending relationships elsewhere.

3.2 Institutional incentive structures of Chinese creditors

- **Commercial banks are highly unlikely to offer debt relief that impacts their balance sheets, due to the competitive dynamic they face,** relative to CDB and Eximbank**.** Their balance sheets and performance also have ramifications for the management of China's foreign reserves, making fiscal responsibility, and maintaining liquidity, even more imperative. As other research has pointed out, Chinese loan renegotiations tend to preserve as much of the loans' net present value as possible, and restructurings that impact the

[9] Development Reimagined and Oxford China Africa Consulting.

loan terms' interest rate are rare.[10] **Debt suspension is a default (i.e. standard) option.**

- **Personal liability and precedent are major factors that influence internal bank incentives around debt negotiations.** Unless a precedent has already been set, decisions by bank staff that potentially impact the bank's bottom line may have personal and professional repercussions, since staff tend to remain within the system and are subject to personnel evaluations that condition their career progression. This **personal liability factor thus tends to encourage conservatism** in staff, to minimise financial losses to the bank, and creates a structural incentive to escalate decisions upwards to the credit committee.

- **Political signals and international pressures matter.** In some cases where we have seen debt restructure from commercial banks (i.e. that changes the interest rate or maturity of the loans), this may be in response to **political signals from the top leadership**. It is clear that a high-level strategic relationship and the decisions of top-level leadership have been highly influential to countries' ability to change the terms of their Chinese loans, as seen with strategic partners such as Ethiopia in 2018, or where China has major financial investments or resource interests (e.g. the Republic of Congo 2019, Chad 2017).[11] Similarly, the involvement of international actors, particularly the IMF, generates an external pressure on China to respond: IMF action tends to crowd in parallel debt relief responses from China, as was the case in some of the major resource exporters, including Angola in 2020.[12]

- **Time horizons matter for debt restructuring possibilities.** If potential defaults are notified further in advance by the borrower (e.g. six months), this gives more time to local branches and teams to negotiate a solution; however, if a default is imminent, the case will be automatically escalated. This is problematic given that borrowers tend to delay reporting bad news for as long as possible, making debt suspension usually the only short-term option for borrowers on the verge of default.[13] **This discussion applies only if the borrower is not already in default.** Once a financial default has been triggered, the process may become more

[10] Agatha Kratz, Allen Feng, and Logan Wright, 'New Data on the "Debt Trap" Question', *Rhodium Group*, 2019 <https://rhg.com/research/new-data-on-the-debt-trap-question/> [accessed 21 July 2019].

[11] Interview 11/3/2021

[12] Karin Strohecker Bavier Joe, 'Angola Negotiates $6.2 Billion Debt Relief from Creditors: IMF', *Reuters*, 21 September 2020 <https://www.reuters.com/article/us-angola-imf-idUSKCN26C2CP> [accessed 15 March 2021]; Gatien Bon and Gong Cheng, *China's Debt Relief Actions Overseas: Patterns, Interactions with Other Creditors and Macroeconomic Implications* (University of Paris Nanterre, 2020).

[13] Interview 11/3/2021

complicated for loans insured by Sinosure. In this case, a default will trigger Sinosure's involvement in representing the creditor in negotiations, and Sinosure has final approval over any loan restructure agreement.[14]

- **China has taken a collaborative, though limited, approach to multilateral debt initiatives**, agreeing to participate in the G20 Debt Service Suspension Initiative (DSSI) in 2020, and subsequently the G20 Common Framework for Debt Treatments beyond the DSSI (CF). This represents the first time China has participated in such a debt initiative, though its approach in the DSSI may be viewed as a case of 'multi-bilateralism', where it supports multilateralism, but maintains a preference for bilateral consultations and resolutions on a case-by-case basis. China played a substantial part in debt relief through the DSSI, however, this was limited to loans from China Eximbank, while CDB was excluded from the initiative, and encouraged to participate on a 'voluntary' basis. The reason being is that China considers CDB loans as commercial loans and not as official loans. The creation of the CF sought to remedy some of the weaknesses of the DSSI, by mandating that participating borrowing governments seek equivalent debt treatments from all creditors, official and private. However, it is yet to be seen how this will be operationalised for the first three participants (Chad, Ethiopia, and Zambia).

[14] See Yunnan Chen, *Sinosure's Role in China's Overseas Lending and Debt Negotiations* (Overseas Development Institute, 2020), p. 6.