Who is who No 2: Basic characteristics of Chinese lending[i]

Loans play a dominant role in Chinese development aid and foreign trade. Their political and economic assessments are the subject of heated debate.

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Today, China is the largest bilateral lender for the low- and middle-income states of the Global South. This is also why only debt relief initiatives which include China can be effective. Nevertheless, who are the players in the Chinese development cooperation and what is their significance? How does Chinese so-called development finance practice differ from that of Western countries?

It is difficult to measure China's accomplishments as a worldwide creditor. In most cases, they do not adhere to the "Official Development Assistance" (ODA) criteria and are not itemised by sector or project when published. A review released by erlassjahr.de in 2019 indicates a credit sum of 476 billion USD for 145 countries in the period between 2000-2017.

Based on numerous loan agreements, signed since 2018 as part of the "Belt and Road Initiative" (BRI), also referred to as the "New Silk Road", the sum is in fact higher. A current study by AidData from September 2021 records 13,427 projects valued at 843 billion USD in 165 countries over a period of 18 years.

In connection with Chinese development financing, the term "debt trap diplomacy" has become a synonym for Chinese loans in the public debate. It was coined in 2017 by the Indian scientist Brahma Chellaney. The premise is the following: the creditor country extends excessive credit to a debtor country in order to extract economic or political concessions once the debtor country becomes unable to meet its repayment obligations.

The debt trap theory has become the subject of intense global debate. One of the main protagonists is Deborah Bräutigam, director of the China Africa Research Initiative in the US. She maintains there is no evidence to support such allegations. Nevertheless, strong criticism of the Chinese allocation practice persists. A study by the Kiel Institute for the World Economy generated much discussion with its analysis of over 5,000 loans and payments worth 520 billion USD since 1949. It emphasised the danger of hidden debts, which do not appear in statistics and purportedly account for half of all Chinese lending.

However, the above-mentioned AidData study also confirms the huge danger of such hidden debts: Almost 70 per cent of Chinese foreign lending today goes to state companies and banks, special purpose entities, joint ventures, and private sector organisations in the recipient countries. For the most part, these debts do not appear on the governmental balance sheets. The practice is likely to increase in the future.

Aid is combined with trade

We therefore cannot treat China as a new conventional development aid player. The "Official Development Assistance" (ODA) is defined by the "Development Assistance Committee" (DAC) as state aid that promotes economic development and welfare in developing countries. The DAC introduced the ODA in 1969 as the "gold standard" of foreign aid. In contrast to OECD country practices, China does not distinguish between commercial credits and classical aid. Aid is thus combined with trade. In addition, only loans by the two state banks China Exim Bank (EXIM) and China Development Bank (CDB) are handled as state loans.

Loans by the four so-called "commercial" but in reality, also state banks – ICBC, Bank of China, Agricultural Bank of China and China Construction Bank – are described as "commercial loans". The CDB is still the world's largest bilateral lender. However, China's commercial banks have surpassed the two state banks EXIM and CDB as main lenders. The number of "mega projects", meaning loans worth at least 500 million USD, has tripled between 2013 and 2018, according to AidData.

Loan instruments of the two state banks are above all project loans, export relief or export insurances, interest-free or low-interest loans, and subsidies from special funds. Blended finance packages are often offered and mixed with market-based prices and products based on commercial loan prices and subsidies. The state banks' official foreign loans are yield-oriented and offer less generous conditions than loans conferred by traditional lenders of the official development aid or multilateral creditors.

On average, the interest rate for a loan amounts up to 4.2 per cent and includes a maximum grace period of less than two years as well as a loan duration of less than ten years. So, most of the Chinese foreign loans are not "development aid" but rather export loans. China puts less emphasis on aid than on debt. According to AidData, China has issued 31 times more loans than grants since the beginning of the BRI.

Banking on collaterals

The new study states, when the stakes are high, Beijing's risk reduction method of choice is collateral security: 40 of the 50 largest loans to foreign borrowers by Chinese state creditors are collateralised. Collateral security has become the mainstay of China's lending strategy – with focus on natural resources and energy. Foreign currency loans are often given to resource-rich countries and are then collateralised by future revenue from raw material exports to reduce repayment and fiduciary risk. Other examples of collaterals include the port of Mombasa in the construction of the Kenyan Mombasa-Nairobi railway line or the land collateralisation in the freeway between the port of Bar and Serbia's capital Belgrade.

The responsibilities and decision-making processes regarding foreign lending and development aid in China involve the Ministry of Commerce and the Ministry of Foreign Affairs. Since 2018, a newly created central coordination unit for development cooperation on a vice-ministry level, the "China International Development Cooperation Agency" (CIDCA), assists the foreign ministry in that regard.

According to Marina Rudyak, sinologist at the University of Heidelberg, the name suggests China now views itself as a development partner when it comes to foreign aid. However, although the agency was created to counteract the lack of accountability and supervision obligations, this premise is significantly flawed. The CIDCA is a subordinate of the institution that it is supposed to be overseeing.

A third ministry, the Ministry of Finance, assumes central control over specific BRI finance institutions. These include the Silkroad Fund but also the Asian Infrastructure Investment Bank (AIIB), the first multilateral investment bank founded by China.

In addition to the completely different understanding of development financing and the specific loan instruments, the AIIB differs from other multilateral development banks due to several uniquely Chinese circumstances:

- Although the AIIB is a multilateral bank, as its Chinese president Jin Liqun repeatedly emphasises, it – together with the Silk Road funds and the large Chinese state banks – maintains the financing of costly infrastructure projects in the energy and transport sector within the Belt and Road Initiative.
- Regional member countries play a central role in the AIIB. Shareholder China holds approximately 30 per cent of the shares. Bangladesh, India, and Indonesia are among the main recipients in recent years.
- The AIIB follows the structure of all other development banks. In its role as major shareholder, China has the (unwritten) right to nominate the AIIB's president – as the USA does with the World Bank.
- The lack of transparency and manipulable flow of information is built into the structure. The administrative board advises on the bank's politics, strategies, and assignments. However, its members do not reside in Beijing but hold their consultations via video conferencing. With this structure, the AIIB intends to realise a part of its business principle "lean, clean, and green". However, this precludes the informal interaction and information flow between board members and management that is part of daily work at the World Bank or the ADB, for example.
- In contrast to other banks, the AIIB does not take much time to interview local communities and prioritises fast project implementation instead. In addition, the protection of indigenous peoples, specified in the ILO convention 169 as "Free Prior Informed Consent" (FPIC), has wilfully been reformulated by the AIIB from "consent" into "consultation".

A country like a large company

It is important to distinguish between political rhetoric and real-life practice. China wants to make its mark as a new development financer, with the goal of building back better, especially in the period after the Covid crisis. To this end, China deploys all available media and diplomatic channels.

Simultaneously, we should adopt a sober and objective stance in this emotionally heated atmosphere. A Chinese colleague once suggested, "Try and see China as a large company". In this company, the aim is to generate profits, with as little delay and complication as possible. In light of the global debt crisis, which Covid has only amplified, and the need to reduce world poverty, solid standards recognising and protecting fundamental rights of local communities are needed. To achieve this goal, a binding catalogue for loans must be developed together with China, and it must be based on disclosure requirements, debt limitation, and ecological and human rights guarantees.

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[i] Another slightly different version was published in German in the journal Südlink, by Inkota, Dec. issue 2021.