

# The New Banks in Town: Chinese Finance in Latin America

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30 INTER-AMERICAN  
DIALOGUE  
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SHAPING POLICY DEBATE FOR ACTION

## ABSTRACT<sup>1</sup>

### The New Banks in Town

In their Inter-American Dialogue report, “The New Banks in Town: Chinese Finance in Latin America,” Kevin Gallagher, Amos Irwin, and Katherine Koleski offer the first comprehensive summary of China’s lending practices in Latin America and the Caribbean (LAC). The authors provide estimates of the volume, composition, and characteristics of Chinese lending to the region since 2005, offer comparisons to international and Western lending institutions, and examine some commonly held notions about Chinese loans to LAC. These include claims that China’s loans have less favorable terms than those of international financial institutions (IFIs) and Western banks, that Chinese lending carries few policy conditions, and that Chinese lenders impose less stringent environmental guidelines than their Western counterparts. The report lends credence to some of these claims, but less so to others.

Through careful examination of government, bank, and press reports from both China and recipient countries, and

through interviews to confirm loan details, the authors estimate that Chinese loan commitments to Latin America have totaled approximately \$75 billion since 2005. Furthermore, China’s 2010 commitments to the region (totaling \$37 billion) exceeded those of the World Bank, Inter-American Development Bank, and the United States Export-Import Bank (US Ex-Im Bank) combined for that year. The report also compares the terms of China’s loans to the region, finding that Chinese Development Bank (CDB) terms are often more stringent than those of the World Bank, while the China Export-Import Bank (China Ex-Im Bank) offers lower interest rates than the US Ex-Im Bank. The authors also confirm that there are virtually no policy conditions associated with Chinese loans, but explain that Chinese banks often require equipment purchases and sometimes oil sale agreements. Finally, the report suggests that Chinese finance operates under an expanding set of environmental guidelines, but that these guidelines are not yet on par with those of IFIs or Western lending institutions.

### China’s “Policy Banks”: CDB and China Ex-Im

Most of China’s international lending comes from the China Development Bank (CDB) and China Ex-Im Bank. During reforms of the financial sector in 1994, the Chinese government created CDB and China Ex-Im Bank as “policy banks,” meaning that their loans would explicitly support the government’s

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<sup>1</sup> A full report is available on the Inter-American Dialogue web site ([www.thedialogue.org](http://www.thedialogue.org)). It includes additional findings on China’s loans to Latin America, an extensive list of loan data sources, and a full bibliography.

# FOREWORD

The Inter-American Dialogue is pleased to provide this abstract of, “The New Banks in Town: Chinese Finance in Latin America,” a Dialogue report written by Kevin Gallagher, Amos Irwin, and Katherine Koleski. Gallagher is associate professor of international relations at Boston University and senior researcher at the Tufts University Global Development and Environment Institute (GDAE). He is also the author of the highly-acclaimed book, *The Dragon in the Room: China & the Future of Latin American Industrialization*. Irwin and Koleski are researchers at GDAE.

The Dialogue’s aim in publishing the report and abstract, as well as our series of China and Latin America working papers, is to inform and engage policy makers, civil society representatives, and academics from China, Latin America, and the United States on evolving themes in China-Latin America relations. We seek to determine areas of interest, identify shared priorities, and develop ways by which emerging relationships can be made most productive for all countries involved.

Our China and Latin America Working Group, of which Gallagher is a member, has been the centerpiece of the Dialogue’s China-related programmatic efforts since it was launched in 2011. The group is made up of approximately twenty select policy makers, analysts, and scholars from Latin America, China, the United States, Europe, and Australia. Group meetings have generated diverse interpretations of the issues driving China and Latin America relations to highlight opportunities for cooperation and address emerging challenges.

The Dialogue’s China-related papers and reports deal with a wide variety of topics including China’s “grand strategy” in Latin America, energy-based engagement and cooperation, the US-China-Latin America dynamic, and the possibility of developing an integrated regional approach to China’s expanding influence. Gallagher, Irwin, and Koleski’s research seeks to provide a better understanding of China’s often misinterpreted financial activity in the region.

We are pleased to recognize the Open Society Institute for its assistance in publishing this report.

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policy objectives. The CDB supports China's macroeconomic policies—as laid out in the Five-Year Plans—focusing on eight areas of development: electric power, road construction, railway, petroleum and petrochemical, coal, postal and telecommunications, agriculture and related industries, and public infrastructure. An estimated 73.7 percent of CDB's total new loans are dedicated to these sectors.

In contrast, the China Ex-Im Bank's mandate is to:

*“facilitate the export and import of Chinese mechanical and electronic products, complete sets of equipment and new and high-tech products, assist Chinese companies with comparative advantages in their offshore contract projects and outbound investment, and promote Sino-foreign relationships and international economic and trade cooperation”* (China Export-Import Bank).

It achieves these set objectives through export or import credit; loans to overseas construction contracts or overseas investment projects; Chinese government concessional loans; international inter-bank loans; etc.

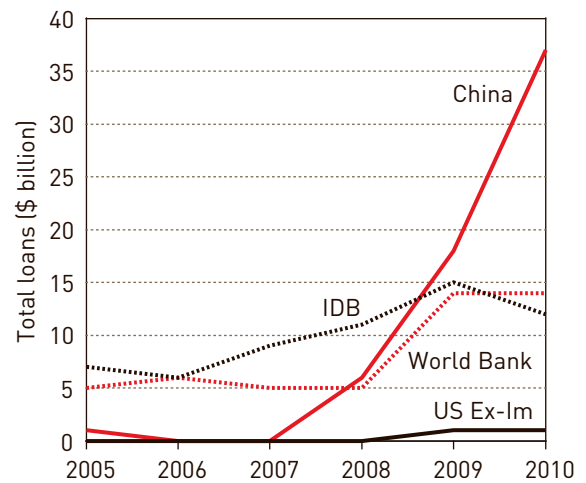
## Chinese Loans to Latin America: Key Findings

### China has provided Latin America with \$75 billion in loan commitments since 2005.

China has provided approximately \$75 billion in loan commitments to Latin American countries since 2005. CDB made 82 percent of these loans, and China Ex-Im Bank and China's ICBC bank contributed 12 percent and 6 percent, respectively. As of 2010, China loaned more to Latin America than the World Bank, IDB and US Ex-Im Bank combined. Prior to 2008, China's annual lending never exceeded \$1 billion, but in 2008 its loans expanded to \$6 billion. By 2010, lending had increased to \$37 billion, well above loan levels of the World Bank (\$14 billion) and IDB (\$12 billion).

Latin America accounts for a major portion of Chinese lending abroad. The *Financial Times* estimates total Chinese loans during 2009-2010 at \$110 billion. If this figure is accurate, more than half those loans were given to LAC countries. The majority (two-thirds) of those loans were in the form of loans-for-oil.

### Comparison of Chinese and Western Bank Loans to Latin America



World Bank, IDB, US Ex-Im Sources: respective Annual Reports

### Chinese banks provide financing to a significantly different set of countries than the IFIs and Western banks, and for different purposes.

Chinese and IFI/Western banks do not overlap significantly in Latin America. They give different size loans to different sectors in different countries. Chinese loans tend to focus on infrastructure and heavy industry, for example, while Western loans cover a range of government, social, and environmental projects. Chinese banks channel 87 percent of their loans into the energy, mining, infrastructure, transportation, and housing (EMITH) sectors. Only 29 percent of IDB loans and 34 percent of World Bank loans go to EMITH sectors, while more than a third are directed toward health, social, and environment sectors. Chinese banks have indicated that they prefer EMITH loans because they directly support economic growth. China Ex-Im Bank's projects, according to its web site, must “be able to generate foreign exchange revenue and create jobs in the borrowing country. The [loans] focus on supporting infrastructure such as energy, transportation, telecommunication projects, and high-efficiency sectors such as manufacturing, processing, and agriculture in the borrowing country.”

In addition to focusing different sectors, Chinese and IFI/Western banks also appeal to different borrowers. Loans to Venezuela, Brazil, Argentina, and Ecuador accounted for

<b>Recipients of World Bank, IDB, and Chinese Lending from 2005–2011</b>				
<b>(\$ million)</b>	<b>Total Loans</b>	<b>World Bank</b>	<b>IDB</b>	<b>China</b>
Venezuela	\$44,528	\$—	\$6,028	\$38,500
Brazil	\$39,628	\$15,338	\$12,559	\$11,731
Mexico	\$27,410	\$14,739	\$11,671	\$1,000
Argentina	\$26,774	\$7,164	\$9,610	\$10,000
Colombia	\$12,118	\$6,241	\$5,877	\$—
Ecuador	\$8,914	\$153	\$2,457	\$6,304
Peru	\$6,113	\$3,045	\$2,868	\$200
El Salvador	\$2,954	\$1,196	\$1,758	\$—
Guatemala	\$2,887	\$1,176	\$1,711	\$—
Panama	\$2,811	\$591	\$2,220	\$—
Costa Rica	\$2,741	\$698	\$1,743	\$300
Dominican Republic	\$2,555	\$854	\$1,701	\$—
Other	\$14,079	\$2,169	\$6,730	\$5,180
<b>TOTAL</b>	<b>\$194,321</b>	<b>\$53,365</b>	<b>\$67,741</b>	<b>\$73,215</b>

World Bank and IDB Sources: respective Annual Reports Chinese Sources: Figure 1

91 percent of Chinese lending to the region since 2005. Although they possess natural resources and other production characteristics of interest to China, the governments of Peru, Colombia, Chile, and Mexico received little to no financing. IFIs and Western Banks, in contrast, dominate lending to Mexico, Colombia, and Peru. Venezuela and Ecuador received only 13 percent of IDB loans and less than a third of a percent of World Bank loans since 2005. Only Brazil and Argentina have received significant shares of lending from both Chinese and Western banks. In these cases, however, the vast majority of the Chinese funds came from a single loan. In the case of Brazil, 85 percent of the lending came from a \$10 billion loan issued in 2009 to fund an ambitious offshore oil project using Chinese inputs. In Argentina, all 2010 financing came in the form of a single loan: \$10 billion to buy Chinese trains.

Chinese loans are also generally larger than Western loans—the overwhelming majority of Chinese financing packages to LAC amounted to \$1 billion or more, compared to 22 percent for the World Bank and 9 percent for IDB.

### **China Development Bank (CDB) loans carry more stringent terms than World Bank loans. The Export-Import Bank of China (China Ex-Im Bank), by contrast, generally offers lower interest rates than the US Ex-Im Bank.**

Some have expressed concern that Chinese banks are replacing the World Bank and Western export credit agencies (ECAs) by offering lower-interest loans and generally better terms. Melissa Graham at the Council on Hemispheric Affairs argues that China's state banks may be replacing Western banks in Latin America by "offer[ing] interest at rates that are lower than other competing developed countries."<sup>2</sup> The *Washington Post* explains that "China is a master at low-ball financing, fashioning loans of billions of dollars at tiny interest rates that can stretch beyond 20 years... This has become a headache for Western competitors, especially members of the 32-nation Organization for

<sup>2</sup> Graham, Melissa. "China Looks South: Problematic Investments in Latin America." Washington, DC: Council on Hemispheric Affairs, 2010. Accessed December 20, 2011. <http://www.coha.org/china-looks-south-problematic-investments-in-latin-america/>.

Economic Cooperation and Development (OECD), which long ago agreed not to use financing as a competitive tool.”<sup>3</sup>

A comparison of Chinese and IFI/Western Banks lends little credibility to these arguments, however. In reality, CDB’s primarily commercial interest rates often exceed World Bank rates. In 2010, CDB offered Argentina a \$10 billion loan at 600 basis points above LIBOR (London Interbank Offered Rate). The same year, the World Bank Group’s International Bank for Reconstruction and Development (IBRD) granted Argentina a \$30 million loan with a spread of 85 basis points. The Chinese spread is more than 5 percent wider, which more than compensates for the larger size of the loan. In 2009, CDB gave Brazil a \$10 billion loan at 280 basis points. The IBRD gave Brazil a \$43.4 million loan in 2000 at a variable spread of 30–55 basis points. Again, the Chinese spread is much larger. In 2009, CDB granted Mexico’s América Móvil a \$1 billion loan at over 100 basis points. The IBRD gave Chile a \$24.8 million loan in 2007 for 5 basis points. Given that Chile and Mexico have similar credit ratings, CDB’s rates again appear higher than the IBRD’s.

When comparing export credit agencies, China’s Export-Import Bank offers slightly lower interest rates than US Ex-Im Bank. The *Washington Post* argues that China is using “low-ball financing” to make its export credits more attractive, since “China has handed out billions of dollars at less than 1 percent interest.”<sup>4</sup> However, China Ex-Im Bank’s lowest-interest loans were its 2 percent loans to Jamaica and Bolivia in 2010. Deborah Bräutigam, American University professor and member of the Dialogue’s China and Latin America Working Group, reports similar rates for China’s Ex-Im Bank loans to African countries. While the US Ex-Im Bank charged 1.5 percent to 2.5 percent above the OECD risk premium, China Ex-Im Bank’s loan rates ranged from 0.31 percent below the premium to 4.4 percent above it.

<sup>3</sup>Pomfret, John. “China invests heavily in Brazil, elsewhere in pursuit of political heft.” *Washington Post*, July 26, 2010. Accessed December 20, 2011. <http://www.washingtonpost.com/wp-dyn/content/article/2010/07/25/AR2010072502979.html?sid=ST2010092006580>

<sup>4</sup>Ibid.

Other than the exceptionally high rate for Ecuador’s Coca-Codo Sinclair Dam, China’s rates fall 1 to 2 percent below US rates.

The lower rates of China Ex-Im Bank stem from China’s unconventional breakdown of commercial and concessional finance rather than from cutthroat competition, however. The IBRD and other development banks offer concessional interest rates as an official form of development aid. Despite

Our best estimate of Chinese loan commitments to Latin America since 2005 is \$75 billion. CDB made 82 percent of the loans, and China Ex-Im Bank and the ICBC bank contributed 12 percent and 6 percent, respectively.

CDB’s “development bank” label, it generally charges borrowers the full cost of finance. China’s concessional finance instead is channeled through China Ex-Im Bank. In other words, Chinese banks are not offering better interest rates than Western banks across the board or by large margins. CDB’s rates appear high when compared to the IBRD. China Ex-Im Bank’s rates fall slightly below US Ex-Im’s rates, but China Ex-Im’s lower rates are the result of government development aid subsidies rather than competition with OECD credit agencies.

**Chinese banks impose no policy conditions on borrower governments but do require equipment purchases and sometimes oil sale agreements.**

IFIs and Western banks impose much stricter conditions than Chinese lenders on borrowing governments in LAC and elsewhere. Chinese loans do not require organizational and/or policy-related reform in return for financing, for example. They also give greater loan spending and tracking freedom to borrowers. As China’s international lending increases, its lack of policy conditions is of growing concern. Paul Wolfowitz has argued that Chinese companies “do not respect” the Equator Principles that set social and environmental

CDB and World Bank Loan Interest Rates								
Year	Lender	Borrowing Country	Borrower	Spread (bp above LIBOR)	Amount (\$m)	Payment Period	Includes Purchase Requirements	Commodity Backed
2010	CDB	Argentina	Government	600	10,000	19	Yes—Trains from CNR	No
2009	CDB	Mexico	América Móvil	>100	1,000	10	Yes—Huawei telecom equipment	No
2009	CDB	Brazil	Petrobras	280	10,000	10	Yes—\$3b for oil drilling equipment	Oil
2010	CDB	Venezuela	PDVSA and BANDES	50–285	20,000	10	Yes—70%, incl CITIC construction	Oil
2000	WB (IBRD)	Brazil	Eletrobras	30–55	43.4	15	No	No
2007	WB (IBRD)	Chile	Government	5	24.8	10	No	No
2010	WB (IBRD)	Argentina	Government	85	30	25	No	No

Chinese Sources: See Annex. World Bank Source: Interview, World Bank Lending Department Official, 2011

standards for loans. Former European Investment Bank (EIB) President Philippe Maystadt alleged that Chinese banks steal EIB's projects by "undercut[ing] the conditions it imposed on labour standards and environmental protection." African officials have noted "there is a risk that some governments in Africa may use Chinese money in the wrong way to avoid pressure from the West for good government."<sup>5</sup> As a result, Oxford professor Paul Collier declared that "the Chinese are making [governance] worse."<sup>6</sup>

Others have argued, however, that Chinese loans offer a new, potentially liberating model of non-interventionist lending. Deborah Bräutigam observes that Chinese lending follows the nation's Five Principles of Peaceful Coexistence, which prohibit meddling in other countries' domestic affairs. She argues that Chinese loans actually constitute a different philosophy of development assistance. Rather than forcing the borrowers to comply with Western norms, Chinese partners treat them as equals and simply seek to do business with them.

While Chinese banks do not seek to reform their borrowers with Western-style policy conditionality, they do attach other strings in an effort to mitigate loan risks.

Chinese banks almost always tie their loans to the purchase of Chinese goods, for example. Aside from a few loans-for-oil and smaller loans with few details available, there are conditions in every loan requiring the borrower to purchase Chinese construction, oil, telecommunications, satellite, and train equipment. Some tie only a small portion of funds to these purchases—CDB's \$1 billion loan-for-oil to Ecuador in 2010 mandated 20 percent Chinese purchases, for example. At the other extreme, China Ex-Im Bank may give 100 percent export credits, as it did in its \$1.7 billion loan to pay a Chinese company to build the Coca-Codo Sinclair hydroelectric dam in Ecuador in 2010. Because Venezuela committed to spend the majority of its \$20 billion loan in 2010 on Chinese goods and services, CDB denominated half in Chinese yuan. This is the largest Chinese-currency loan to date, but China Ex-Im has also issued yuan-denominated lines of credit to Jamaica and Bolivia for equipment and construction. Whether the loans are issued in yuan, dollars, or simply establish a line of credit with a given Chinese company, the purchase requirements allow Chinese banks to reduce their exposure to default risk.

<sup>5</sup>Swann, Christopher, and William McQuillen. "China to Surpass World Bank as Top Lender to Africa." Bloomberg, November 3, 2006. Accessed January 9, 2012. <http://www.bloomberg.com/apps/news?pid=newsarchive&rsid=aZ4KJul1kja.g>.

<sup>6</sup>Bräutigam, Deborah. *The dragon's gift: the real story of China in Africa*. Oxford: Oxford University Press, 2009.



## The financing terms in oil sale agreements seem to be better for the South Americans than most people believe.

A common misconception about the structure of China's loans-for-oil in LAC and elsewhere has caused many to criticize Chinese financing mechanisms as harmful for borrowing countries. Loans-for-oil with Latin America have reached \$46 billion in only three years, well over half of China's total commitments to the region. A common assumption about these oil-based agreements is that they require borrowing countries to simply pay back the loan by shipping oil to China. This would be equivalent to selling a fixed quantity of future oil to China at a pre-set price, and it would rob the exporters of massive revenues as oil prices rise.

Instead, China's loans-for-oil generally combine a loan agreement and an oil-sale agreement that involves two countries' state-owned banks and oil companies. For example, a Chinese bank grants a billion-dollar loan to an oil-exporting country like Ecuador. Ecuador's state oil company, Petroecuador, pledges to ship hundreds of thousands of barrels of oil to China every day for the life of the loan. Chinese oil companies then buy the oil at market prices and deposit their payments into Petroecuador's CDB account. CDB withdraws money directly from the account to repay itself for the loan. The majority of Chinese loans-for-oil in Latin America are therefore linked to market prices, not quantities of oil. These agreements also generally secure more oil than is necessary to pay back the loan—it would be politically untenable for the borrowing countries to give China oil and get nothing in return.

China's terms, though sometimes costly, are appealing to those countries in the region that have difficulty accessing global capital markets. As energy economist Roger Tissot argued in an Inter-American Dialogue Latin America Advisor interview, "Chinese financing is often the 'lender of last resort.' It is not a cheap one, but due to the concern the international financial community has over Venezuela and

Ecuador, and the large risk premiums they would charge, Chinese lending is an attractive option." Chinese lending to Venezuela and Ecuador has effectively filled in for sovereign debt markets in these countries. In addition, because Chinese loans do not come with the sorts of policy conditionalities that are tied to IFI and Western loans, they allow LAC nations flexibility to invest in domestic infrastructure and industrial projects, which are thought to enhance long-term development.

## Chinese finance does operate under a set of environmental guidelines, but those guidelines are not on par with those of IFI's and Western banks.

Because most Chinese loans are in environmentally sensitive industries, environmental advocacy organizations have expressed concern about the potential for Chinese firms to transfer their lax adherence to domestic environmental regulation to construction projects in Latin America and

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Africa. Within China, environmental regulations are often circumvented. In 2009, the Ministry of Environmental Protection reported that 15.5 percent of projects started construction without approval, 9.6 percent of enterprises that were closed for environmental reasons resumed production without permission, and 25 percent of the main sources of pollution were not operating properly.<sup>7</sup>

China's international environmental track record is also controversial. International Rivers and Friends of the Earth, two environmental advocacy organizations, noted in July 2004 that the China Ex-Im Bank financed projects that other financial institutions had refused to fund. Chinese-led investments in Angola and Zambia have led to documented

<sup>7</sup> McElwee, Charles. "China's Environmental Compliance Rates." *China Environmental Law* blog, April 16, 2009. Accessed February 7, 2012. <http://www.chinaenvironmentallaw.com/2009/04/16/chinas-environmental-compliance-rates/#more-1576>.

**Side-by-Side Comparison of China Ex-Im Bank with US Ex-Im Bank\***

Environmental Guidelines	U.S. Export-Import Bank	Export-Import Bank of China
Ex-ante environmental impact assessment	X	X
Project review of environmental impact assessment	X	X
Industry-specific social and environmental standards	X	
Ensure compliance with host country environmental laws and regulations	X	X*
and international environmental laws and regulations	X	
Public consultations with communities affected by the project	X	X
Grievance mechanism	X	
Independent monitoring and review	X	
Establishing covenants linked to compliance	X	X
Ex-post environmental impact assessment	X†	X

\*China Ex-Im Bank requires that if the host country's environmental standards are inadequate, the firm follow Chinese standards or international best practices.

†Members of the Equator Principles are required to submit annual public reports for review. Not sure if this is supposed to be part of the \* note or if it stands alone.

international labor and environmental violations.<sup>8</sup> In Peru, poor environmental practices were a factor in a nearly two-decade-long conflict between the Chinese mining firm Shougang and Peruvian citizens. In 2007, the OECD recommended that China “improve governmental oversight and environmental performance in the overseas operations of Chinese corporations.”

Over the past five years, the Chinese government has sought to incorporate social and environmental guidelines into its banks' procedures to improve both domestic and international lending practices. However, despite significant progress, China's guidelines have yet to match those of IFIs and Western banks. Furthermore, it is difficult to determine the extent to which Chinese development banks have implemented their environmental guidelines. The relative newness of the laws, lax adherence to domestic environmental laws, language barriers in conducting consultations with affected communities, and lack of publicly available information have all limited effective assessment of environmental guideline implementation.

## Toward “Win-Win” Financing?

Chinese finance has brought about great opportunity for LAC, but also poses and accentuates real risks. China offers a new source of finance for domestically appealing development projects, and with none of the policy conditionalities associated with IFIs and Western banks. However, Latin Americans generally have to pay a higher premium for Chinese finance, and face strings attached in terms of equipment purchases and employment. Perhaps of greatest concern is that Chinese finance appears to increase incentives for Latin Americans to rely on primary commodities as a source of growth. Commodities-centered development is not optimal for long-term growth or from an environmental perspective. Chinese finance may prove boon to the region, but only if Latin Americans can seize upon opportunities and channel new effort into innovation, industrial diversification, and policies for macroeconomic stability and equity.

<sup>8</sup>Kotschwar, Barbara, Theodore Moran, and Julia Muir. “Do Chinese Mining Companies Exploit More?” *Americas Quarterly*. Fall 2011. Accessed January 30, 2012. <http://www.americasquarterly.org/do-chinese-mining-companies-exploit-more>.





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