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EXPORT FINANCE ACTIVITIES BY THE CHINESE GOVERNMENT

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EXPORT FINANCE ACTIVITIES BY THE CHINESE GOVERNMENT

Abstract

This note analyses the functioning of Chinese export finance activities and their potential implications for OECD members and China's partner developing countries. From our analysis, it emerges that over the past decades, China's policy banks (China Eximbank, Sinosure, China Development Bank, and China Agricultural Development Bank) have provided an increasing amount of export credit financing which may take several different forms including preferential export buyers' credits, export sellers' credits, mixed credits, natural resource-backed loans or lines of credit, concessional loans, and export special economic zones. Chinese export finance activities have played an important role for China's "going-global" strategy: they have strengthened China's economic relationships with several developing countries especially in Africa, ensured China of significant access to natural resources, and enhanced China's sphere of influence. At the same time, Chinese export credits have become a competitive threat to exporters from the OECD. China is not a member of the OECD and is therefore not obliged to comply with the OECD guidelines that: limit tied aid; regulate credit practices; impose maximum repayment terms, country risk classification and minimum interest rates; require the exchange of information; and impose social, environmental and governance standards on financing activities. This creates an unfair advantage for Chinese exporters. Chinese export credit financing can also have important implications for China's partner countries. In particular, it can lead to new debt sustainability issues, slower reform processes in countries with weak governance systems, drain local natural resources without contributing enough to development, and it can also become a threat for local products and workers.

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1. INTRODUCTION

Export credits are financial instruments used to support domestic companies to do business overseas by mitigating commercial and/or political risks. They can mitigate the risks of default or insolvency of the buyers or cover against the risks of non-payment by buyers due to currency issues, political unrest, and others factors. In 2009, the global market for trade finance (credit and insurance) was estimated to amount to USD 10-12 trillion, and supported about 80% of world trade flows, which in 2008, were valued at USD 15 trillion (Aubin 2009).

National governments provide official export credits through Export Credit Agencies (ECAs), which can be state-owned, private, or mixed. They can provide credits directly to foreign buyers of national exports, or indirectly via private financial institutions (te Velde 2010).

Over the past decades, Chinese export finance activities have increased significantly, and have become a competitive threat to exporters from the OECD. Chinese export credits have often been criticised by OECD countries for leading to unfair trade practices because allegedly they are not provided on a cost recovery basis. The purpose of this note is to analyse in depth the functioning of Chinese export finance activities as well as their potential implications for OECD members and China's partner developing countries.

The remainder of the note is structured as follows. Section 2 discusses the rationale behind Chinese export credit financing, its main actors, instruments and modalities. It also reports a number of selected country case studies, showing recent patterns of China export credits in Africa, Latin America and Asia. Section 3 compares China's practices with OECD rules on the provision of officially supported export credits focusing on three key aspects: financing terms; transparency; and environmental, social and governance standards. It also discusses a few alleged cases of unfair trade practices in Chinese export credits. Section 4 analyses how export finance activities have contributed to strengthen China's trade relationships with African, Latin American and South-East Asian countries, and it examines possible explanations for the apparent success of Chinese export credits in boosting Chinese trade. It also discusses the positive and negative consequences for partner developing countries from their engagement with China. Section 5 concludes and provides some policy suggestions.

2. CHINESE EXPORT FINANCE ACTIVITIES

In China, export finance activities are central to the "going-global" strategy since they support domestic companies to do business overseas by mitigating commercial and/or political risks. Over the last few years, export credit financing in China has increased significantly reaching values well above those of several developed countries. Table 1 (below) shows that while Japan and the United States supported respectively only 0.7 and 1 percent of merchandise exports through medium and long-term ECA financing between 2005 and 2008, the ECA finance to exports ratio for China averaged over 3 percent over the same period. The ratio for China was also much higher than that for EU member states such as the United Kingdom, Germany, France and Italy.

By providing export credit financing, China aims to promote three core objectives: diplomacy, ideological values, and business (Haroz 2011; Brautigam 2010). First, it secures diplomatic support for the One China Policy (i.e. diplomatic recognition of China and rejection of Taiwan). Second, Chinese engagement in other countries is influenced by China's own development experience. Indeed, the natural resource-backed loans employed by Chinese in Africa (see Section 2.2) mirrors the long-term trade agreement signed in 1978 between China and Japan. According to this agreement, Japan pledged low-interest loans to finance export of USD 10 billion in industrial technology and materials to

China in exchange for Chinese oil and coal. The Chinese, in turn, used this financing to hire Japanese firms to build China's main transport corridors, coal mines and power grids (Haroz 2011). Third, China provides export credit financing to promote its own economic interests. For example, China wants Africa to develop, not only for Africa's benefit, but also because a richer Africa can afford Chinese exports, produce key investment opportunities for Chinese firms, and provide natural resources.

Table 1: Medium- and long-term ECA financing as a share of merchandise exports (%)

Country	Average 2005-08
Canada	0.9
France	1.9
Germany	1.0
Italy	2.2
Japan	0.7
United Kingdom	0.7
United States	1.0
Brazil	4.1
China	3.2
India	3.3

Source: Adapted from Hufbauer et al. (2011)

2.1 Main actors

In China, the bulk of export credits is provided by policy banks which were created in the 1990s before the country's WTO accession: China Export-Import Bank (Eximbank), China Export and Credit Insurance Corporation (Sinosure), China Development Bank, and China Agricultural Development Bank. All these policy-oriented financial institutions have the mandate to promote Chinese exports and investment abroad; they are fully owned by the Chinese government, and their management is appointed by, and report to, the State Council. Nevertheless, they differ in the services offered as described below.

China Eximbank

The Export-Import Bank of China was created in 1994 with the mission to promote the exports of Chinese mechanical and electronic products and high- and new-tech products, to support Chinese enterprises that have a comparative advantage in their "going-global" operations, to develop and strengthen relations with foreign countries, and to enhance Sino-foreign economic and technological cooperation and exchanges[1].

The China Eximbank primarily offers overseas financing through a range of activities such as export credits (including export seller's credit and export buyer's credit), international guarantees, loans for overseas construction and investment, and official lines of credit. It is the only Chinese bank authorised to provide concessional loans (Foster et al. 2009; Davies 2010). Its customer base consists mainly of state-owned enterprises and foreign trade corporations, but it also serves small and medium-sized enterprises (EIU 2011). The Bank's main source of funding is the bond market (Wang 2007). In 2010, its credit rating was upgraded from A+ to AA- from Standard and Poor's (EIU 2011).

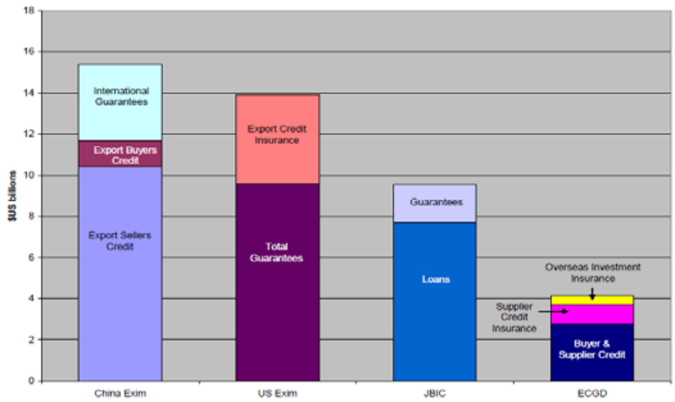
The China Eximbank's overseas financing activities have grown rapidly over time (see Figure 3 in section 2.2). According to the China Eximbank's 2009 Annual Report, in 2009 newly signed export seller's credit

[1] See http://english.eximbank.gov.cn/profile/intro.shtml

amounted to RMB 224.168 billion with disbursement adding up to RMB 173.085 billion; newly signed export buyer's credit amounted to USD 3.248 billion with disbursement of USD 4.313 billion; and the total value of issued letters of guarantee amounted to USD 6.711 billion.

The China Eximbank is now the third largest ECA in the world (Davies 2010). According to Moss and Rose (2006), China Eximbank's primary commercial operations in 2005 were (much) greater than those of export credit agencies in the US, UK and Japan (Figure 1).

Figure 1: China Eximbank versus OECD major ECAs, 2005



Source: Moss and Rose (2006). Notes: JBIC is the Japan Bank for International Cooperation;

ECGD is the UK Export Credits Guarantee Department.

Moreover, in 2009 the China Eximbank's assets base amounted to USD 116 billion (from USD 292 million in 1994) compared to an asset base of the Export-Import Bank of the United States equal to just USD 7.8 billion[2].

The China Eximbank is particularly active in supporting Chinese companies investing in infrastructure, oil and gas, mining, and telecommunication projects abroad, especially in Africa (Davies 2010; EIU 2011), and as a result has a focus on large-scale projects. In 2009 African assets accounted for one-third of the total asset base of the China Eximbank (compared to a share in Africa of only 7% of the total exposure of the Export-Import Bank of the United States)[3]. A share of 80% of the China Eximbank's funding activity in Africa is directed toward infrastructure projects[4].

China Export and Credit Insurance Corporation

The China Export and Credit Insurance Corporation (Sinosure) was created in 2001 – by merging the export-credit insurance departments of China Eximbank and the People's Insurance Company of China (PICC), with the mandate to promote exports and cross-border investments through export credit insurance and investment insurance. Sinosure is the sole policy-oriented insurer in China. So, different from China Eximbank, it is specialised in export credit insurance.

The wide range of services offered by Sinosure include short-, medium- and long-term export credit insurance, bond and guarantee facilities, as well as investment insurance and credit information service (EIU 2011). However, there is evidence that Sinosure is mainly focused on providing short-term (one-year) export credit insurance. Indeed, the PRI Centre (2007) reports that short-term insurance represents about 80% of the Corporation's business. In the first quarter of 2010, short-term export credit insurance

[2] See http://www.chinasourcingblog.org/2010/07/how-china-exim-bank-and-china.html

[3] Ibid.

[4] Ibid.

increased about 228 percent on year reaching a value of USD 26.5 billion, while medium- and long-term export credit insurance amounted to about USD 2 billion[5].

Sinosure's client base consists of Chinese-owned companies based both in China and overseas that have export licences (EIU 2011). Over the last years, Sinosure has made its services more accessible to SMEs. In Q1 of 2010, it provided an amount of USD 3.5 billion export credit insurance to them, soaring 169 percent in a year.

In the past few years, Sinosure's activities have grown significantly. Indeed, in 2010 the volume of insurance and guarantees reached a value of more than USD 150 billion, that is three times the volume of the Corporation's business in 2008 (EIU 2011). Export credit insurance amounted to USD 28.6 billion during the first quarter of 2010[6].

China Development Bank

The China Development Bank (CDB) is one of China's policy banks, but in 2008 the Bank's plan to transition to commercial status was approved (Brautigam 2010). The CDB is China's major domestic development bank and the world's largest development bank as measured by assets (Foster et al. 2009) At the end of 2010 the Bank's assets exceeded RMB 5 trillion[7]. In contrast to the China Eximbank, the CDB is focused less on international affairs. Indeed, its primary lending is aimed at investment within China especially in infrastructure, core industries (e.g. coal, electricity, oil, transport agriculture, forestry, water and communication) and nationally strategic projects, which accounted for almost three-fourth of the Bank's lending in 2010[8].

Nevertheless, the CDB has also extended its overseas financing activities by creating in 2007 an equity fund, the so-called China-Africa Development Fund (CADF), which aims to support Chinese firms investing in Africa. The proposed financing cap for the CDAF was $5 billion (Robertson and Corkin 2011). In 2009, the CADF invested USD 148 million on Africa, while deals announced in 2010 include USD 226 million for a South African wind farm, USD 284 million for a copper mine in the Democratic republic of Congo, and USD 228 million for a platinum company in South Africa[9].

China Agricultural Development Bank

The China Agricultural Development Bank is a state-owned agricultural policy bank founded in 1994. It promotes development of agriculture and rural areas and finances the government's subsidies for farmers. Its major businesses include; loans for procurement, reserves and marketing of grain; edible oil and cotton; loans for the construction of agricultural infrastructure (i.e. rural roads, power grids, water network, information networks, rural energy and environmental facilities); and loans for integrated agricultural development. Its financing is focused on rural areas in China.

The Bank's credit support for agriculture has increased significantly over time. At the end of 2010, the total loan balance in the China Agricultural Development Bank was twice that of 2005, reaching a value of RMB 1671.07 billion. Loans for procurement and reserves of grain, cotton and edible oil reached RMB

[5] See http://www.stonebtb.com/news/Export_Credit_Insurance/47913-China-s-export-credit-insurance-keeps-rising-in-Q1.shtml

[6] Ibid.

[7] See http://www.cdb.com.cn/english/Column.asp?ColumnId=100

[8] Ibid.

[9] See http://www.chinasourcingblog.org/2010/07/how-china-exim-bank-and-china.html

278.79 billion in total in 2010, while the loan balance for the agricultural infrastructure programme launched in 2007 amounted to RMB 468.24 billion[10].

2.2 Instruments and modalities

China offers a broad array of instruments to promote its exports, guarantee preferential access to natural resources and new markets, and to improve import terms with the developing world. These instruments include: (i) preferential export buyers' credits; (ii) export sellers' credits; (iii) mixed credits; (iv) natural resource-backed loans and lines of credit; (v) concessional loans; and (vi) others such as direct government subsidies or export economic zones. As the discussion below shows, some of these instruments seem to be official aid from China, but according to Chinese practices they are actually lines of credit. Moreover, the available public information on the instruments used by the Chinese government to support the country's export is very scarce.

1. *Preferential export buyers' credits* refer to credit provided to foreign borrowers to finance their imports of Chinese goods. They are subsidised but since their aim is to promote Chinese exports they do not classify as ODA. Preferential export buyers' credits can be offered at modest concessional rates (around 3 to 6 percent) in order to support particular deals of interest to China, and usually have a grace period that goes from 3 to 6 years, with maturities between 8 and 12 years (Brautigam 2010). They are always denominated in foreign currency.

2. *Export sellers' credits are* preferential loans for Chinese companies operating abroad. They are provided by the China Eximbank and are non profit-oriented. The capital of the Bank comes directly from a fiscal allocation by the Chinese government with the purpose of supporting Chinese exports, improving their competitiveness in the international market and helping to earn foreign exchange currency[11]. Figure 2 shows the trends of China Eximbank's export buyers' credits and export sellers' credits over the past years. It is worth noting that during and after the global financial crisis (2007-2008), both types of credit not only maintained their levels, but almost doubled their disbursements by the end of 2009.

Figure 2: Actual disbursements of export credit

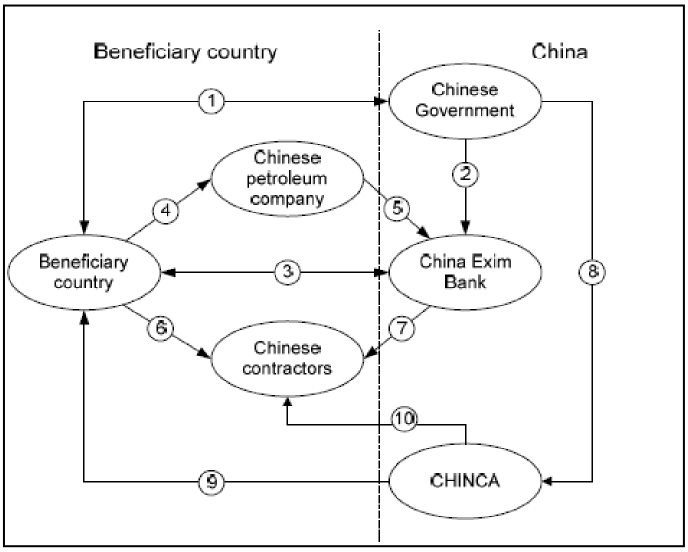
Source: Adapted from Chen (2010).

[10] See http://www.adbc.com.cn/report/2010report/en/25.htm
[11] See http://english.eximbank.gov.cn/businessarticle/activities/export/200905/9395_1.html

3. *Mixed credits* refer to a package financing mode which combines lines of export buyers' credit granted to a borrowing country together with export sellers' credit (short-term credit) provided to a Chinese company, and concessional loans (in the form of foreign aid) often offered for a specific project. These types of credits are similar to the mixed credits used by most OECD member countries (Brautigam 2010).

4. *Natural resource-backed loans and lines of credit (Angola Mode)*. In these types of credit, countries use their natural resources to guarantee a loan provided by China (usually to build infrastructure) with better terms and conditions than those available from traditional commercial banks. In most cases, the loan is contingent on a Chinese company obtaining preferential access to the natural resources to be developed. Figure 3 details a typical "Angola Mode" line of credit.

Figure 3: Angola Mode



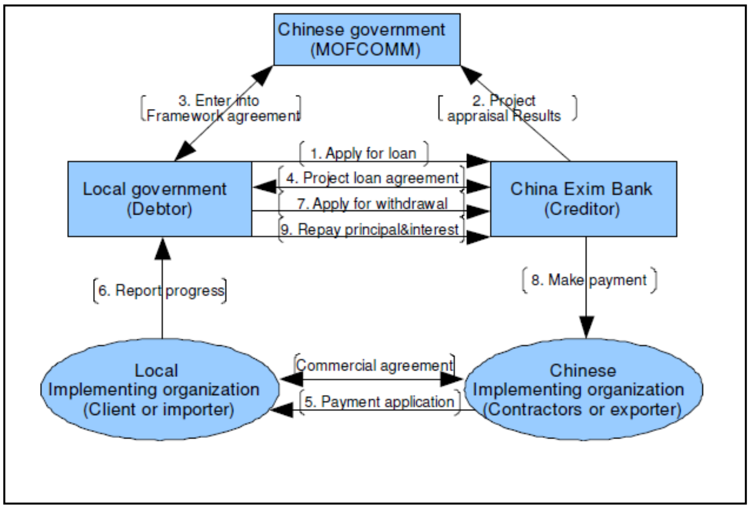
Source: Chen (2010).

According to the figure above, the flow works as follows: (1) the beneficiary country enters a framework agreement; (2) then the Chinese government nominates as the lender the China Eximbank; (3) the beneficiary country and the Eximbank reach a loan agreement; (4) the beneficiary country awards a Chinese company a license to extract the natural resources; (5) this company provides payment in-kind for the financial loan to Eximbank; (6) the beneficiary government then instructs a Chinese company to construct high priority infrastructure projects; (7) the Eximbank provides a loan for the project construction; (8) the Chinese government nominates as the coordination agency the China International Contractors' Association (CHINCA); (9) CHINCA in turn recommends to the beneficiary country a qualified candidate from its member contractors; and finally (10) CHINCA coordinates the Chinese contractors.

5. *Concessional loans* are loans offered to developing countries at subsidised interest rates, and are usually tied to Chinese exports. In other words, they are contingent on a certain percentage of Chinese goods and services being procured with that loan. This methodology is similar to the concessionary finance provided by traditional donors, and allows Chinese companies to gain an advantageous entry point to new markets. The loan can be used to buy equipment, technology, materials and/or services. However, at least 50 percent has to come from China (Davies 2010). It usually has a maximum maturity of 20 years with a grace period of 3 to 7 years (during this

period only interest payments are made, no repayment of the principal), and is denominated in Chinese Renminbi (Davies 2010). Figure 4 describes the flows of the parties involved and the different processes involved in a typical concessional loan.

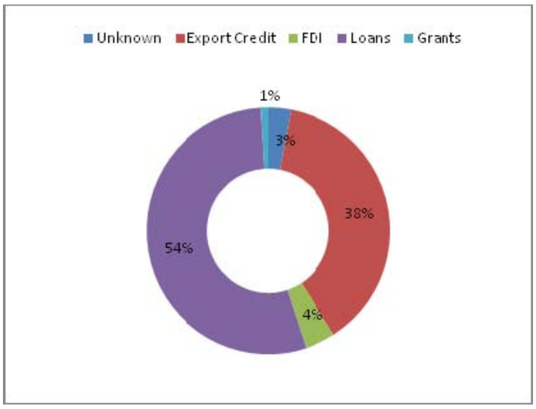
Figure 4: Structure of a Chinese concessional loan



Source: Chen (2010).

These types of loans are the most commonly used by China in Africa, accounting for more than half of Chinese finance of infrastructure projects within the continent (Figure 5).

Figure 5: Chinese finance commitment in Africa by financing modality, 2001-2009



Source: Adapted from Chen (2010).

6. *Special Economic Zones (SEZs)* are special areas that the Chinese government settled within China to attract domestic and foreign investment, and promote exports. The SEZs enjoy significant administrative autonomy when it comes to policies dealing with investment, taxation, pricing, labour and other related economic areas (e.g. the majority of foreign investments are approved locally, with very little central clearance). They offer better economic incentives (15 percent corporate income tax on all enterprises within the SEZs, compared to 33 for foreign owned enterprises and 55 percent for state owned enterprises outside the zones) and all imported inputs used in exports are free of import taxes or duty[12]. In 2006, as part of the so called "Going Global" plan, the Chinese government decided to establish up to fifty overseas economic and trade cooperation zones around the world, albeit without giving a precise

[12] See http://www.columbia.edu/~ap2231/Policy%20Papers/F&D-China-India-june95.pdf

timeframe (Brautigam 2009). The overseas zones usually involve three parties: (i) Chinese developers; (ii) local governments; and (iii) the Chinese government, where Chinese developers include both state-owned and private enterprises from China; local governments regulate the zones' activities and provide incentives for their development; and the Chinese government provides material and networking support for the zone developers.

2.3 Country examples

Chinese export credit financing through the instruments described above has increased remarkably over the past decades. Even though policy banks do not report their lending activity by country, some evidence can be found in the existing economic literature and in the media[13].

China Eximbank has been active in supporting Chinese exports, especially in Africa, according to its official "African Policy" that "encourages and supports Chinese enterprises' investment and business in Africa, and will continue to provide preferential loans and buyers credits to this end" (Government of China, 2006). By 2006 alone, China Eximbank had financed 259 projects in 36 African countries (Robertson and Corkin 2011). According to the World Bank, the sectoral concentration of these projects in Africa was 40% in power, 24% multi-sectoral, 20% transport, 12% telecom and 4% water, with 80% of the loans in 2006 going to Angola, Nigeria, Mozambique, Sudan and Zimbabwe (Durkin 2010). Export credit financing has also been extended to countries in South America and Asia. For example, China Eximbank, Sinosure and China Development Bank support several Chinese state enterprises in their hydropower project initiatives in Laos, Cambodia and Vietnam (IISD 2008).

One of the most highly publicized examples of Chinese *natural resource-backed loan* is the one arranged by China Eximbank in **Angola** in 2004. According to this agreement, China provided highly concessionary loans to build and rehabilitate Angolan infrastructure (e.g. railways, hospitals, telecommunications, secondary schools, etc.) in exchange of barrels of oil. After the success of the oil-backed financing in Angola, the mechanism became popular and the resources used to back deals have diversified to include bauxite (**Guinea** for the construction of the Souapiti dam in 2006), chromium (**Zimbabwe** for the construction of coal mines and thermal power stations in 2006), iron ore (**Gabon** for the Belinga iron ore reserve in 2006), and even cocoa (**Ghana** for the construction of the Bui dam in 2007) – see Table A1 in the Appendix. In 2007, China Eximbank offered to **Nigeria** an infrastructure loan of USD 2 billion at a very competitive commercial rate in exchange of preferential access to oil blocks; and signed an agreement with the Congolese government according to which China Eximbank offered USD 6 billion infrastructure loans to the Democratic Republic of Congo (**DRC**) secured by a copper-cobalt mining venture, of which Chinese firms would own 68 percent (Brautigam 2010). Moreover, in 2008 China provided a concessional loan of USD 4 billion to **Venezuela** to finance infrastructure, electricity, health and education projects to be paid back in oil (Lum et al. 2009). In 2009, China lent **Brazil** USD 10 billion in exchange for future oil shipments[14]. Similar package deals to finance construction projects were also concluded with **Costa Rica** and **Suriname**[15].

Regarding *mixed credits*, there is evidence that preliminary agreements were signed in 2006 between the China Eximbank and several African countries, such as the Republic of Congo, **Ethiopia**, **Equatorial Guinea**, Nigeria and **Mauritania** (Brautigam 2010). Other packages were also negotiated with Ghana, **Namibia**, and **Eritrea** (Brautigam 2010). In 2008, a package of USD 100 million combining a

[13] Note however that funds from China are frequently far below what is portrayed in the media (Brautigam 2010).

[14] See http://theglobalrealm.com/2011/04/20/south-america-awake-to-risks-of-china-ties/

[15] See Sangmeister H. "China's development policy engagement in Latin America and the Caribbean", Digital Development Debates. Available at: http://www.digital-development-debates.org/03-development-cooperation/new-donor-china/chinas-development-policy-engagement-in-latin-america-and-the-caribbean.html

concessional loan with credit lines was agreed between the China Development Bank and the Banco de **Chile** to support China's investment in ports, transport and mining (Lum et al. 2009).

On the other hand, in 2006 a USD 200 million *preferential buyers' credit* was provided by China Eximbank to **Nigeria** for the construction of the country's first communications satellite (Moss and Rose 2006), and a RMB 200 million preferential credit was also offered to **Turkmenistan** for telecommunications equipment (Chan-Fishel 2007). In 2004, the China Eximbank offered *sellers' export credit* to **Laos** for the construction of the Nam Mang 3 dam (IISD 2008).

Concessional loans were extended to several countries not only in Africa, but also in Latin America and South East Asia. As reported in Table A2 in the Appendix, in 2008 China provided concessional loans to **Gabon**, **Kenya**, **Sierra Leone**, **Grenada**, Venezuela, **Brazil**, and **Indonesia** among others. Moreover, a USD 2 billion loan was offered in 2007 for infrastructure projects in the **Philippines**, and in 2005 a USD 1 billion loan for the construction of a power plant was provided in **Vietnam** (Lum et al. 2009).

Interesting examples of *special economic zones* (SEZ) developed by Chinese are those in Zambia and Nigeria. The SEZ created in **Zambia** in 2003 represents the first Chinese-developed SEZ in Africa which concentrates on metal processing and light industries (e.g. food processing, pharmaceuticals, textiles, etc. – see Robertson and Corkin 2011). On the other hand, China funded two SEZs in **Nigeria** in 2006 and 2007 respectively. Both are mainly focused on manufacturing (Robertson and Corkin 2011). Other SEZs were settled in Algeria, Egypt, Ethiopia, and Mauritius[16].

In 2010, several deals involving China Eximbank were announced: a USD 900 million agreement to fund railway and other projects in Nigeria; a USD 300 million deal to build a power plant in **Vietnam**; more than USD 400 million for e-government and water supply projects in Ghana; a USD 1.7 billion loan to build a hydropower plant in **Ecuador**; a USD 20 billion deal to pump oil from the Orinoco Belt bloc in **Venezuela**; and a USD 10 billion loan to renovate the railway system in **Argentina** (EIU 2011)[17]. Other deals were agreed to back an airport upgrade in **Mozambique**, and to develop water supply in **Zimbabwe**[18].

3. CHINA AND THE OECD RULES ON EXPORT CREDIT

The rise of China's export finance activities poses an important challenge to Western exporters. China is not a member of the OECD and therefore does not need to comply by the same OECD rules that; limit tied aid and credits practices in OECD countries; impose maximum repayment terms, country risk classification and minimum interest rates; require the exchange of information on export finance activities; and impose social, environmental and governance standards on financing activities. This leads to unfair advantages for Chinese exporters.

3.1 Financing terms

In order to promote a level playing field for official support, a number of OECD members (i.e. Australia, Canada, the European Community, Japan, Korea, New Zealand, Norway, Switzerland, and the United States) agreed to the 1978 *Arrangement on Officially Supported Export Credits* which places limitations on the terms and conditions of officially supported export credit financing, so that competition among exporters is based on the quality and price of goods and services exported, rather than on the most favourable officially supported financial terms and conditions. It also limits the ability of governments to

[16] See http://www.american.edu/sis/faculty/upload/Brautigam_Tang_JMAS-2011.pdf

[17] See also http://theglobalrealm.com/2011/04/20/south-america-awake-to-risks-of-china-ties/

[18] See http://www.chinasourcingblog.org/2010/07/how-china-exim-bank-and-china.html

tie their concessional export credits to procurement of goods and services from their own countries (OECD 2010; te Velde 2010).

The OECD Arrangement stipulates the following (OECD 2010; te Velde 2010; Brautigam 2010):

- All forms of officially supported export credits are subject to repayment requirements within specific time limits;
- ECAs have to use the relevant Commercial Interest Reference Rate (CIRR) as the minimum interest rate;
- ECAs that provide guarantees or insurance need to charge a Minimum Premium Rate (MPR) to cover the credit risk, which shall be risk-based and adequate to cover long-term operating costs and losses;
- No concessional export credits shall be offered to countries whose income level, according to the World Bank data, is above the upper limit for lower middle income countries.
- No concessional export credits should be extended to commercially viable projects, for which CIRR should be used (so only commercially non-viable projects in lower income countries are eligible for concessional export credits);
- When allowed, concessional export credits should be given a concessional level of at least 35 percent, or 50 percent if the beneficiary country is a least developed country.
- Terms and conditions for concessional export credits should not be fixed for more than two years.

China did not agree to these norms. Even though there is no public information available on the financial terms offered by Chinese policy banks, anecdotal evidence shows that China usually offers more favourable financing terms than its Western competitors. For example, China's Eximbank loans have longer grace and repayment terms as well as generally lower interest rates (Robertson and Corkin 2011). Moreover, as shown by the country examples reported in Section 2.3, China has extended concessional loans to middle income countries such as Gabon and Brazil.

3.2 Transparency

In order to keep a level playing field for official support, OECD members agreed that export finance activities should be transparent. Indeed, the OECD Arrangement stipulates that (OECD 2010):

- a member who commits the official support is required to inform all other members;
- the credit terms and conditions of which should be notified to all other members.

China, which is not party to the OECD, is not constrained by these rules. Therefore, China Eximbank usually does not report the terms of its own export finance activities which thus often constitute unfair trade practices (see Section 3.4).

3.3 Environmental, social and governance standards

OECD members conform to an agreed set of environmental, social and governance standards in their export finance activities. For example, they have signed up to common approaches, Even though China has not put significant effort on promoting environmental and social standards, there is evidence that things are rapidly changing especially with respect to environmental responsibility.

The China Development Bank currently has a publicly disclosed environmental policy, according to which a loan application is not considered complete until the applicant has obtained approval from the relevant environmental agencies and the Bank is satisfied with its environmental compliance, and the companies engaged in the project are required to submit environmental impact assessment reports to the State Environmental Protection Administration (Chan-Fishel 2007). The China Eximbank also disclosed its environmental policy in April 2007 according to which environmental impact assessments for funded projects are required in the approval phase, implementation phase, and in the post-completion phase (Chan-Fishel 2007). New guidelines for social and environmental assessments, aligning the Bank's approach with the central government's "Green Credit" policy, were published in July 2008 (Brautigam 2010). Moreover, in 2008 China's State Environmental Protection Agency adopted the Equator Principles, and its State Council established a new "super ministry" of Environmental Protection (Brautigam 2010).

Nevertheless, there are still many projects funded by the China Development Bank and China Eximbank that are socially and environmentally controversial. For example, the China Eximbank-backed Ramu nickel mine in Papua New Guinea which employs the destructive practice of submarine tailings disposal (discharging mining waste into the ocean), or the financing provided by Eximbank to construct the Nam Mang 3 dam in Laos which is accused of destroying the habitat of elephants and many other rare species (Chan-Fishel 2007).

On the governance side, China does not impose conditions on governance and human rights before financing projects in other countries. This is in accordance with its policy of non-interference and contrasts with OECD members policies. OECD members agreed to the *OECD Recommendations on Bribery and Officially Supported Export Credits*, which aim to deter and sanction bribery of foreign public officials in international business transactions supported by official export credits, but these measures have not been adopted by China, even though it has ratified the UN Convention against Corruption (Brautigam 2010).

3.4 Examples of alleged unfair trade practices undertaken by the Chinese

There are several cases in which China, thanks to its more favourable financing terms, was able to undercut major OECD ECAs. For example, in 2010 the **Brazil**'s largest land-line company (Tele Norte), which was looking to buy network equipment, choose the offer made by Huawei Technologies Co. because of unbeatable terms compared to those of American and European bids. Indeed, thanks to the support of the China Development Bank, Huawei could offer access to a USD 30 billion credit line with an interest rate two percentage points lower than the London interbank rate, and a two-year grace period on payments (Hufbauer et al. 2011).

Other Chinese projects that won over their Western competitors include a USD 240 million project for a bridge construction in **Serbia**, which was 85 percent funded by China Eximbank at less than half the market rate; and a highway project in **Poland** that was secured with a tender one-third lower than the next lowest bid (EIU 2011).

Recently, in order to win a USD 477 million contract with the **Pakistan** government for the supply of 150 locomotives, China adopted a financing strategy by offering to finance USD 437 million of the total with a 12-year loan, at a fee of 8 percent (EIU 2011; Hufbauer et al. 2011). Nevertheless, in January 2011 the Export-Import Bank of the United States offered to match China's financing terms under the condition that Pakistan buys trains made by the American GE. Even though an initial agreement was reached between the GE and Pakistan Railways, the Lahore High Court in Pakistan ordered that the procurement tender was re-opened for bidding by all countries.

4. THE IMPACT OF CHINESE PRACTICES

China's export credits, concessional loans, and SEZs have played a strategic role in strengthening the economic relations between China and other developing countries, especially in Africa. This is vital for China in order to gain access to natural resources essential for its growing economy; to gain access to new markets for its manufactured goods; and to enhance its sphere of influence to become a global superpower (Haroz 2011).

As a result, Chinese trade deals with the developing world have increased markedly over the past decade. Sino-African bilateral trade increased from just USD 10 billion in 2000 to over USD 100 billion in 2008, and then reached a value of USD 129 billion in 2009 (Euro 90 bn)(Robertson and Corkin 2011). It is worth noting that while Chinese exports to Africa doubled between 2005 and 2009 from USD 20 billion to USD 40 billion, US exports to Africa moved from just USD 12 billion to USD 18 billion over the same period (Durkin 2010). The African Economic Outlook 2011 reports that in 2009 China surpassed the US, and China became Africa's main trading partner. In comparison EU (27) trade (exports plus imports) totalled some Euro 280bn in 2008. The EU exported goods worth Euro 120bn to Africa in 2008 and 2009. The economic recession in 2009 led to a sharp decline in African exports to the EU so that in 2009 the African surplus (mostly thanks to oil and gas) had changed to a virtual balance in trade (Eurostat, 2010)

Sino-Latin American trade has also soared from USD 12 billion in 2000 to more than USD 140 billion in 2008. China has become an important trading partner for major countries in the region, and is second only to the United States as an importer of commodities and goods from Latin America. China's largest trading partners in the Latin American region are Argentina, Brazil, Mexico, Chile, and Peru (Lum et al. 2009).

Chinese trade ties have also increased with South-East Asia. China became Vietnam's main trading partner during the past decade, having surpassed Japan, the European Union and the United States. It also became one of the main trading partners for Cambodia, exporting some USD 881 million USD to the country in 2007, a four-fold increase since late 2001. China's exports to South-East Asia are related mainly to machinery, consumer goods, electronic goods and fertilizers, while South-East Asian countries like Vietnam export to China raw materials, agriculture products, seafood and consumer goods (IISD 2008).

How have Chinese export finance activities been successful in contributing to the Chinese penetration of foreign markets? The main reasons of success of Chinese export credits are the following:

- China through the Eximbank supports its companies to invest in infrastructure, a sector which is vital for developing countries but which Western economies have often neglected in their aid strategies in favour of other sectors such as education and health. This is especially the case in African countries where such projects are considered unable to deliver a sufficient rate of return to offset the investment risks (Moss and Rose 2006; Haroz 2011).
- While the exposure of OECD ECAs is concentrated in a few middle income countries such as Russia, Saudi Arabia, Nigeria, or Brazil, China's policy banks support Chinese firms entry into markets that tend to be ignored by Western companies because they are too risky or corrupt (Moss and Rose 2006).
- Chinese banks offer more favourable loan terms such as longer grace and repayment terms, and lower interest rate (Robertson and Corkin 2011; Haroz 2011). Moreover, in contrast to Western ECAs, China provides export credit financing with (almost) no political, economic, environmental or human rights conditions attached (Robertson and Corkin 2011; Moss and Rose 2006). Indeed, China's only condition for political and economic cooperation is the One China Policy, i.e. partner

governments may not have official contacts with Taiwan. This has been key in Chinese penetration of markets such as Sudan and Zimbabwe that have questionable governance regimes and cannot have access to funding from traditional donors.

– China's export credits represent an alternative source of unconditional financing for countries heavily dependent on Western aid such as Ghana and Mozambique. Chinese loans can also be used as leverage against traditional donor demands.

– The lack of any colonial relationship between China and its partner countries, especially in Africa, means that Chinese engagement does not carry the baggage of the past, which may facilitate negotiations (Moss and Rose 2006, Haroz 2011).

– China is seen as more ready to transfer technology to its partner countries. For example, there is evidence that China has established a growing number of factories to process African raw materials in Africa, instead of just extracting low value-added African commodities for onward processing in China (Haroz 2011)[19]. Moreover, China offers professional training to African workforce. Evidence shows that between 2000 and 2006 16,000 African professionals were trained in China; another 15,000 received training between 2007 and 2009; and 20,000 more African professionals are expected to be trained from 2010 to 2012 (Haroz 2011). A Nigerian official noted that "The Western world is never prepared to transfer technology – but the Chinese do, [and] while China's technology may not be as sophisticated as some Western governments', it is better to have Chinese technology than to have none at all" Haroz 2011). This is probably a reference to the protection of their intellectual property rights by EU exporters that generally use more sophisticated technology.

– The credit export instruments offered by China contribute to increase partner countries' trade volumes which might help economic development. Even though most of African exports to China consist of timber, fuel and other crude materials, there is some evidence that China has started to encourage a broader range of African exports (Haroz 2011). Between 2006 and 2008, African exports to China increased by an annual average of 110 percent (Haroz 2011). But there must be some concern that dependence on raw materials exports to the OECD countries may be replaced by a similar dependence on exports to China.

Nevertheless, the increases in China's export credit financing is not risk-free for its partner countries, especially in Africa:

– Low-income countries have received debt relief from the OECD countries through the heavily indebted poor countries (HIPC) initiative, in which China refused to participate[20]. China could however be said to be benefiting from HIPC in that the Western debt relief has provided scope for developing countries to incur new debt from China. If African countries now accumulate too much debt too quickly by borrowing from China to finance much needed investments, they may experience new debt sustainability issues (see Box 1 below). Foster et al. (2009) by comparing the face value of Western debt relief (i.e. the sum of bilateral – Paris Club –, HIPC and multilateral debt relief initiatives) with new financial commitments to China in a selected number of African countries, show that Guinea has already contracted Chinese debt in excess of the value of

[19] There is also evidence that Chinese companies partner with local firms when submitting bids in Senegal, and subcontract local firms in Angola and DRC (Brautigam 2010).

[20] HIPC debt relief was also conditional. In other words, governments relieved of debt were obliged to use the resources released by debt relief for key development-related expenditure that included, for example, education and health care.

Western debt relief, and other countries such as Mauritania and Nigeria have contracted loans equivalent to a high share of their Western debt relief, i.e. 39 and 54 percent respectively. Moreover, some of the largest beneficiaries of Chinese finance (Angola, Sudan and Zimbabwe) might be at risk since they have not even been beneficiaries of debt relief initiatives.

Box 1. The debt sustainability issue in DRC

The problem of debt sustainability emerged in the case of the natural resource-backed loan signed in 2008 between China Eximbank and the DRC government. According to this agreement, Chinese firms pledged to build infrastructure in exchange for copper and cobalt mining concessions. Nevertheless, DRC was heavily indebted and had an interim status in the HIPC programme. So, the deal with China risked hampering DRC's chances of reaching the HIPC completion point thus raising the issue of debt sustainability. For this reason, the IMF (successfully) pressed for a revision of the agreement to make it compatible with the viability of the DRC's debt.

Source: Davies (2010).

– The rise of China as a significant source of finance may present a threat to governance improvements in its partner countries, especially those characterised by weak institutions such as Angola, Congo, Nigeria and Sudan (Brautigam 2010, Haroz 2011). First, by transferring large funds to poorly governed regimes, China may contribute to increased corruption. Second, since China does not impose any conditions on governance or human rights before financing projects, Chinese finance may provide a lifeline for repressive and authoritarian governments (Brautigam 2010).

– The stream of cheap Chinese exports to (especially) Africa may reduce incentives for African firms to build productive capacity or make their products less competitive in foreign markets. This is true for Latin American countries as well. Indeed, recently Argentina was forced to impose anti-dumping measures on Chinese footwear and textile products due to unfair competition[21]. Moreover, since Chinese infrastructure loans require hiring a certain number of Chinese workers, Chinese migrants may become competitors for Africans or Latin Americans in their job markets.

– Finally, there is a risk that countries endowed with natural resources such as several African countries are seeing their resources drain slowly away without profiting enough from Chinese deals. So far, there is some evidence suggesting that countries such as Nigeria, Congo and Angola are not using their resources to leverage better deals with China in order to further promote their own development (Haroz 2011). The situation may become even worse in smaller and less resource-rich countries such as Togo, Mali and Burundi.

Furthermore, as reported in Section 3, China's export finance activities pose an important challenge for EU exporters. China is not a member of the OECD and therefore it is not constrained by OECD rules:

– China is not covered by the Arrangement on Officially Supported Export Credits which guides OECD countries' export credit financing, ensures transparency of export finance activities and helps to ensure that competition among exporters is based on the quality and price of goods and services exported rather than on the most favourable officially supported financial terms and conditions.

- China does not impose conditions on governance and human rights before financing projects in other countries while OECD countries have reached agreements on combating bribery.
- The effort of OECD countries in promoting environmental and social standards in export finance activities is not mirrored in projects funded by Chinese policy banks, many of which are socially and environmentally controversial.

All this has led to unfair advantages for Chinese exporters (compared to their Western competitors) in making deals with other countries.

[21] See http://theglobalrealm.com/2011/04/20/south-america-awake-to-risks-of-china-ties/

5. CONCLUSIONS

Chinese export credit financing has increased remarkably over the last years, reaching values well above those of several OECD members (including the US and different EU member states) and has been an important part of China's "going-global" strategy.

The bulk of export credit is provided by China's policy banks (i.e. China Eximbank, Sinosure, China Development Bank, and China Agricultural Development Bank), which are policy-oriented financial institutions with the mandate to promote Chinese exports and investment abroad, and it comes in a broad variety of instruments including preferential export buyers' credits, export sellers' credits, mixed credits, natural resource-backed loans or lines of credit, concessional loans, and export economic zones (SEZs).

Through all these export finance instruments, China has strengthened its economic relationships with countries in several developing regions: Latin America, Asia, but especially Africa. In this way, it has gained significant access to natural resources and new markets, and enhanced its sphere of influence to become a global superpower.

There are many reasons behind the success of Chinese export credits in contributing to China's penetration of foreign markets. First, export finance has been extended to countries and sectors (especially infrastructure) that have been often neglected by Western economies in their aid strategies. Secondly, Chinese policy banks usually offer more favourable financial terms than their OECD competitors. Thirdly, China's export finance represents an alternative way of financing for countries heavily dependent on Western aid, does not come with conditions on human rights, governance and environment, and can be used as leverage against traditional donor demands. Finally, China is beginning to transfer some technologies and offer some limited professional training to its partner countries.

Nevertheless, China's export credit financing is not risk-free for its partner countries. Indeed, it can lead to new debt sustainability issues, and slower reform processes in countries with weak governance systems. China can also become a threat for local products and workers in partner countries, and can drain their natural resources without contributing enough to development. There have also been reports that the quality of Chinese backed infrastructure is poor.

Furthermore, as long as China is not ready to develop common standards with OECD countries, China's export finance activities pose an important challenge for Western exporters. China is not obliged to comply by OECD rules that limit tied credits practices; impose maximum repayment terms, country risk classification and minimum interest rates; require the exchange of information on export finance activities; and impose social, environmental and governance standards on financing activities. This has led to unfair advantages for Chinese exporters (compared to their Western competitors).

In order to remove distortions to international trade an important first step would be to introduce transparency in Chinese export finance activities and make sure that exporters operate on equal terms. Better information on financial terms of Chinese deals should also be gathered with a view to developing common standards. It is important to continue promoting engagement with Chinese officials. Indeed, it is hard to believe that endemic corruption in Africa only apply to European contractors while all the Chinese ones are at arm's length and pay fair market value for the resources they exploit. Contracting practices are murkier than those generally followed by the EU and may suggest that not everything is done according to sound let-alone best international practice.

From a developing country perspective, governments of China's partner countries should do more to benefit more from Chinese financed deals. They should bargain better deals with China, for example insisting on competitive tenders for their procurement requirements, or building up local capacity to negotiate favourable natural resource deals with China. They should also make efforts to safeguard their job and product markets.

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7. APPENDIX

Table A1: Selected Chinese natural resource-backed financing, 2001-07

Country	Year of commitment	Natural resource to be received in payment	Project description	Total Chinese financing (USD millions)
Congo Rep. of	2001	Oil	Congo River Dam. Backed by crude oil guarantees.	280
Sudan	2001	Oil	Construction of the El-Gaili (Al Jaily) Power Plant, first two phases with Sudan's oil serving as collateral for the loans.	128
Angola	2004	Oil	Oil-backed loan to repair damaged infrastructure bombed in the country's civil war (power, transport, ICT, and water portion). China to receive 10,000 barrels of oil per day.	1,020
Nigeria	2005	Oil	Construction of gas turbine power plant at Papalanto. PetroChina secured by a deal to purchase 30,000 barrels of crude oil a day from Nigerian National Petroleum Corporation for a period of one year, renewable.	298
Guinea	2006	Bauxite	Souapiti Dam Project. Reportedly linked to mining (bauxite) revenues.	1,000
Gabon	2006	Iron	Belinga iron ore reserve. Loan to be repaid via sales of iron ore to China.	Not available
Zimbabwe	2006	Chromium	Construction of new coal mines and three thermal power stations in Dande, in the Zambezi valley on the Zambian border. In exchange Zimbabwe was to provide China with chromium.	Not available
Ghana	2007	Cocoa	Bui Dam hydropower project. Part of the loan will be repaid in cocoa exports to China.	562
Total				**3,287**

Source: Adapted from Foster et al. (2009).

Table A2: Selected Chinese concessional loans (announced or begun), 2008

Country	Type of Assistance or Investment	Funding Source	Description	Value in US dollars (b= billion, m= million)
Africa				
Congo	Infrastructure/Public Works	Concessional Loan	optical cable network	35 m
Gabon	Infrastructure/Public Works	Concessional Loan	Hydroelectric dam	83 m
Kenya	Infrastructure/Public Works	Concessional Loan	road construction	120 m
Sierra Leone	Infrastructure/Public Works	Concessional Loan	Telecommunications network	20 m
Latin America				
Brazil	Natural Resources	Concessional Loan	oil exploration	10 b
Cuba	Humanitarian	Concessional Loan	hurricane relief - repair of hospitals	70 m
Grenada	Infrastructure/Public Works	Concessional Loan	tourist marina	83 m
South-East Asia				
Indonesia	Infrastructure/Public Works	Concessional Loan	power plants	615 m

Source: Adapted from Lum et al. (2009).

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