

## SIGNIFICANT DECLINE IN CHINA'S LENDING TO LOW- AND MIDDLE- INCOME COUNTRIES

### — AGAINST THE BACKDROP OF A CHANGING ECONOMIC ENVIRONMENT AND A RISE IN PROBLEM LOANS —

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#### SUMMARY

- China's loans to low- and middle-income countries in 2020 amounted to US\$13.8 billion. While it is still the world's largest lender, China's loans have fallen to about 40% of the record high seen in 2018 (US\$33.1 billion).
- However, there has been no major change in the list of the loan recipients. The reason for the decrease in the volume of loans is thought to be that China has become cautious about lending to low- and middle-income countries generally, following changes in the economic environment and an increase in problem loans giving rise to concerns over repayment. It is unlikely that lending will increase significantly again.
- It is possible that the decline in Chinese lending could lead to situations where low- and middle-income countries lack the funds required for social infrastructure development or suffer a deterioration in their foreign currency cash flow.

As the volume of loans extended by China to low- and middle-income countries began to increase in the 2010s, warnings were sounded over China's growing influence, and the term "debt trap"<sup>1</sup> began to be heard. However, according to the World Bank's International Debt Statistics, China's lending reached its peak in 2018 and has since declined. This report presents an overview of the changes in the volume of loans provided by China to low- and middle-income countries, traces the change in the countries and regions in receipt of large loans from China, and examines the reasons for the decline in China's lending. The report also looks at the possible impact on the low- and middle-income countries should this decline continue.

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#### 1. CHINA'S LOANS TO LOW- AND MIDDLE-INCOME COUNTRIES DECREASE FOR TWO SUCCESSIVE YEARS

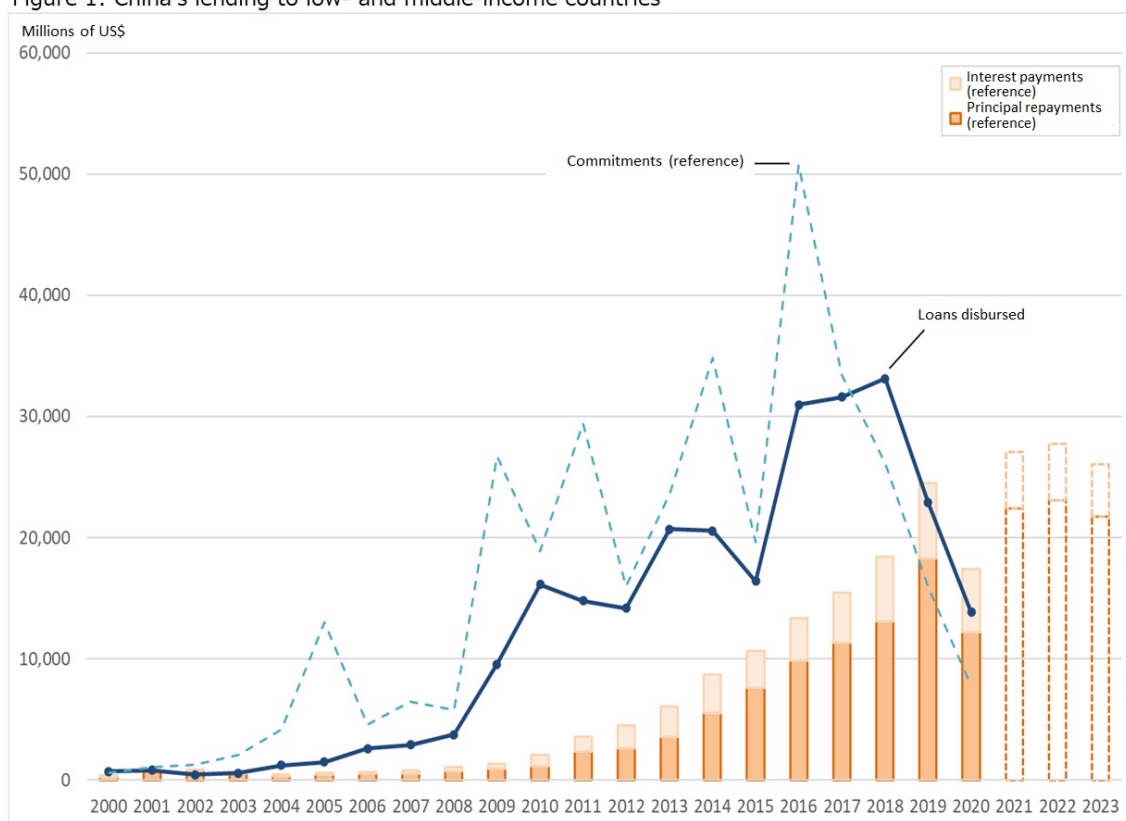
##### 1-1. From US\$33.1 billion in 2018 to US\$13.8 billion in 2020

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<sup>1</sup> While there is no strict definition for this term, in this case it refers to the acquisition of a borrower's real assets, such as social infrastructure, in return for releasing the borrower from repayment of the loan, or to the act of making a loan with the specific aim of acquiring real assets.

According to the International Debt Statistics, China's loans to low- and middle-income countries in 2020<sup>2</sup> amounted to US\$13.8 billion (Figure 1). The debt of these countries against China increased from US\$166.4 billion in 2019 to US\$170.4 billion. While this is still larger than any other country in the world, the volume of loans has fallen for the past two years, to about 40% of its peak of US\$33.1 billion in 2018<sup>3</sup>. Equivalent loans by Japan, the world's second largest lender nation, amounted to US\$11.9 billion in 2020, significantly narrowing what had previously been approximately a three-fold difference with China. Furthermore, China's loan commitments to low- and middle-income countries fell for four years in a row, from a 2016 peak of US\$50.8 billion to US\$7.8 billion in 2020, which was a sign that China's lending was going to decline.

Figure 1: China's lending to low- and middle-income countries



Note: Dashed columns indicate estimates.

Source: Compiled by MGSSI based on the World Bank's International Debt Statistics

## 1-2. Average loan amount falls

In 2020, China provided a simple average of US\$230 million in loans per country to 60 low- and middle-income countries. In 2018, the figure was US\$490 million for loans to 68 countries. While the amount loaned to individual countries may have fluctuated, the average amount decreased. Compared to the other large loan lender nations,

<sup>2</sup> The International Debt Statistics are compiled based mainly on the reports of long-term government debt submitted to the World Bank by debtor countries (borrower countries) financed by the World Bank, and strictly speaking, it is not possible to ascertain the amount of loans made by creditor countries (lending countries). In this report, for the long-term debt of low- and middle-income countries, the amount borrowed by a particular country from China is considered to be equal to the amount loaned by China to that country. Also, the total amount of Chinese loans is regarded as being equal to the total borrowings of 122 low- and middle-income countries excluding China itself.

<sup>3</sup> According to the International Debt Statistics, the Netherlands loaned a total of US\$28.3 billion to low- and middle-income countries in 2020, significantly higher than the loans extended by China and Japan. However, US\$28.1 billion of this amount consisted of private sector loans to Brazilian public enterprises that were guaranteed by the Netherlands' Export Credit Agency. In terms of bilateral government loans to Brazil, for example, China was the leading lender, providing US\$11 billion in loans, followed by Japan with US\$10.6, compared to the Netherlands' zero. At the end of 2020, China was the largest creditor, with a balance of loans standing at US\$170.4 billion (of which US\$156.1 were bilateral government loans), followed by Japan with US\$125.2 billion (US\$119.6 in bilateral government loans), and the Netherlands with US\$71.4 billion (26th place in terms of bilateral government loans, which totaled US\$700 million).

a particular feature of China's loans to low- and middle-income countries is that large amounts are provided to specific countries in specific years, with the largest loans of US\$12 billion going to Angola in 2016, US\$8 billion to Brazil in 2017, and US\$7.8 billion to Pakistan in 2018<sup>4</sup> (Figure 2). However, this trend subsided in 2020, and the largest loan China provided was US\$3.2 billion to Pakistan. Moreover, in 2020, Chinese loans to oil-producing countries such as Angola and Ecuador decreased significantly, and this appears to be a consequence of lower energy prices.

Figure 2: Leading recipients of China's loans to low- and middle-income countries

(US\$100 mil.)

	2016		2017		2018		2019		2020		Debt (reference)	
Total	309.7		316.1		331.3		229.1		138.5		1,703.8	
1	Angola	119.6	Brazil	80.0	Pakistan	78.2	Pakistan	54.3	Pakistan	32.1	Pakistan	233.9
2	Ecuador	33.7	Angola	43.6	Angola	51.1	Angola	24.1	Bangladesh	9.3	Angola	220.8
3	Pakistan	20.4	Pakistan	39.3	Brazil	20.0	Laos	9.7	Sri Lanka	7.9	Ethiopia	79.3
4	Egypt	16.3	Kenya	15.0	Egypt	19.6	Belarus	9.6	Kenya	7.6	Kenya	74.0
5	Ethiopia	14.0	Argentina	10.7	Bangladesh	18.5	Republic of t <sup>r</sup>	9.4	Angola	6.9	Sri Lanka	68.2
6	Kenya	12.7	South Africa	10.0	Sri Lanka	13.8	South Africa	9.0	South Africa	6.2	Laos	54.7
7	Uzbekistan	5.7	Ethiopia	9.2	Kenya	11.6	Kenya	8.0	Côte d'Ivoire	5.3	Ecuador	51.4
8	Serbia	5.6	Sri Lanka	6.7	Ecuador	10.0	Serbia	7.8	Uzbekistan	4.9	Brazil	50.6
9	Belarus	5.6	Cameroon	6.6	Laos	9.0	Nigeria	7.6	Uganda	4.8	Belarus	47.8
10	Sri Lanka	5.1	Kazakhstan	6.5	Belarus	8.3	Sri Lanka	6.8	Laos	4.7	Bangladesh	45.7

Note: Debt is as of December 31, 2020.

Source: Compiled by MGSSI based on the World Bank's International Debt Statistics

## 2. LEADING RECIPIENTS OF CHINESE LOANS REMAIN UNCHANGED

### 2-1. Three South Asian countries top the list of China's borrowers

The leading recipient of Chinese loans in 2020 was Pakistan, which received US\$3.2 billion, followed by Bangladesh at US\$900 million, and Sri Lanka at US\$800 million; therefore, the three top recipients were South Asian countries, while India was not among them. Pakistan's outstanding debt to China is US\$23.4 billion, the largest of the 122 low- and middle-income loan recipients. The China-Pakistan Economic Corridor is said to be the flagship project of China's Belt and Road Initiative, while Sri Lanka is seen as a key strategic point on the Maritime Silk Road. Looking at Pakistan's bilateral government debt, 63% of the total is owed to China, and in the case of Sri Lanka, it is 47%. This indicates that these countries have a close relationship with China. On the other hand, 25% of Bangladesh's total bilateral government debt is owed to China, far less than the 47% that is owed to Japan<sup>5</sup>. Moreover, progress on the Bangladesh-China-India-Myanmar Economic Corridor is said to have halted due to opposition from India<sup>6</sup>.

### 2-2. China's Continued Interest in Africa

By region, Asia's share of Chinese finance increased in 2020 compared to 2019, and while loans to Africa still accounted for almost 40% of the total, it represented a slight decrease. Nevertheless, since five of the top ten borrowers were the sub-Saharan African countries of Guinea, Angola, South Africa, Cote d'Ivoire, and Uganda, China's interest in Africa cannot be said to have diminished. For example, Guinea received US\$800 million, increasing the country's loan balance to US\$1.5 billion in 2020, more than double the 2019 figure of US\$700 million. Guinea possesses the world's largest reserves of bauxite, a raw material used for producing aluminum, and is home to some of the mines with the world's largest reserves of iron ore. Moreover, China provided no

<sup>4</sup> A large loan to Angola in connection with the capital restructuring of the state-owned oil company Sonangol, a large loan to Brazil for debt repayment by the state-owned oil company Petrobras, and a relatively large loan to Pakistan for hydroelectric and coal-fired power generation projects are recorded for the period from 2016 to 2018 in a dataset compiled by AidData, a research lab at the College of William and Mary in the US. AidData (2021), "AidData's Global Chinese Development Finance Dataset, Version 2.0". <https://www.aiddata.org/data/aiddatas-global-chinese-development-finance-dataset-version-2-0>

<sup>5</sup> According to the International Debt Statistics, India is the recipient of the largest amount of bilateral government loans from Japan at US\$22.7 billion. In second place is Vietnam at US\$15.7 billion, followed by Indonesia at US\$12.6 billion and Bangladesh at US\$ 8.6 billion.

<sup>6</sup> The Sasakawa Peace Foundation, Mitsuki Fukasawa "Politics, Economy, and China in the South Asia Region: Trends in Today's South Asia Amid the Covid-19 Pandemic (July 15, 2021), [https://www.spf.org/asia-peace/covid19/20210715\\_1.html](https://www.spf.org/asia-peace/covid19/20210715_1.html)

finance to South Africa until 2016, but since an initial loan of US\$1 billion in 2017, South Africa's balance of Chinese loans has since grown to reach US\$2.9 billion in 2020.

### 2-3. Little change in the leading borrowers over the past 20 years

Looking back over the past 20 years, the leading recipients of Chinese loans can be broadly divided into three groups: (1) energy-producing countries such as Angola, (2) neighboring countries and countries along the Belt and Road corridor such as Pakistan, and (3) major African countries such as Ethiopia (Figure 3). While some countries, such as Iran, Sudan, and Myanmar, have disappeared from the list in recent years, the leading recipients have not changed significantly.

Figure 3: Changes in the leading recipients of Chinese loans to low- and middle-income countries

	Energy-producing countries		Neighboring and BRI countries		Major African countries				(US\$100 mil.)
	2001-05	2006-10	2011-15	2016-20	2001-20 Total				
Total	<b>46.1</b>	<b>350.0</b>	<b>866.7</b>	<b>1,324.6</b>	<b>2,587.3</b>				
1	Iran 10.0	Brazil 80.4	Angola 103.0	Angola 245.2	Angola 400.5				
2	Sudan 6.2	Angola 50.7	Turkmenista 71.1	Pakistan 224.2	Pakistan 292.1				
3	Pakistan 4.5	Sudan 19.5	Ecuador 67.1	Brazil 100.7	Brazil 181.4				
4	Laos 2.8	Pakistan 18.1	Ethiopia 63.9	Ecuador 54.8	Ecuador 129.9				
5	Serbia 1.9	Ethiopia 18.1	Pakistan 45.2	Kenya 50.8	Ethiopia 115.1				
6	Nigeria 1.6	Sri Lanka 13.8	Myanmar 38.6	Egypt 43.7	Sri Lanka 90.8				
7	Angola 1.6	Turkmenista 11.8	Sri Lanka 35.8	Sri Lanka 40.3	Turkmenista 83.2				
8	Republic of t 1.5	Myanmar 11.0	Belarus 33.8	Bangladesh 38.7	Kenya 82.4				
9	Venezuela 1.3	Belarus 9.1	Kenya 29.0	Belarus 34.3	Belarus 77.5				
10	Philippines 1.2	Ecuador 8.0	Tanzania 23.5	Ethiopia 33.0	Laos 62.3				

Source: Compiled by MGSSI based on the World Bank's International Debt Statistics

## 3. WHY HAS CHINA'S LENDING DECREASED?

### 3-1. Changes in China's economic environment

One of the reasons for the decrease in Chinese lending to low- and middle-income countries is thought to be changes in the economic environment surrounding the country. Not only has economic growth slowed, but China's current account surplus, which had exceeded US\$100 billion since 2005, plummeted to US\$24.1 billion in 2018 when trade friction with the US intensified. With its huge current account surplus exposed to international criticism, it seems that it was China's intention to increase its lending to low- and middle-income countries and thereby compensate for its deteriorating international reputation. Furthermore, as shown by the government's dual circulation strategy that attracted much attention in 2020, the fact that China's policy management was, relatively speaking, focused on domestic demand is also believed to be a factor.

### 3-2. An increase in problem loans

As China's lending increased over time, some borrowers had trouble making repayments and the number of problem loans gradually increased, and the fact that China therefore became more cautious about providing loans is also considered to be a factor behind the decrease in lending. The total volume of loans for which China agreed to a repayment grace period surged from US\$100 million in 2019 to US\$1.4 billion in 2020. The bulk of this amount is believed to be the result of the application of the Debt Service Suspension Initiative (DSSI)<sup>7</sup> that was agreed upon by major countries in light of the spread of COVID-19. Considering that many countries in receipt of loans from China are low-income countries in the first place, this cannot necessarily be a problem peculiar to Chinese financing. That said, of the top ten recipients of Chinese lending over the past decade, more than half, six to be exact, are in receipt of support from the International Monetary Fund's (IMF) Extended Fund

<sup>7</sup> An initiative introduced at a G20 Finance Ministers and Central Bank Governors' Meeting in April 2020 and agreed upon by the Paris Club (a group of major creditor countries) that offers 73 low-income debtor countries the opportunity to request deferral of the repayment of bilateral government debt. When requested by a debtor country, the initiative applies to all the country's creditors, not just China.



Facility<sup>8</sup>. Like Angola, the recipient of the largest total loan amount, many of these countries are concerned about the sustainability of their debt repayment capabilities. Ecuador, China's third largest borrower in the past decade, partially defaulted on its debt in 2020.

### 3-3. The possibility of China's lending to low- and middle-income countries increasing again

It appears that China has become cautious about lending to low- and middle-income countries generally, and at the same time is avoiding taking excessively large risks. The slowdown in China's economic growth is likely to continue, and considering the grace periods for repayment after loans are made, it is probable that loans to low- and middle-income countries that have the potential to develop into problem loans will still increase. While it is possible that changes in bilateral relations between China and borrowing countries have had an effect, or that the COVID-19 pandemic may have spurred the decline in lending in 2020, given that the amount of loans to most countries has fallen, it is unlikely that China will significantly step up its loans to low- and middle-income countries again. However, if heightened concern over the supply of primary commodities prompts action to secure resources again, or if China decides to embark on new environmental projects, leveraging its competitiveness with respect to low- and middle-income countries, it is possible that China's lending could increase.

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## 4. THE EFFECT OF THE DECLINE IN CHINESE LENDING

As mentioned at the beginning of this report, the increase in China's lending to low- and middle-income countries gave rise in some quarters to alarm over China's growing influence. Conversely, if China's lending continues to decline, China's influence can be expected to wane.

However, many low- and middle-income countries run current account deficits<sup>9</sup>, and have concerns over foreign currency financing to varying degrees. While countries with sufficiently large current account surpluses or foreign currency reserves should not need to worry for the present, for countries whose foreign currency financing is supported by Chinese loans there is a risk that a decrease in Chinese lending will put pressure on cash flows. In such cases, one countermeasure would be to reduce imports of goods and services. It should also be noted that this could delay or hinder the development of social infrastructure in low- and middle-income countries.

Also, in the case of countries that have received large loans from China to date, the outflow of foreign currency may increase going forward due to debt repayments. Combined with the decline in China's lending, this will cause "double trouble" for some countries, and could lead to countries defaulting, especially those heavily in debt to China.

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<sup>8</sup> The Extended Fund Facility (EFF) is an IMF mechanism for providing medium-term support to countries experiencing balance of payment problems. As a general rule, the IMF requires countries to implement structural adjustments as a condition for extending supportive loans. Of the leading ten low- and middle-income countries receiving Chinese loans in 2020, six countries, Angola, Pakistan, Ecuador, Ethiopia, Kenya, and Sri Lanka, are currently in receipt of EFF loans.

<sup>9</sup> Of the 121 low- and middle-income countries, excluding Syria and China, 96 had a deficit in their total current account balance in the three years from 2018 to 2020, and 25 had a surplus.