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China's approach to sovereign lending and debt restructuring: A primer for African public debt managers

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Acknowledgements

This primer was prepared for discussions on the options and opportunities for restructuring sovereign debt, with a special focus on how lenders from China view debt restructuring in Africa, during CABRI's Policy Dialogue on negotiating fair and balanced contracts with creditors/investors in Africa, on 6 October 2021. The primer was compiled by Ms Yunnan Chen, Senior Research Officer, with assistance from Ms Shakira Mustapha, Research Fellow at the Overseas Development Institute (ODI), and reviewed by Philipp Krause and Johan Krynauw of the CABRI Secretariat.

Acronyms and abbreviations

BRI	China’s Belt and Road Initiative
CDB	China Development Bank
CF	Common Framework for Debt Treatments beyond the DSSI
CIDCA	China International Development Cooperation Agency
DSSI	Debt Service Suspension Initiative
ECCO	Economic and Commercial Counsellor’s Offices
FOCAC	Forum of China Africa Cooperation
ICBC	Industrial and Commercial Bank of China
LIBOR	London Inter-Bank Offered Rate
MDB	Multilateral Development Bank
MOF	Ministry of Finance (People’s Republic of China)
MOFA	Ministry of Foreign Affairs (People’s Republic of China)
MOFCOM	Ministry of Commerce (People’s Republic of China)
NPV	net present value
OECD	Organisation for Economic Co-operation and Development
PBOC	People’s Bank of China
SAFE	State Administration of Foreign Exchange

1 Introduction

Over the last two decades, China has emerged as Africa's largest bilateral official creditor, alongside an increasingly diverse set of creditors from other emerging economies as well as the private sector. Due to the magnitude of its lending, China will play an important role in debt restructuring for several African countries experiencing difficulties in repaying their debts due to the COVID-19 shock, in addition to debt vulnerabilities existing before the pandemic.

China has provided an important source of financing for the region and contributed to various development gains. However, Chinese lending has, in some cases, exacerbated debt management challenges and contributed to debt vulnerabilities. Chinese lending has also been controversial due to the lack of transparency of its terms and conditions. This has fuelled fears that Chinese debt contracts impose harsh terms on governments and undermine sovereignty. Although some of these fears are overblown, lack of transparency around Chinese debt can complicate debt restructuring, as shown by the recent experiences of Zambia and Angola.

The government of China and its various lending institutions rarely make detailed information on its lending terms and policies publicly available. Officially, China has released three white papers on international development cooperation; these were published in 2011, 2014, and most recently in January 2021. The most recent white paper provides some high-level details about a small proportion of China's official overseas finance between 2013 and 2018 but does not cover details of commercial loans and export credits from policy banks or commercial banks (State Council 2021).

However, there is an emerging body of research that provides significant insights into China's lending patterns, historical patterns of debt restructuring (Development Reimagined and OCAC 2019; Kratz, Feng, and Wright 2019) as well as new research on China's loan contracting arrangements (Gelpern et al. 2021).

This primer aims to serve as a guide for African policymakers, particularly in the debt or aid management office, seeking to understand China's approach to sovereign lending and debt restructuring. We draw on the most recent knowledge and literature on China that is publicly available from reputable sources, particularly academia and think-tanks, as well as selected interviews with experts in this area.

The primer is structured as follows. Section 2 describes trends and patterns of Chinese lending to Africa, the key financial and political institutions involved in Chinese lending, and the terms and conditions of Chinese lending. Section 3 outlines China's approach to renegotiating different types of loans and the politics of the process, and assesses the implications of the recent G20 Debt Service Suspension Initiative and the Common Framework for China's approach to helping debtor countries resolve liquidity and solvency issues. Section 4 concludes with the key take-away messages and recommendations for public debt managers and other decision-makers in borrower governments.

"China has provided an important source of financing for the region and contributed to various development gains."

2 China's lending and debt in Africa: an overview

This section describes:

- Trends and patterns in Chinese lending to Africa
- Key financial and political institutions involved in China's overseas lending
- Terms and conditions of China's overseas lending.

2.1 Trends and patterns in Chinese lending to Africa

Chinese loans to African governments have been on an upward trajectory for more than a decade. Although the Chinese government does not publish official country-by-country data on its overseas lending, it is estimated to have lent US$152 billion to African governments and state-owned enterprises between 2000 and 2018, with a peak in 2013 coinciding with the announcement of China's new Belt and Road Initiative (see Box 1) (SAIS-CARI n.d.; GDPC 2020). The top recipients of Chinese loans in Africa are Angola, Ethiopia, Zambia and Kenya, accounting for almost 50 percent of China's total lending to Africa between 2000 and 2018.

New loan commitments to Africa tend to follow the cycle of the Forum of China Africa Cooperation (FOCAC), which takes place every three years (most recently in 2018). The next FOCAC summit is due to be held in late 2021, in Senegal and online. FOCAC serves as a platform to signal sectoral priorities in China-Africa cooperation on, for example, infrastructure, industry and trade (Calabrese et al. 2018). The 2018 FOCAC was the first summit that did not see an increase in the pledged financing commitment from China, which continued the 2015 commitment of US$60 billion over three years (Brautigam 2018; Moore 2018). In general, Chinese state-led overseas lending volumes have been in decline since 2017 (GDPC 2020). China's Belt and Road Initiative (BRI) now places increasing emphasis on "high quality investment", including through greater use of project finance, risk mitigation tools, and green finance (Xie 2020).

Box 1: China's Belt and Road Initiative

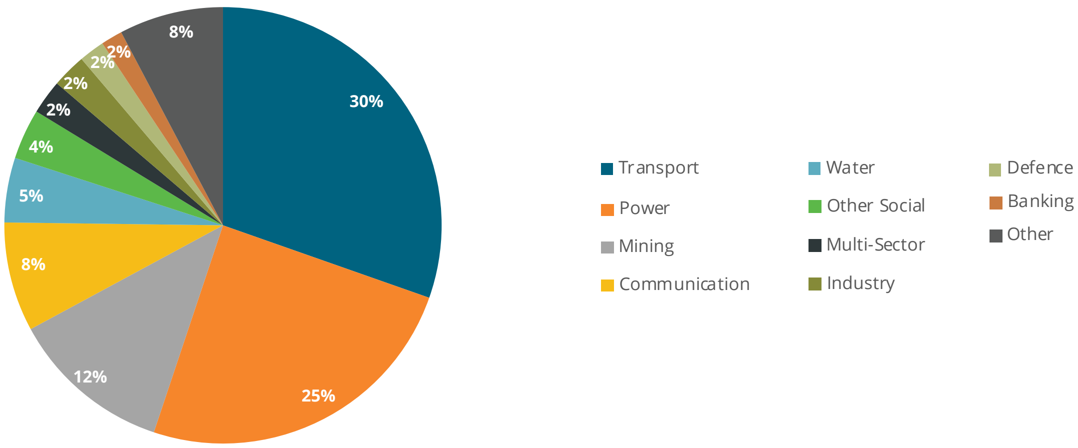
China's BRI, a strategy initiated by the People's Republic of China in 2013, seeks to connect Asia with Africa and Europe via land and maritime networks with the aim of improving regional integration, increasing trade and stimulating economic growth. While it does not entail a systematic programme, and remains a nebulous concept, it has become the dominant policy framework through which China engages in economic and diplomatic partnerships overseas.

The five major priorities of the initiative are policy coordination; infrastructure connectivity; unimpeded trade; financial integration; and connecting people. To help achieve these priorities, the BRI involves a very large programme of investments in infrastructure development for ports, roads, railways and airports, power plants and telecommunications networks, as well as cultural programmes and exchanges. As of January 2021, at least 133 countries have signed a memorandum of understanding with China to be part of the BRI, including 40 African countries. The rhetoric of the BRI has also become part of FOCAC since 2015 and is a central theme in the most recent 2021 white paper on development cooperation.

By sector, Chinese loans focus overwhelmingly on hard infrastructure sectors, with over half of the loans going to transportation and power sectors, where they have supported high-profile and high-cost projects in railways, roads, hydropower dams and transmission projects. These projects tend to be tied to a Chinese contractor or supplier, generally via the engineering, procurement and construction (EPC) model.[1]

1 Further information on Chinese financed projects in Africa can be found at the Boston University China's Overseas Development Finance database found here: https://www.bu.edu/gdp/chinas-overseas-development-finance/. This data is not directly provided by the Government of China and has been compiled using official government documents, contractor websites, fieldwork, interviews, and media sources.

Figure 1: Sectoral distribution of Chinese loans to Africa, 2000–2019



2.2 Key financial and political institutions involved in China's overseas lending

The Chinese government is not a single creditor with a coherent policy framework guiding all its official lending activities. There are many Chinese lending institutions, including state-owned policy banks, state-owned commercial banks and state-owned enterprises, all engaged in official lending activities, and each with their own lending policies.

The bulk of China's lending comes from a small set of institutions: the two primary policy banks, China Eximbank and China Development Bank (CDB). China Eximbank has been the largest bilateral financier in Africa, although CDB has grown in presence since 2010. Foreign aid loans have been managed by the new foreign aid agency, the China International Development Cooperation Agency (CIDCA), since 2018, before which they were disbursed through the Ministry of Commerce (MOFCOM). Much of this foreign aid comes in the form of zero-interest loans, and concessional loans, where aid is used to subsidise the interest rate. A small but growing subset from the larger Chinese commercial banks (primarily the Industrial and Commercial Bank of China [ICBC] and the Bank of China) are also emerging as lenders in Africa. Further details on each of these financial institutions are provided in Table 1.

Although the major policy banks have relative autonomy in decisions around lending, they are accountable to and supervised by a set of political institutions. These include the State Council, various ministries, China's Central Bank and the recently created CIDCA. **The State Council is the most important institution in decisions around major debt restructuring.** Alongside CIDCA, the Ministry of Finance (MOF) plays a key role in foreign aid loans and is involved in debt relief for zero-interest loans and concessional loans, while the Ministries of Commerce and Foreign Affairs play a coordinating role in the overseas activities of Chinese companies, particularly via embassies and consulates in host countries (see Table 2 for further details).

Table 1: Key financial institutions involved in China's overseas lending

Financial institution	Description
China Development Bank	CDB is a ministry-level government agency under the supervision of the State Council and regulated by the China Banking and Insurance Regulatory Commission (CBIRC). It is one of the major policy banks, and supports national level strategies in China-Africa cooperation and the BRI. Despite this strategic role it occupies a hybrid status as a bank, and the Chinese government insists that CDB is not an official bilateral lender but a commercial bank in the context of the Debt Service Suspension Initiative (see Section 3.4 below), as it lends only on commercial terms without government subsidy.
China Export-Import Bank (China Eximbank)	China Eximbank is a vice-ministry-level government agency and the largest export credit agency. It is a policy bank and an "official" creditor. It is the only institution to provide foreign aid subsidised concessional loans, which are used for CIDCA-approved infrastructure projects. The majority of China Eximbank's loans are export buyers' credits, which provide USD-denominated loans to governments and parastatals, and are tied to the purchase of Chinese goods and services. These subsidise up to 85% of the project cost. They are more costly than concessional loans and are not subsidised by the government.
Sinosure	Sinosure is an export credit agency under the supervision of the State Council. It does not offer direct loans, but provides insurance for Chinese exporters, contractors, and lenders, and is the primary provider of risk insurance for China's overseas investment and the BRI. Sinosure provides political and commercial risk insurance in the event of loan non-repayment, which is often considered essential for commercial loans issued by CDB and commercial banks. Sinosure plays a critical role in approving loan agreements for loans that have credit insurance, and must be notified of any repayment issues. In the case of default, Sinosure will assume the rights of the lenders in negotiating outcomes, and has final say in the approval of any loan restructuring (Chen 2020).
Other commercial lenders (ICBC, Bank of China)	China's major banks are ultimately state-owned, but act as independent, commercial institutions. ICBC and Bank of China are two relatively new but emerging players in Africa.

Table 2: Political bodies involved in China's overseas lending

Political institution	Description
State Council	The State Council constitutes the highest administrative authority in China, and governs China's foreign aid and international development cooperation policies. It has final authority in the approval of foreign aid budgets and grants, and other loan projects above certain thresholds, and it also has final authority over any loan restructuring from the major policy banks and Sinosure.
Ministry of Finance	The MOF provides financing and approvals for foreign aid loans (zero-interest loans and concessional loans), and plays a role in China's multilateral finance as a creditor and shareholder to several major multilateral development banks. It is not involved in commercial loan restructurings but oversees any debt relief for foreign aid lending.
People's Bank of China (PBOC)	PBOC is China's central bank, governing monetary policy and regulation of the financial sector. It also represents China as a non-borrowing shareholder in several regional multilateral development banks. PBOC manages China's foreign exchange reserves via the State Administration of Foreign Exchange (SAFE). PBOC and SAFE do not play an active role in overseas debt restructuring. However, SAFE does have substantial shareholding in the major commercial banks, in Sinosure and in CDB, which entails structural pressures on banks' lending in foreign currency to recoup losses.
Ministry of Commerce	Prior to 2018, MOFCOM was the primary actor in China's overseas foreign aid projects and in managing the activities of Chinese companies and investments overseas. Since 2018, the administration of foreign aid has moved to CIDCA. MOFCOM is represented in-country by the Economic and Commercial Counsellor's Offices (ECCOs), which occupy a similar status to the official embassy, and may play a coordinating function with Chinese contractors and private enterprises.
Ministry of Foreign Affairs (MOFA)	MOFA oversees foreign aid and loan projects to ensure they support China's foreign policy and may coordinate with CIDCA in initiating new projects. The ambassador and embassy on the ground may also play a coordinating role in Chinese enterprises, alongside the ECCOs.
China International Development Cooperation Agency	CIDCA is a vice-ministry level agency under the State Council in charge of political coordination of foreign aid. It was established in 2018 through a merger of foreign aid staff from both MOFCOM's Department of Foreign Aid and the Ministry of Foreign Affairs (MOFA), and replaced MOFCOM as the lead coordinator of foreign aid. CIDCA is in charge of overall foreign aid policymaking and foreign aid country programming, conducts foreign aid negotiations on behalf of the Chinese government, signs international agreements and approves Eximbank's concessional loans and zero-interest loans. However, as a vice-ministry, it is outranked by MOFCOM, MOFA and many of the state-owned enterprises it is meant to supervise.

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2.3 Terms and conditions of Chinese official lending

Depending on the financial institution, China provides foreign aid loans in the form of zero-interest loans and concessional loans, non-foreign aid official loans and commercial loans. On average, the terms of Chinese official lending (from state-owned policy banks, China Development Bank and China Eximbank) tend to be less concessional than World Bank lending, but still more concessional than private or commercial lenders, making it a competitive alternative for borrowing governments (Morris, Parks and Gardner 2020). Based on available data, the financial terms of loans typically offered by each Chinese lending institution are summarised in Table 3.

Compared to other Organisation for Economic Co-operation and Development (OECD) official bilateral creditors, Chinese lending and loan contracts also appear to be more commercial in character. Chinese loan contracts include common-use clauses to manage repayment risk through mechanisms such as collateral, often via revenues from commodity exports or other forms of revenue streams, which are held in special reserve accounts (Gelpern et al. 2021). This has been particularly prominent in Angola, which accounts for 70 percent of China's total resource-backed loans to Africa – when Angola is excluded, only 8 percent of China's loans to Africa are resource-backed (Acker and Brautigam 2021). Such mechanisms, as well as the use of confidentiality clauses and "non-Paris Club" clauses that restrict debt restructuring, more closely resemble contracts of commercial or private sector creditors than of official creditors.

Crucially, confidentiality clauses do not appear to override domestic laws and requirements for parliamentary scrutiny. Contracts may be made public if mandated by domestic law. This reinforces the need for African governments to develop and adhere to robust institutional and legal frameworks that clearly define the legal decision-making process and requirements for borrowing.

> ***"Depending on the financial institution, China provides foreign aid loans in the form of zero-interest loans and concessional loans, non-foreign aid official loans and commercial loans."***

Table 3: Common terms of Chinese overseas lending

Lending institution	Terms of financing
China's Ministry of Commerce/CIDCA	Zero-interest loans, typically RMB-denominated (0% interest rates, 20-year maturities, 10-year grace periods); no counterpart funding required.
China Development Bank (CDB)	Medium- and long-term market rate loans in USD/EUR, set to LIBOR rate plus margin at a typical rate of 4.5–6%; varying maturity and grace periods.
China Eximbank	Concessional loans in RMB, set to fixed rate (usually 2–3%, 15–20 year maturities, 5-year grace periods). Export buyers credits, export sellers credits, preferential export buyers credits, USD-denominated. Terms vary, but typically fixed interest rates and more generous than prevailing market rates. Preferential export buyers credits slightly more expensive (higher interest rates, shorter maturities, and shorter grace periods) than China Eximbank concessional loans, but more competitive than standard export buyers credits (usually at market rates).
Sinosure	Political and commercial risk insurance for overseas lending. May cover up to 95% of loan cost for export buyers' credit insurance. Provides short-term export credits for trade, investment insurance to private and state-owned enterprises.
Other commercial lenders (ICBC, Bank of China)	Medium and long-term market rate loans in USD/EUR, set to LIBOR rate plus margin at a typical rate of 4.5–6%; varying maturity and grace periods.

3 China's approach to debt restructuring

This section describes:

- Renegotiating foreign aid loans
- Renegotiating policy bank loans
- Political economy of Chinese loan restructurings
- China's participation in COVID-19 debt relief initiatives.

While China can be characterised as a flexible and often collaborative partner, institutional and political constraints within financial institutions means that **debt cancellation is usually extremely limited, and large-scale debt forgiveness highly unlikely.** Debt negotiations and decision-making structures vary greatly by the type of loan and the creditor involved, and outcomes are determined on a case-by-case basis. While asset seizures in the event of a default (the "debt-trap" myth) are very unlikely (Acker, Brautigam and Huang 2020; Kratz, Mingey and D'Alelio 2020), so is outright debt cancellation, or the use of debt relief instruments, such as debt-for-equity swaps.

Since 2012, as BRI loans have increased, China has forgiven significantly less debt. Debt rescheduling, which extends the repayment period of the debt, has become more common than haircuts that would reduce the principal amount of the loan (Development Reimagined and OCAC 2019; Bon and Cheng 2020). Like most creditors, Chinese lenders seek to preserve the net present value (NPV) of the loans, thus postponing debt repayments or extending grace periods is possible, as long as interest payments on loans are being met (Kratz, Mingey and D'Alelio 2020). **As such, the G20 Debt Service Suspension Initiative (DSSI), which temporarily suspends debt service payments and thus does not involve any form of debt cancellation, does not represent a deviation from past practice for China (see section 3.4 below).**

3.1 Renegotiating foreign aid loans

For foreign aid loans, restructuring decisions are made at the ministerial level through a collective decision-making process between MOFA, MOFCOM and CIDCA (as the implementing agency for foreign aid after 2018).

Since zero-interest loans come from the foreign aid budget, cancellations tend to be responsive to political signals. They are largely the only loans that have been subject to outright loan forgiveness. In Africa, Beijing extended debt cancellations for zero-interest loans due to mature by the end of 2020 (Xinhua 2020). While such write-offs are common in China's previous debt restructures with developing countries, they are small in impact. Zero-interest loans form no more than two percent of overall lending to Africa, and this debt relief does not apply to the bulk of concessional, commercial and export credit lending that characterises Chinese overseas loans (Acker, Brautigam and Huang 2020; Kratz, Mingey and D'Alelio 2020; Kratz, Feng and Wright 2019).

3.2 Renegotiating policy bank loans

For debt renegotiations regarding Eximbank and CDB loans, requests for debt relief are considered on a case-by-case basis, the terms of which differ, depending on whether they are Eximbank or CDB loans, or loans from the commercial banks.

As a pure policy bank, Eximbank loan restructuring of concessional loans requires a government-to-government agreement, whereas this does not apply to CDB and commercial banks. In the past, this was evaluated by a coordinating committee in Beijing, led by the MOF, along with MOFCOM, CIDCA, Eximbank and CDB (Brautigam 2020), although it is not clear if this is still the case. Since many of the infrastructure project loans from Eximbank have both concessional and commercial components, these credit facilities require separate, parallel processes for negotiation, and may entail a more prolonged process overall.[2]

CDB and other commercial banks such as ICBC or Bank of China can act more autonomously regarding amendments to loan terms and debt restructuring. However, because commercial banks, and to a degree, CDB, operate in a competitive market context, their capacity to offer debt relief is highly constrained by their need to avoid impact on their balance sheets. In the case of commercial loans, any request for changes in commercial loan agreements are first escalated to the credit committee in the bank, who

2 Interview, 10 March 2021.

Table 4: Loan restructuring outcomes by type of facility

Type of loan	Lending institution	Renegotiation process	Likely outcomes
Foreign aid loans	CIDCA/MOFCOM: zero-interest loans	Collective decision between MOFA, MOFCOM and CIDCA	Loan forgiveness/write-off
	Eximbank: concessional loans	Government-to-government agreement	Rescheduling, maturity extension
Non-foreign aid official loans	Eximbank: export buyer's credits	(Likely) government-to-government agreement	Rescheduling, maturity extension, haircuts to interest rate in rare cases
	CDB: market-rate loans	Internal to CDB, may be subject to political pressure	Rescheduling, rare cases of maturity extension
Commercial loans	ICBC, Bank of China, China Construction Bank, Agricultural Bank of China: market-rate loans	Internal to bank	Rare cases of rescheduling

Source: Rudyak and Chen 2021

have the power to approve repayment deferrals. Negotiations can then be escalated upwards to the board, who have final decision over any changes to loan agreement terms. However, political and institutional factors, discussed below, mean any changes that entail a financial loss to the bank are highly unlikely.

For commercial loans with Sinosure involvement, Sinosure must also be notified of any issues that may lead to delayed repayment. In the event of a default, Sinosure plays a decisive role in overseeing and approving any loan restructuring agreement. Sinosure is supervised by the State Council, and can escalate decisions up to the State Council for final approval.

3.3 The political economy of Chinese loan restructuring

Structural factors of personal liability and precedent in Chinese financial institutions mean that any financial losses recorded have career and possible political repercussions for personnel. This personal liability factor encourages bank staff to be conservative, and can lead to a rigid and aggressive negotiation process with borrowing governments and a structural incentive to escalate decisions upwards, even to the State Council. Political authorisation is **essential** for any decision in loan restructuring that may entail a financial loss for the institution.

China has historically resisted joining the Paris Club, an informal group of official bilateral creditors that seeks to find coordinated solutions for debtor countries experiencing payment difficulties. However, China responds to international pressures, with Chinese debt relief frequently coinciding with debt relief actions by OECD and other lenders. Chinese debt restructuring appears responsive to IMF actions, which are more likely to coincide with a principal haircut (reducing the amount of debt repayment) than rescheduling (Bon and Cheng 2020). For example, China's restructuring of the Republic of Congo's debts in 2019 was partly due to pressure from the IMF (Gardner et al. 2020).

China's approach to debt is highly sensitive to the bilateral relationship. In cases of significant loan restructuring for commercial loans, the strategic bilateral relationship of the borrower, and endorsement from the top level has been key:

the 2018 restructuring of Ethiopia's Addis-Djibouti railway loan, for example, was secured with personal interventions from Prime Minister Abiy Ahmed and President Xi Jinping during the FOCAC summit that year (Maasho 2018).

The negotiation capacity and bargaining power of governments matter. In 2019, prior to the COVID-19 crisis, the Republic of Congo faced pressure from the IMF to restructure its debts to China in order to gain access to an IMF package. A financial analysis of the terms of the restructure show that the republic was able to extend the maturities of most of its China Eximbank loans and gain haircuts on the interest rates of others. However, despite the favourable appearance of these terms, the NPV of total repayments to Eximbank after the restructuring was actually higher, and does not leave the Republic of Congo's long-term debt position better off (Gardner et al. 2020). The case indicates the need for strengthened analysis and public scrutiny of these deals before they are finalised.

3.4 China's participation in COVID-19 debt relief initiatives

In 2020, Beijing pledged to hold "friendly consultations with African countries according to market principles" in dealing with commercial loans with sovereign guarantees (FMPRC 2020). The most recent white paper on foreign aid makes clear that loan renegotiation will occur on a bilateral basis (State Council 2021), although China has proactively taken part in multilateral debt initiatives. As of 2021, 13 countries are in ongoing debt negotiations with China.

China's approach to sovereign debt restructuring has not changed fundamentally despite supporting the two G20 initiatives in the wake of COVID-19: the DSSI and the Common Framework for Debt Treatments beyond the DSSI (CF). The DSSI temporarily suspends debt service payments, owed by 73 low-income countries to official bilateral creditors, between April 2020 and December 2021 (following two extensions). The CF proposes a reduction in overall debt levels on a case-by-case basis for those DSSI countries deemed to have unsustainable debt. Participation of debtor countries in both initiatives is voluntary and starts with a request from the debtor country. To date 32 African countries are participating in the DSSI and 3 countries (Chad, Ethiopia and Zambia) have requested a CF treatment (see Box 2).

Although the G20 DSSI and CF have not led to a substantive change in China's approach to debt restructuring as described above, **China's support and participation in these two initiatives are politically significant**. The G20 text for the CF essentially creates a Paris Club-like arrangement that includes China (and other G20 members that are not part of the Paris Club), without a move by the Chinese government to formally join the club itself. **However, operationalising these initiatives is not without its challenges**.

First, China's leadership have restricted the scope of the DSSI's application for overseas lending. China constitutes the largest contributor of debt relief within the mechanism, covering a combined US$2.1 billion under the framework, according to China's Ministry of Finance (Reuters 2020). However, only China Eximbank is classed as an official creditor under the framework. China Development Bank is excluded, despite its clear strategic role as a "policy bank", since it is framed as a commercial bank whose lending is not subsidised directly through the state budget. As such, the DSSI does not automatically apply to CDB loans, which must be negotiated bilaterally outside of the initiative.

Outside of the DSSI participant countries, China has been in bilateral negotiations with Liberia and Rwanda. Private Chinese creditors, CDB and ICBC have also been in negotiations to suspend debt service in the case of Zambia in the last year, acting independently of the DSSI framework, but ostensibly influenced by it.

The CF does adopt the Paris Club's comparability of treatment standard for all creditors, which would require debtors to seek debt relief from CDB. This conflicts with the "Non Paris Club" clauses that may be found in some CDB contracts. Although such a requirement is unlikely to be enforceable in the court of any major financial jurisdiction, combined with other contract terms, it could give the lender more bargaining power in a crisis (Gelpern et al. 2021). Moreover, because neither the Paris Club nor the IMF insist on the restructuring of any particular creditor's claims – only on comparability and adequate financial assurances from all creditors in the aggregate – **there is little reason to believe that CDB would be compelled to absorb a proportionate share of the losses.** This in turn may discourage other creditors, particularly private sector creditors, from providing comparable debt treatments.

Second, China's willingness to provide debt relief under the CF may be undermined by the lack of private sector participation and vice versa. In contrast to the DSSI, for which private sector participation is voluntary, the CF requires participating debtor countries to seek treatment on comparable or better terms from other creditors, including the private sector. However, despite placing this burden on debtor governments, the CF lacks a mechanism for meaningful private creditor involvement. Fear of creditor downgrades and loss of market access may also prevent governments from requesting private sector involvement, and further deter other borrowing countries from participation. The lack of private sector engagement can lead to a stand-off between Chinese creditors and bondholders, as was the case in Zambia in late 2020. Neither bondholders nor Chinese creditors were willing to grant concessions for debt relief, given the assumption that gains from debt relief were to be used to repay the other creditor. The final agreement between Zambia and CDB and Sinosure was to defer repayments from October 2020 until April 2021.

Third, the scope of both the DSSI and the CF is small, covering only a subset of developing countries classed as "least developed countries" (LDCs). It does not cover middle-income emerging market countries, including some of China's largest borrowers, or countries currently in arrears, and it remains voluntary to borrowers.

Despite challenges, China's participation in the CF and with the IMF has been constructive to date, and it clearly views participation to be within its interests. Two official Chinese bilateral creditors (Eximbank and CIDCA) have provided over US$1.3 billion in G20 DSSI relief to 23 countries worldwide, including 16 African countries, according to Chinese officials (CARI 2021). This has been driven largely by China's Ministry of Finance, with Eximbank representing negotiations in the creditor committee. The Paris Club acts as a focal point for OECD and commercial creditors.[3] If the first three cases under the CF prove positive for debtor states, then the framework may become more attractive to other debtor countries that need to restructure their debts (see Box 2 for further details). While developments are still uncertain, there is ambition on the part of the CF creators to create an institutionalised debt workout structure that would go beyond the Paris Club and the current fragmented arrangements.

Beyond the DSSI and the CF, other debt relief mechanisms are also being proposed by a variety of international actors. Proposals linking debt relief to climate and sustainability goals – for example, through debt-for-nature or debt-for-climate swaps – are gaining prominence (Koop 2021; Simmons et al. 2021; Yue and Wang 2021) These proposals potentially align with China's articulated policy commitment to climate action, including its pledge towards carbon neutrality by 2060, its promotion of climate investment in a "green" BRI, and its commitments to biodiversity and conservation. Through the PBOC, China has also seen an expansion of green financial instruments in recent years, including green bonds, signifying a broad-based prioritisation of green objectives in China's financial system and overseas lending. Other proposals using Brady-type debt restructuring were successfully deployed in Latin America in the 1990s, and commodity-linked bonds have also been floated. Given China's position as a major importer of many primary commodities, the latter may be of potential interest to Chinese creditors, as it takes advantage of the natural commodities that many African economies have in abundance as a natural hedge, reducing credit risk for the lender (Qian 2021).

Thus far, China's position on debt-swaps is unclear; the strategy has not yet been trialled for any overseas loans from Chinese creditors. However, the current crisis may be a critical juncture that provides incentives for innovative solutions. It is likely that any significant debt relief proposals involving such instruments will require top-down political endorsement from the State Council or above, and would mark a significant departure from the current reliance on deferrals/rescheduling.

Box 2: Update on negotiations under the Common Framework for Debt Treatments beyond the DSSI

As of September 2021, only three countries have signed up to the CF: Chad, Ethiopia and Zambia (Republic of Zambia Ministry of Finance 2021; Shalal and Strohecker 2021). The debt challenges that these countries face are quite different, and the CF is intended to provide a treatment that is tailored to their specific needs. Each of these cases will be a key test of the comparability of treatment clauses in the CF, particularly that of Zambia due to the importance of bondholders.

Chad was the first country to apply to the CF in January 2021 and appears to be furthest along in discussions: a creditor committee comprising the major bilateral creditors was formed in April 2021, and an agreement reached with the IMF.[4] As of September 2021, the creditor committee have agreed to provide debt treatment for Chad, but details of the intervention have not yet been released.[5] Although there is still no clarity on private sector restructuring, the absence of publicly traded external debt, such as Eurobonds, possibly makes Chad's debt restructuring less complex.

Ethiopia requested to join the CF in February 2021 and a creditor committee has recently been established to enable the delivery of the debt operation that Ethiopia is requesting. The first meeting was held on 16 September 2021 (Endeshaw 2021).

Zambia was the third country to request debt restructuring under the CF, in February 2021. Zambia was also the first pandemic-era sovereign default in November 2020 after failing to make payment of a coupon on one of its dollar bonds. Although talks with the IMF have progressed, with broad agreement on the macroeconomic framework, it is expected that much of the work for the restructuring will begin after September 2021, following the August election.

3 Interview, 15 September 2021.
4 Interview, 30 June 2021.
5 Telephone conversation, 2 September 2021.

4 Conclusion

4.1 Key take-away messages

China's system of overseas lending is fragmented between multiple institutions and actors, and patterns of debt renegotiation and outcomes will vary, depending on the type of debt and lending institution. Only zero-interest loans, which come from the foreign aid budget, are likely to receive debt cancellation, while options for debt relief become narrower for more commercial loans. In fact, while official Chinese financial institutions may agree to debt rescheduling deals when a government falls behind on scheduled repayments, and have engaged in renegotiating the terms of the original loan, this is much rarer for loans from state-owned commercial banks.

Chinese lenders are structurally constrained from providing debt relief, particularly for commercial loans that result in a balance sheet loss. Structural and political incentives within banks mean that individual bankers have limited authority over loan restructuring decisions, and rely on escalation and approval from the top down for significant changes to loan terms. This may entail a prolonged negotiation and restructuring process.

Political signals and international pressures can make a difference. In cases where we have seen debt restructuring or significant debt relief, this is often in response to political signals from top leadership. Forums such as FOCAC and other BRI summits can be key venues for leveraging political relationships. However, this depends heavily on the initiative and leverage of governments, and is not systematic. Similarly, the involvement of other international actors, such as the IMF, can generate external pressures on China to respond and sometimes crowd in parallel debt relief.

China's support of the G20 DSSI and CF has improved coordination among official bilateral creditors on debt treatments for eligible countries facing a range of sovereign debt challenges. However, China's assertion that CDB is not an official creditor, the exclusion of middle-income emerging economies from these initiatives and significant uncertainty regarding private sector involvement suggest limited progress on a multilateral arrangement for debt workouts.

4.2 Recommendations for public debt managers

1. Review the details of existing and new Chinese loans in terms of the lending institution involved and the terms of debt contracts related to debt restructuring. As described above, different Chinese financial institutions have different approaches to debt restructuring, which will in turn influence the restructuring outcomes that are likely to be acceptable. Knowing which specific institution money is owed to and awareness of potentially problematic clauses in debt contracts (and seeking legal advice where necessary) will help governments to manage expectations and develop an informed negotiating position.

2. Maintain relationships and credibility with lenders. Compared to other lenders, Chinese creditors are often more pragmatic than others when borrowers are in difficulty, due in part to the salience of the bilateral political relationship. Chinese creditors therefore take a long-term view of the lending relationship, potentially offering greater flexibility for borrowers, compared to other commercial creditors.

Notification of potential defaults or repayment difficulties in advance can give more time to local bank teams to negotiate a solution, and build credibility and goodwill in the banking relationship. **Dedicating capacity within ministries of finance to manage the relationship with Chinese lenders can help enhance credibility**. Timely coordination with all lenders and Sinosure is key. In the event of default, Sinosure becomes responsible for negotiations and approval over any loan restructure agreement, which can further complicate and prolong negotiation processes.

3. Improve the transparency of debt negotiations as well as the terms and conditions. Loans from Chinese creditors aim to protect Chinese commercial interests, through confidentiality clauses and other arrangements that seek to ensure repayment. However, such confidentiality requirements generally cannot interfere with sovereign laws and regulations of governments. Since China places great emphasis on host-country regulation, governments must bolster their laws and regulatory environment. A clearly defined legal framework that requires legislative oversight and approval of debt agreements as well as mandatory reporting can enhance borrowers' bargaining power in debt negotiations by introducing checks and balances. Debt data transparency is also important and should go beyond recording and reporting basic lending terms. Governments should implement a systematic mechanism for collecting and recording non-basic lending terms, including on collateralisation and other types of security. This information should be shared, at the minimum, with the IMF, parliament and other creditors. In the event of a debt crisis, the prospect that this information may be hidden can frustrate and delay the restructuring process due to creditors' fears of unequal treatment.

4. Stay informed of developments and outcomes under the CF. The framework is a mechanism still in its development phase, and faces the challenge of many weaknesses in its implementation. However, it remains the most advanced instrument for comprehensive debt restructuring currently in place. Debt managers should closely monitor developments and outcomes from the initial CF cases and push for greater transparency and disclosure of CF procedures and decision processes from CF participants and convenors. With respect to the former, CABRI can play an important role in facilitating discussions and sharing relevant information via its bi-monthly newsletter for public debt managers in Africa.[6]

5. Identify potential opportunities for new debt relief instruments, and linkages to climate agendas. While instruments to link debt and climate investment have not been trialled by any Chinese institutions, the current climate crisis may present an opportunity for certain debtor countries and China to resolve both debt distress challenges and to pilot new mechanisms that would contribute to climate goals – for example, in exchanging debt relief for climate investment in renewable energy expansion or other climate infrastructure that in turn might generate commercial opportunities for Chinese firms. African governments should carefully consider possible solutions, including Brady-type bonds, commodity-linked bonds and other proposed instruments which may be attractive to, and feasible for, creditors in the current juncture.

"Since China places great emphasis on host-country regulation, governments must bolster their laws and regulatory environment."

6 See https://www.cabri-sbo.org/en/newsletters.

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