Businessweek
Economics

China Lent Heavily to Developing Nations. Now It's Helping Them Manage Their Debt

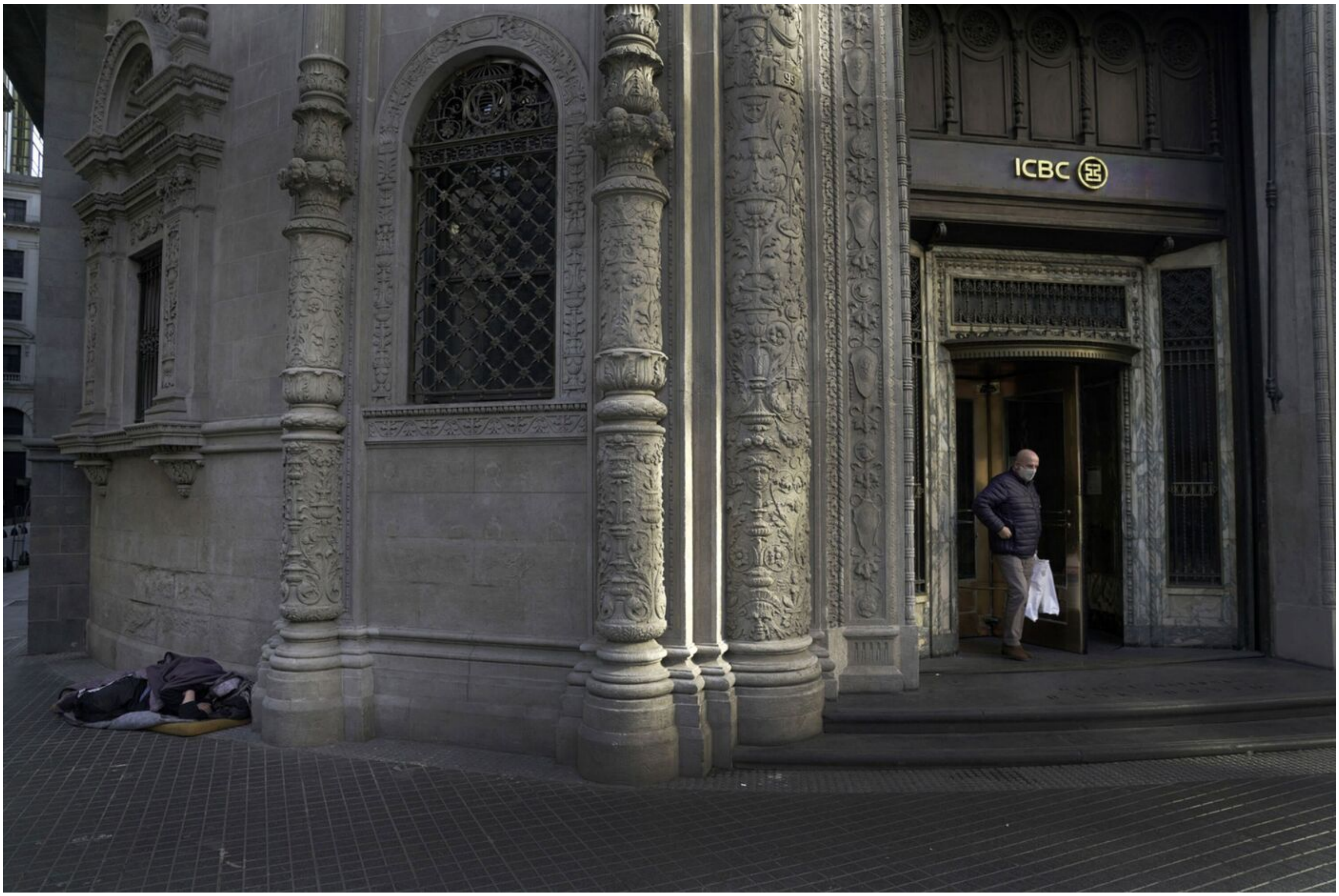
A new study shows that the People's Bank of China has deployed at least $240 billion since 2000 to assist foreign borrowers.

The People's Bank of China (PBOC) building in Beijing. *Source: Bloomberg*

By Shawn Donnan and Tom Hancock
March 27, 2023 at 6:00 PM EDT

Over the course of a generation China has become the world's biggest sovereign lender to developing economies as part of a push for business and influence that mirrors the 20th century spread of US economic power. Now comes the next chapter: With a growing list of poor countries facing debt problems, China is drawing on its enormous central bank reserves to establish itself as a source of emergency funds to bail out some of the very nations it spent years lending to.

In a new study that offers a rare look at how the People's Bank of China (PBOC) wields its $3.3 trillion arsenal, a group of leading economists document at least $240 billion in assistance that Beijing has funneled into 22 countries including Argentina, Pakistan and Nigeria since 2000.



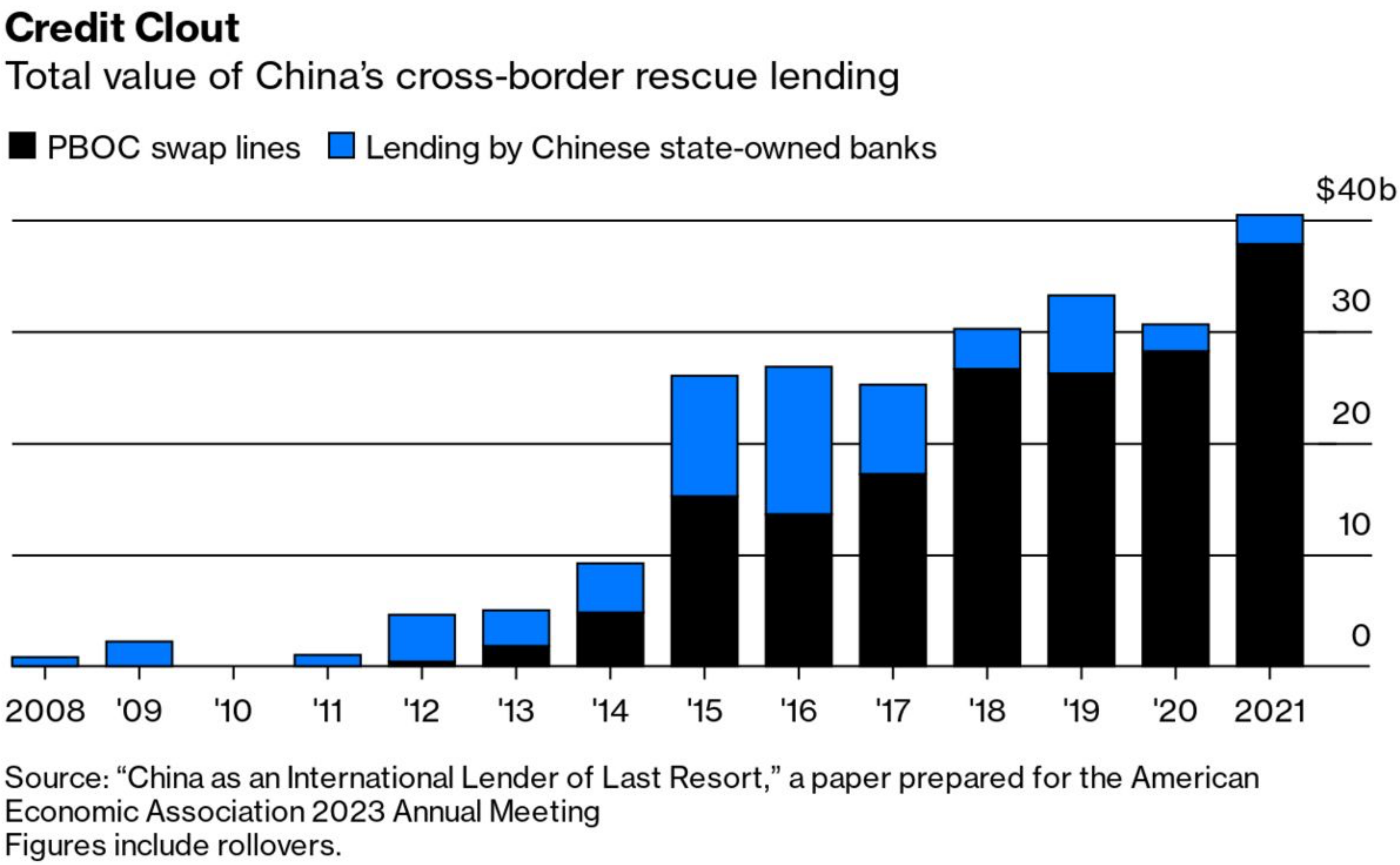
A branch of Industrial and Commercial Bank of China, a source of funds for infrastructure projects, in Buenos Aires. *Photographer: Pablo Piovano/Bloomberg*

To the authors it amounts to "a new global system for cross-border rescue lending to countries in debt distress" that rivals the US-led frameworks in place since the 1940s. It's also turning the PBOC into an influential lender of last resort at a time of growing rivalry between the US and China.

China deployed more than three-quarters of the money, or $185 billion, from 2016 to 2021, during which several emerging-market and developing countries grappled with financing difficulties made worse by the pandemic. While exact comparisons are difficult, that $185 billion surpassed the $144 billion disbursed by the International Monetary Fund over the same period. (The IMF also issued $650 billion in a special pandemic increase in quotas in August 2021 that countries could pull from to bolster reserves.)

The bulk of the aid was made available through PBOC foreign-currency swap lines, which are essentially low-interest-rate loans between central banks. Over the past two decades, the PBOC has negotiated swap agreements with 40 countries and trade blocs worth about $580 billion, as part of a drive to spur international use of China's currency, the renminbi, for trade and other commercial purposes.

During that time, the study documents, 22 countries have drawn down at least $170 billion on those credit lines. The remaining $70 billion has come via loans to governments from Chinese state-owned banks and companies.



The increase in Chinese lending via its central bank comes in the wake of President Xi Jinping's "Belt and Road" initiative (BRI), a soft-power push that's funded $900 billion in infrastructure and other projects around the world. Critics charge the BRI contributed to debt difficulties in countries such as Sri Lanka and Pakistan and to a hangover for Chinese state-owned lenders to whom much of the money is owed.

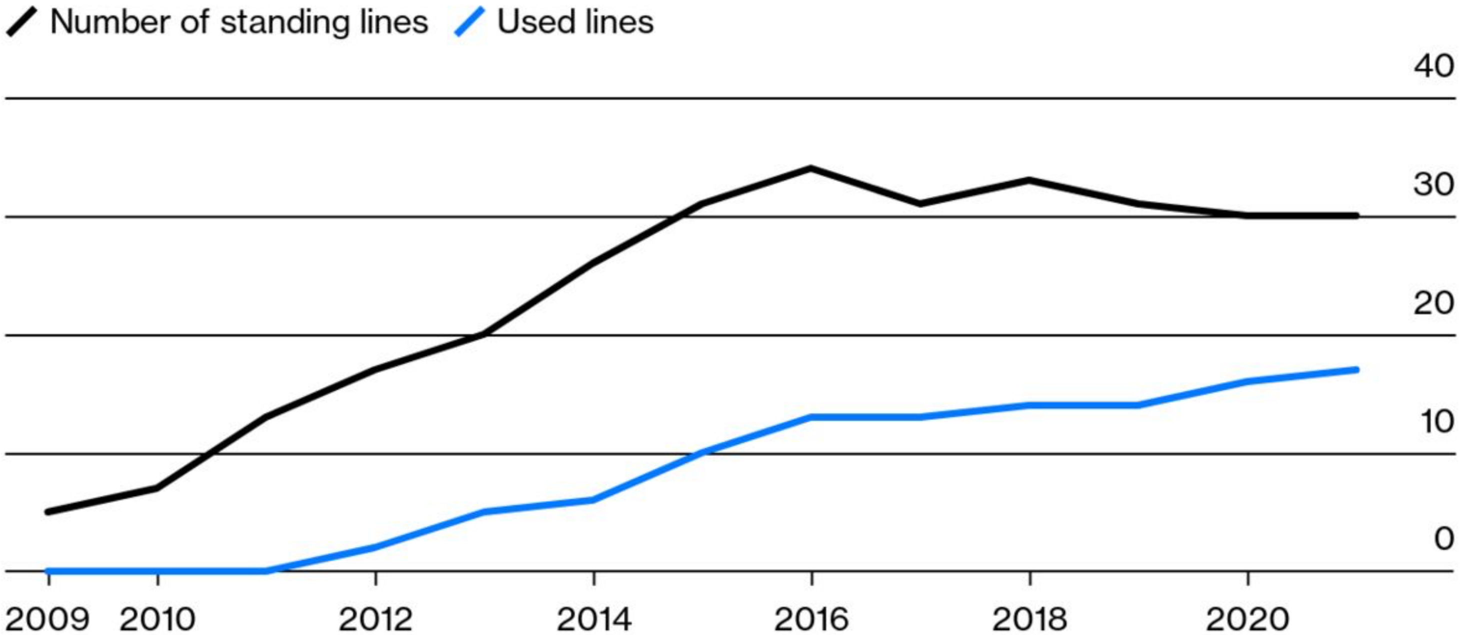
Currency swap agreements have become a feature of crisis responses since the 2007-08 global financial meltdown. At the height of the Covid-19 pandemic's economic turmoil in May 2020 major central banks drew down almost $450 billion from US Federal Reserve swap lines, according to the Bank of International Settlements. The Fed and four other central banks also relied on existing swap lines this month as part of their efforts to keep dollars flowing in the financial system as the fallout from the collapse of Silicon Valley Bank spread across the Atlantic to Credit Suisse. The short-term loans are typically repaid within days.

What's different with China's currency swap agreements, the study published on March 27 argues, is that developing countries are tapping the lines for purposes other than shoring up liquidity. They're using them to bolster their central banks' foreign reserves in times of crisis to avoid credit rating downgrades and attacks on their currencies. They're also using them to help fund government budgets. This has the effect of turning China's central bank into a source of emergency funds, or bridge loans, traditionally the remit of the IMF.

Officials at the PBOC declined to comment for this story. Speaking at an online forum on Monday, Jin Zhongxia, head of the international department at the PBOC, called Chinese lending "only a small part of a big picture" and implied the debt problems in the developing world had been aggravated by the Fed and other rich-world central banks' monetary tightening campaigns.

Rollout and Use of China's Swap Line Network

Bilateral agreements signed by the PBOC



Source: "China as an International Lender of Last Resort," a paper prepared for the American Economic Association 2023 Annual Meeting

The new study by economists at the World Bank, William & Mary's AidData research project, Harvard University and Germany's Kiel Institute for the World Economy arrives at an important time. While much of the attention on the US and China's rising tensions is focused on trade, technology and industrial policy, debt is another friction point.

The US and other creditor nations are tussling with China over the best way to restructure the debt of developing countries, including Sri Lanka and Zambia, that have defaulted on their loans. As of the end of February at least three dozen of the world's poorest countries were in debt distress or at high risk of it, according to the IMF. Middle-income countries such as Egypt and Pakistan are facing their own debt woes.

China has traditionally declined to take part in debt negotiations involving a group of creditor nations or the IMF, preferring to cut its own deals. And instead of forgiving debt, Beijing usually gives borrowers more time to pay off loans.

Carmen Reinhart, a former World Bank chief economist and one of the study's authors, is a critic of China's approach. "This is the onset of what will be a very long, protracted period of debt difficulties for these countries," she says. "And the role China plays at this stage is kicking the can down the road."

The study found a correlation between the drawing down of PBOC swap lines by countries and their level of indebtedness to China. Reinhart, who teaches at Harvard, says her suspicion is that Beijing is indirectly bailing out Chinese lenders whose loans for Belt and Road projects have gone sour.

She says the report's authors can't prove that is what's happening. But "money is fungible," Reinhart says. "Whether or not PBOC funds go directly to paying Chinese lenders matters little. Bolstering central bank reserves frees up money to go elsewhere in a crisis." The Federal Reserve did something similar in the 1980s to protect US banks that got into trouble lending to Latin American countries, she says.

There are some signs that China is becoming more careful in how it manages access to swap lines. In Sri Lanka, where a $3 billion IMF rescue is getting underway, a $1.4 billion PBOC swap line has been frozen until the country has accumulated international reserves equivalent to the cost of three months' worth of imports, the IMF said in a recent report.

William Kring, executive director of Boston University's Global Development

Policy Center, says that unlike the Fed's swaps, which are available only to a select group of rich-economy central banks, China's reach many more countries. "In many cases, the PBOC swaps provide rapid, high liquidity volumes to central banks that otherwise would not typically have access to emergency liquidity and fill a critical gap in the global financial safety net," he says.

Officials in Washington continue to warn that Beijing has lured many poor countries into a debt trap. "China has come in and created a lot of debt," White House adviser Amos Hochstein said in a talk at a Washington think tank on March 22. And now, Hochstein said, the IMF and other countries are being asked to bail out countries indebted to China.

Because Chinese loan contracts often include confidentiality clauses, the extent of countries' debts to Beijing often becomes known only when the IMF is called in. Likewise, learning just how much countries have drawn down from PBOC swap lines depends on research like the new study. In contrast, the New York Fed publishes almost real-time details of swap line transactions online.

What's clear is that China is rapidly playing a greater role in the calculations crisis-afflicted countries must make and offering an alternative to a system that's guided the world's response to economic emergencies for decades. That matters as the two largest economies increasingly battle for influence in a global financial and monetary system that, as the study's authors write, is "becoming more multipolar, less institutionalized, and less transparent." *–With Daniel Flatley and Eric Martin*

Read next: US Apparel Companies Can't See a Future Without China