

The New Banks in Town: Chinese Finance in Latin America

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30 INTER-AMERICAN
DIALOGUE YEARS
SHAPING POLICY DEBATE FOR ACTION

Executive Summary

We estimate that since 2005, China has provided loan commitments upwards of \$75 billion to Latin American countries. China's loan commitments of \$37 billion in 2010 were more than those of the World Bank, Inter-American Development Bank, and United States Export-Import Bank combined for that year. After providing estimates of Chinese finance, we also examine the common claims that Chinese loans to Latin America have more favorable terms, impose no policy conditions, and have less stringent environmental guidelines than the loans of international financial institutions (IFIs) and Western governments. We find that:

- China Development Bank (CDB) loans carry more stringent terms than World Bank loans.
- The Export-Import Bank of China (China Ex-Im Bank), by contrast, generally offers lower interest rates than the US Ex-Im Bank—though this difference stems from the fact that the World Bank offers concessional interest rates as a form of aid, while China offers concessional rates not through CDB but rather through China Ex-Im.
- Chinese banks provide financing to a significantly different set of countries than the IFIs and Western banks,

namely Argentina, Ecuador, and Venezuela, which are not able to borrow as easily in global capital markets.

- Chinese and IFI/Western banks do not overlap significantly in Latin America: They give different size loans to different sectors in different countries. Chinese banks have largely focused on loans to natural resource-based and infrastructure sectors.
- Chinese banks impose no policy conditions on borrower governments but do require equipment purchases and sometimes oil sale agreements.
- The financing terms in oil sale agreements seem to be better for the South Americans than most people believe.
- Chinese finance does operate under a set of environmental guidelines, but those guidelines are not on par with those of its Western counterparts.

It is our hope that this report will provide a more empirical-based foundation for research on Chinese finance in Latin America and the Caribbean (LAC). Our investigation lends credence to some claims about China in Latin America, but less so to others.

On the positive side, China is a new and growing source of finance for LAC, especially for the nations having trouble gaining access to global capital markets. Chinese loans do not come with the policy conditionalities that are tied to IFI and Western loans. Finally, LAC nations can get more financing for infrastructure and industrial projects to enhance long-run development rather than for the latest Western development fads.

However, contrary to much of the commentary on the subject, LAC nations generally pay a higher premium for loans

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FOREWORD

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

This report, a product of the Dialogue's China and Latin America program, offers the first comprehensive summary of China's lending practices in Latin America and the Caribbean (LAC). The authors provide estimates of the volume, composition, and characteristics of Chinese lending to the region since 2005, offer comparisons to international and Western lending institutions, and examine some commonly held notions about Chinese loans to LAC. These include claims that China's loans have less favorable terms than those of international financial institutions (IFIs) and Western banks, that Chinese lending carries few policy conditions, and that Chinese lenders impose less stringent environmental guidelines than their Western counterparts. The report lends credence to some of these claims, but less so to others.

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

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

The Dialogue's China-related papers and reports have dealt with a wide variety of topics including China's "grand strategy" in Latin America, energy-based engagement and cooperation, the US-China-Latin America dynamic, and the possibility of developing an integrated regional approach to China's expanding influence. This report in particular seeks to provide a better understanding of China's often misunderstood financial activity in the region.

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

Margaret Myers

Director, China and Latin America Program

Michael Shifter

President

from China. That higher premium comes in the form of interest rates, not loans-for-oil. It is commonly thought that LAC simply sends barrels of oil to China in return for financing and, thus, may lose out given the rising price of oil. Our analysis shows that this misreads the evidence: the majority of Chinese loans-for-oil in Latin America are linked to market prices, not quantities of oil. Another cost of Chinese finance can be tied to working with Chinese contractors and businesses. This reduces “spillover” effects in LAC in terms of local contracting related to the loans.

And finally, the composition and volume of Chinese loans are potentially more environmentally degrading than Western banks’ loan portfolios in LAC. Although the IFI/Western banks’ environmental record is far from perfect, Chinese banks require less demanding environmental standards.

1. Background and Methodology

There is a burgeoning literature on the Chinese-Latin American economic relationship and its implications for Latin American development and global geopolitics (see Hearn and Leon-Marquez 2011; Gallagher and Porzecanski 2010; Jenkins and Dussel 2009; Ellis 2009). For the most part, this literature has focused on Sino-Latin American trade relations. There are two reasons for this. First, China-LAC trade took off in the early 2000s, while China-LAC investment and loans did not follow suit until the later part of the decade. Second, unlike the China-LAC trade data in the UN Comtrade database, there is no reliable database of Chinese investment or loans in the region. Despite the lack of data, there has been increasing speculation and alarm about Chinese investment and loans.

Scholars and researchers have had to resort to assembling their own databases in order to study Chinese economic activity overseas. Deborah Bräutigam of American University has been tracking Chinese finance in Africa. Derek Scissors of the Heritage Foundation has compiled data on China’s large foreign direct investments worldwide, but no similar efforts have addressed Chinese loans (2011).

To our knowledge, our report provides the first comprehensive summary of Chinese loans to Latin America.

In 2007–2008, the Congressional Research Service teamed up with students at New York University to produce a report on China’s economic assistance to Latin America (Lum 2009). While pioneering, it only includes concessional loans, and it was published too early to capture the vast majority of Chinese lending that came since 2008. Erica Downs of the Brookings Institution published an analysis of China’s major loans-for-oil borrowers across the

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globe, including those in Latin America (2011). Our study includes those loans-for-oil projects as well other loans and commitments in other forms and sectors. Our goal in this report is to establish a comprehensive empirical foundation for future analysis of Chinese lending to Latin America.

Most of China’s international lending comes from the China Development Bank (CDB) and China Export-Import Bank (China Ex-Im Bank). During 1994 reforms of the financial sector, the Chinese government created CDB and China Ex-Im Bank as “policy banks,” meaning “tools of the government” (Bräutigam 2009, 79). Their loans would explicitly support the government’s policy objectives. Prior to 1994, policy lending had been the responsibility of the “big four” Chinese banks (Bank of China, China Construction Bank, Agricultural Bank of China, and ICBC), so the new policy banks were designed to free the four to act as commercial banks. In separating policy from commercial lending, the government sought to reduce bank managers’ moral hazard. If managers could blame all their losses on policy loans, they had an incentive to direct their commercial loans toward high-risk, high-return projects (Steinfeld 1998, 71). The creation of separate policy banks would hold commercial banks accountable for rational, market-based lending.

The CDB mainly supports China's macroeconomic policies—laid out in the Five-Year Plans—focusing on eight areas of development: electric power, road construction, railway, petroleum and petrochemical, coal, postal and telecommunications, agriculture and related industries, and public infrastructure (CDB). An estimated 73.7 percent of CDB's total new loans went to these sectors (CDB "Strategic Focus"). In contrast, the China Ex-Im Bank's mandate is to:

There is no easy way to measure Chinese banks' loans to Latin America. Unlike the World Bank and Inter-American Development Bank, Chinese banks do not regularly publish detailed figures regarding their loan activities.

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

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

Though the government designed the reforms to divorce policy and commercial lending, Chinese banks continue to mix them. Steinfeld points out that the government still forced the nominally commercial banks to bail out state-owned enterprises (1998, 70). At the same time, the policy banks have become quite commercial. CDB head Chen Yuan has successfully married the bank's policy objectives with sound commercial loans so that CDB has high profits and a balance sheet that is even healthier than China's big commercial banks (Downs 2011, 11). China Ex-Im Bank also often lends at commercial rates and boasts a low share of nonperforming loans (Bräutigam 2009, 114; Downs 2011, 13). Premier Wen Jiabao announced in 2007 that the

policy banks eventually would be converted into commercial banks, but the process has stalled following the financial crisis (Downs 2011, 22).

The Chinese government's "Going Global" policy has brought this amalgamation of commercial and policy lending to the international stage. In 1998, President Jiang Zemin championed the internationalization of Chinese investment and lending. He argued: "Regions like Africa, the Middle East, Central Asia, and South America with large developing countries [have] very big markets and abundant resources; we should take advantage of the opportunity to get in" (Chen 2009). As Downs points out, CDB is the main bank supporting this strategy with loans to Chinese and foreign companies overseas (2010, 9). Bräutigam

adds that "the Eximbank has been at the center of China's strategy of 'going global'" (2009, 112). Over the last five years, both banks have reached new heights in international lending (Bräutigam 2009, 112, 116).

There is no easy way to measure Chinese banks' loans to Latin America. Unlike the World Bank and Inter-American Development Bank, Chinese banks do not regularly publish detailed figures regarding their loan activities. We follow the lead of scholars such as Bräutigam, who examine government, bank, and press reports in both China and borrowing countries in order to compile a list of loans and their characteristics. This method is highly imperfect. Although we have gone to great lengths to ensure reliability by confirming reports in both China and LAC, our estimate should not be taken as a precise figure. On the one hand, we may have underestimated Chinese finance in Latin America because we do not examine many loans under \$50 million. On the other hand, we may have overestimated the total in the event that most recent loans are partially or entirely cancelled or if a line of credit is not fully committed.

We consulted a wide variety of publicly accessible sources to gather details on each loan. We found loan agreements published by the Venezuelan and Bolivian governments in their Official Gazettes. Brazil's state-owned oil company, Petrobras, is a publicly traded corporation; we uncovered the interest rate on CDB's loan-for-oil deals with Petrobras

by examining the company's filings with the US Securities and Exchange Commission (SEC). We discovered four Chinese loans in the Jamaican government's 2011 Annual Report to the SEC.

We classified loans as commercial or concessional based on reports from Chinese embassies in the borrowing countries. We found details on Brazilian and Ecuadorian loans-for-oil in local newspaper interviews with the countries' finance ministers. We only include one detail that is not publicly accessible online—the interest rate on the 2008 China Ex-Im Bank loan to Chinalco Peru, which we learned in interviews with company officials in Lima. We supplemented and double-checked all sources with newspaper articles or governments in both the borrowing countries and China. We omit loans that have not been confirmed by reliable sources on both sides of the Pacific. We cite the most valuable sources for each individual loan in the report's annex.

Acquiring World Bank and Inter-American Development Bank (IDB) loan information to compare with the Chinese loans was more difficult than we had anticipated. These Western banks publish lists of loans in their annual reports, and the World Bank even publishes individual loan contracts—but it withholds key details. The World Bank considers the interest rates on outstanding loans to be proprietary information and refused to provide it officially for this study. For interest rates, the most important indicator of the fairness of a loan, we had to approach these otherwise transparent institutions in the same way as their Chinese counterparts. Just as in the case of Chinalco Peru, we acquired the World Bank interest rate information through a confidential interview with a World Bank employee.

This paper is divided into eight parts. Part 2 presents our estimates on the quantity of Chinese finance in LAC. Part 3 examines the terms of Chinese finance to LAC with a comparative perspective. Part 4 examines the special case of commodity-backed loans in LAC. Part 5 discusses the composition of Chinese finance. Part 6 analyzes the extent to which Chinese loans attach Western-style conditionality.

Part 7 analyzes the nature of Chinese environmental guidelines for its loans and puts that in a comparative perspective. Part 8 suggests topics for further research and draws policy implications.

2. Chinese Loans to Latin America Are Larger and Growing Faster than Their Western Counterparts

Our best estimate of Chinese loan commitments to Latin America since 2005 is \$75 billion (Table 1). CDB made 82 percent of the loans, and China Ex-Im Bank and the ICBC bank contributed 12 percent and 6 percent, respectively. The loans were quite large and heavily concentrated among a few borrowers. The governments of Venezuela, Brazil, Argentina, and Ecuador received 91 percent of the total.

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Two thirds of all the loans were loans-for-oil. Although they possess natural resources and other production characteristics of interest to China, the governments of Peru, Colombia, Chile, and Mexico received little to no financing.

A comparison of our \$75 billion estimate to previous estimates of total Chinese financing suggests that Latin America accounts for a large part of Chinese lending abroad. The *Financial Times* estimated total Chinese loans during 2009–2010 at \$110 billion (Dyer 2011). If it is accurate—and we cannot confirm that—more than half those 2009–2010 loans went to LAC.

China has only just started providing financing to Latin America, but in 2010 it already loaned more than the World Bank, IDB and US Ex-Im Bank combined (Table 2). Prior

Table 1. Summary of Chinese Loans to Latin America

Year	Borrowing Country	Borrower	Lender	Amount (\$m)	Purpose
2005	Brazil	Gerdau Acominas	ICBC and BNPP	201	Steel mill equipment
2005	Chile	Codelco	CDB	550	Improve company efficiency and technology
2007	Jamaica	Government	Ex-Im	45	Montego Bay Convention Center
2008	Costa Rica	Government	SAFE	300	Government bonds
2008	Peru	Chinalco Peru	Ex-Im	2,000	Mining Equipment
2008	Venezuela	BANDES and PDVSA	CDB	4,000	Funding infrastructure, other projects
2009	Bolivia	YPFB	Ex-Im Bank	60	Home gas lines, oil drilling rigs
2009	Brazil	Telemar Norte/Oi	CDB	300	Expand telecom network
2009	Brazil	Petrobras	CDB	10,000	Pre-salt business plan
2009	Ecuador	Petroecuador	PetroChina	1,000	Advance payment for Petroecuador oil
2009	Mexico	América Móvil	CDB	1,000	Telecom network infrastructure/equipment
2009	Multiple	BLADDEX	CDB	1,000	Regional trade financing
2009	Peru	Cofide	CDB	50	Transportation, infrastructure
2009	Venezuela	BANDES and PDVSA	CDB	4,000	Infrastructure, including satellite
2009	Venezuela	CVG	CDB	1,000	Mining project credit
2010	Argentina	Government	CDB and others	10,000	Train system
2010	Bahamas	Government	Ex-Im Bank	58	Airport infrastructure
2010	Bolivia	Government	CDB	251	Chinese satellite
2010	Bolivia	Government	Ex-Im Bank	67.8	Infrastructure
2010	Brazil	Vale Mining Company	CDB and Ex-Im	1,230	Ships to transport iron ore to China
2010	Ecuador	Government	Ex-Im Bank	1,682.7	Hydroelectric dam Coca-Codo Sinclair
2010	Ecuador	Petroecuador	CDB	1,000	80% discretionary, 20% oil-related
2010	Ecuador	Government	Ex-Im Bank	621.7	Sopladora hydroelectric dam
2010	Jamaica	Government	Ex-Im Bank	340	Road construction
2010	Jamaica	Government	Ex-Im Bank	58.1	Shoreline reconstruction
2010	Venezuela	PDVSA	CDB and BES	1,500	Trade-related credit facility
2010	Venezuela	BANDES and PDVSA	CDB	20,000	Funding infrastructure
2011	Bahamas	Baha Mar Resort	Ex-Im Bank	2,450	Resort Construction
2011	Bolivia	Government	Ex-Im Bank	300	Helicopters, infrastructure
2011	Ecuador	Government	CDB	2,000	70% discretionary, 30% oil-related
2011	Peru	BCP	CDB	150	Finance
2011	Venezuela	PDVSA	CDB	4,000	Infrastructure
2011	Venezuela	PDVSA	ICBC	4,000	Housing
TOTAL				75,215.3	

Sources: see Annex

to 2008, China's annual lending never exceeded \$1 billion. But in 2008, loans ramped up to \$6 billion. In 2009, lending tripled again to \$18 billion, passing the World Bank's \$14 billion and IDB's \$15 billion. In 2010, lending doubled once more to \$37 billion, well above loan levels of the World Bank (\$14 billion) and IDB (\$12 billion). China overtook the World Bank and IDB despite the fact that, from 2006 to 2010, both those banks had doubled their lending to the region. Since 2005, China Ex-Im Bank has out-financed US Ex-Im by a factor of almost four, \$8.3 billion to \$2.2 billion. That said, both China and US Ex-Im banks have historically concentrated on guarantees and insurance, and these direct loans comprise only a small part of their portfolios.

It is unlikely that Chinese lending to LAC will continue to double every year. China's 2009 and 2010 lending booms were driven by a \$20 billion loan commitment to Venezuela and \$10 billion in commitments to Brazil and Argentina. With these mammoth loans to major South American economies already concluded, Chinese lending may plateau due to a lack of demand. We have uncovered less than \$13 billion in loans in 2011; China's 2011 lending will still probably exceed that of the World Bank and IMF, but it will fall short of 2010 levels.

Chinese banks provided financing to a significantly different set of countries than the IFIs and Western banks. Chinese banks dedicated 61 percent of lending to Venezuela and Ecuador. This is an enormous share considering that these countries make up only 8 percent of the LAC region's population and 7 percent of its GDP. The Chinese loans equal almost 10 percent of the two countries' combined annual GDP. Over the same period, Venezuela and Ecuador received 13 percent of IDB loans and less than a third of a percent of World Bank loans. IFIs and Western Banks dominate lending to Mexico, Colombia, and Peru. Peru received its largest Chinese loan to date four months after the country's new president, Ollanta Humala, took office.

Chinese and Western banks barely overlap when it comes to their borrowers. Only Brazil and Argentina have received significant shares of lending from both. In both cases, the vast majority of the Chinese funds came from a single loan. In the case of Brazil, 85 percent of the lending came from

a \$10 billion loan issued in 2009 to fund an ambitious offshore oil project using Chinese inputs. In Argentina, all 2010 financing came from a single loan: \$10 billion to buy Chinese trains.

For Ecuador and Venezuela, the large influx of Chinese lending has served as a key source of foreign finance. The World Bank has almost no lending presence in these countries; since 2005, it has given two small loans to Ecuador and nothing to Venezuela. IDB's lending to these countries was higher in both absolute and relative terms in 2009-

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2010 than it was in 2006-2008. The increase in lending in 2009-2010 is significant, since Chinese lending over the same period exploded from zero to over 20 times IDB lending. IDB lending had been higher in 2005, but it fell years before China began lending to these countries. Viewed in this context, Chinese lending is adding to, rather than replacing, IDB lending.

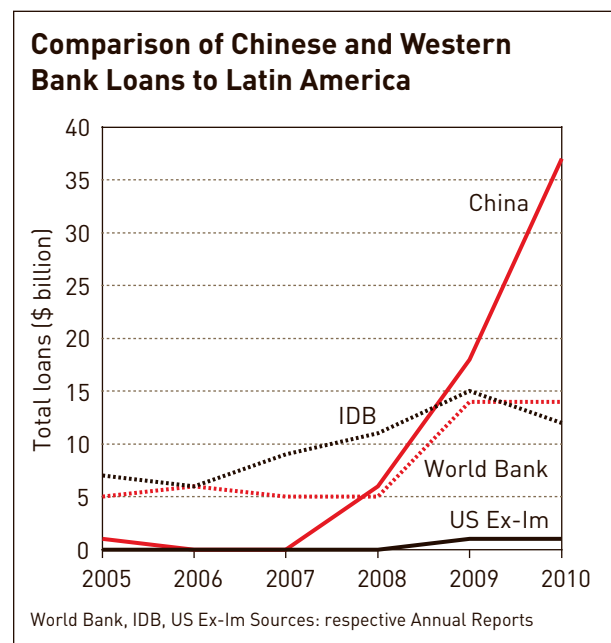


Table 2. Recipients of World Bank, IDB, and Chinese Lending from 2005–2011

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

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

Chinese and Western banks also differed in another way. China's loans were much larger. The overwhelming majority of Chinese financing packages to LAC were \$1 billion or greater, compared to 22 percent for the World Bank and 9 percent for IDB. Some 93 percent of the large World

Bank and IDB loans went to Brazil and Mexico, with the remaining 7 percent for Argentina. Meanwhile, 68 percent of China's large loans went to Ecuador, Bolivia, and Venezuela—countries where large loans from Western banks have been absent.

Interestingly, Chinese lending to Venezuela and Ecuador is filling in for the sovereign debt markets. As energy economist Roger Tissot argues, "Chinese financing is often the 'lender of last resort.' It is not a cheap one, but due to the concern the international financial community has over Venezuela and Ecuador, and the large risk premiums they would charge, Chinese lending is an attractive option" (Myers 2011). Argentina and Ecuador essentially cut themselves off from mainstream lending by defaulting on their sovereign debt in 2001 and 2008–2009, respectively. The Venezuelan government has scared off some investors by its domestic actions as well. As a result, the sovereign debt markets charge Argentina, Ecuador, and Venezuela spreads of 838, 935, and 1220 basis points, respectively (Table 4). These are four to six times higher than interest rate spreads for South American countries with similar size economies. For example, the spread for Colombia is 195 basis points and, for Peru, 218 (JP Morgan 2011). Chinese banks loaned disproportionately large amounts to these high-risk

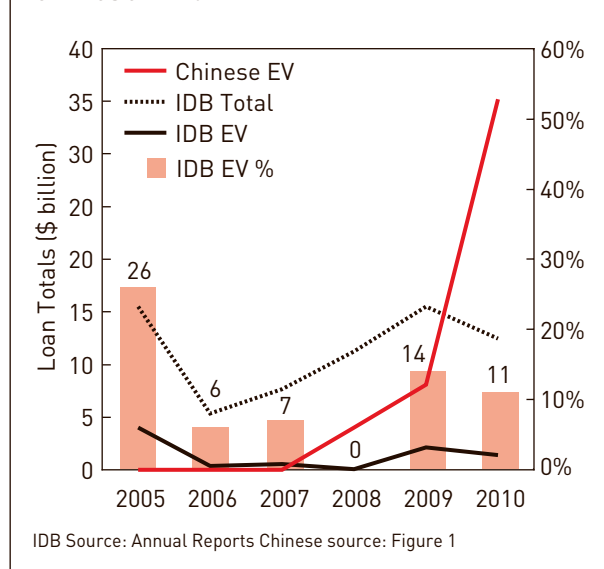
Figure 2. IDB Lending to Ecuador and Venezuela Before and During the Chinese Influx


Table 3. Recipients of World Bank, IDB, and Chinese Loans of \$1 Billion or Greater

(\$ million)	Total	World Bank	IDB	China
Venezuela	\$38,500	\$—	\$—	\$38,500
Brazil	\$17,675	\$3,445	\$3,000	\$11,230
Mexico	\$11,221	\$8,021	\$2,200	\$1,000
Argentina	\$11,200	\$—	\$1,200	\$10,000
Ecuador	\$5,683	\$—	\$—	\$5,683
Bahamas	\$2,450	\$—	\$—	\$2,450
TOTAL	\$86,729	\$11,466	\$6,400	\$68,863

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

Table 4. Chinese Lending and Government Debt Ratings

Country	% of Chinese Lending to Government	OECD Risk Rating	OECD Premium	S&P Rating	EMBI+ Debt Spread
Chile	0.8%	2	162	A+	
Panama	0.0%	3	177	BBB-	186
Mexico	0.0%	3	177	BBB	188
Peru	0.3%	3	177	BBB	218
Brazil	13.7%	3	177	BBB	219
Costa Rica	0.4%	3	177	BB	
Colombia	0.0%	4	198	BBB-	195
Bolivia	0.9%	6	231	B+	
Jamaica	0.6%	6	231	B-	
Ecuador	8.6%	7	251	B-	838
Argentina	13.7%	7	251	B	935
Venezuela	52.6%	7	251	B+	1220

http://www.cbonds.info/cts/eng/index_detail/group_id/1/

countries, compensating for the lack of sovereign debt lending (Figure 3).

China has used its loans-for-oil and purchase requirements to reduce the cost of lending to these otherwise non-creditworthy borrowers. CDB does not subsidize its interest rates as development aid or to outcompete other lenders, instead offering the loans at cost (Bräutigam 2009, 115). But as CDB founder Chen Yuan stated, “backing loans with oil shipments effectively keeps risks to a minimum level” (Forsythe and Sanderson 2011). The risk mitigation of loans-for-oil seems to explain why CDB was able to offer the \$20 billion Venezuelan loan at a floating rate

of 50-285 basis points over LIBOR, only a fraction of its 935 basis point cost in sovereign debt markets. Similarly, China’s \$10 billion line of credit to Argentina is actually a credit line to Chinese railway companies, meaning that the money will effectively stay in China. Since the \$10 billion loan will directly support these Chinese companies, CDB charged 600 basis points above LIBOR, well below the 935 basis point spread on Argentine sovereign debt (Gill 2011). Similarly, China Ex-Im Bank gave Ecuador a \$1.7 billion export credit at a rate of 6.9 percent, well below Ecuador’s 838 basis point spread.

Another factor is that CDB is backed by the Chinese government. Borrowers who default risk angering not only the CDB but also the Chinese government, and that might jeopardize future deals with Chinese firms.

China's surrogate sovereign lending has helped Ecuador heal after its default. Chinese loans have covered its budget shortfall. Only two years after the default, Ecuador has largely regained investor confidence. Government bonds are performing better than any others in Latin America. As

nor their borrowers routinely announce loans to the public. That limits us to major loans reported in the news, approved by legislators, recorded by publicly traded companies, or announced by proud government officials. We have likely missed a number of loans under \$50 million.

More importantly, we rarely learn of loans between branches of the Chinese government, from state-owned banks to state-owned companies operating overseas. The Heritage Foundation's China Investment Tracker lists 36 large-scale Chinese investment projects in Latin America worth more than \$42 billion, but we have recorded only one case of Chinese intra-state lending, the \$2 billion China Ex-Im Bank loan to Chinalco Peru in 2008.

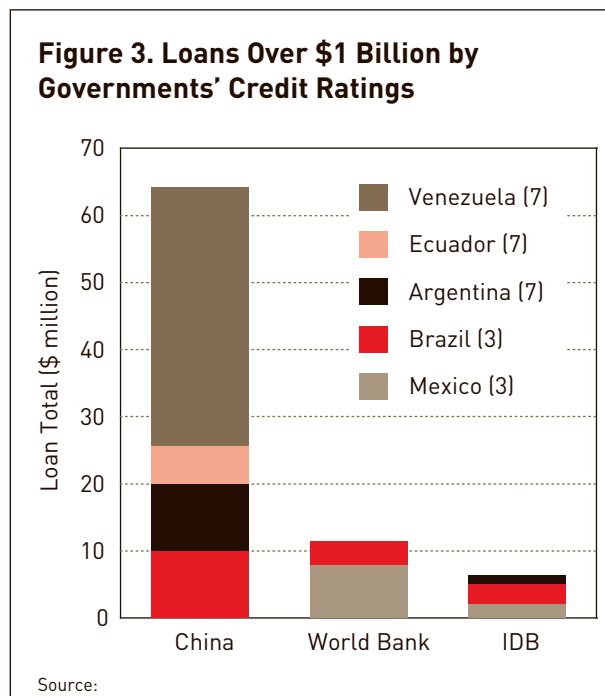
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a result, government investment is driving record economic growth (Gill 2011). By taking the place of shell-shocked sovereign lenders, China has given Ecuador a second chance to rebuild investor confidence.

Our China loan totals may actually underestimate the level of Chinese lending. Unlike the World Bank and IDB, which provide annual reports and searchable databases with complete lists of their loans, neither the Chinese banks

We confirmed this deal only because we had the opportunity to interview Chinalco officials in Peru. We assume that similar deals go unreported.

There is another side to this, however. Despite our best efforts to use reliable sources, suspended and canceled loans may cause us to slightly overestimate the loan totals. Moreover, some nations may not draw the full line of credit. Agreed-upon, signed, and ratified loans may not always materialize due to political or economic changes on either end. The *Financial Times* reports: "In some cases, developing country governments have announced large sums for loan agreements which have not been realised" (Dyer 2011). Congressional Research Services warns in its report on Chinese foreign aid that "estimated totals should be interpreted with caution. Some reported values may be inflated: some loans represent offers or pledges that may not have been fulfilled; some projects may have been cancelled" (Lum 2009). Loan agreements, like Argentina's \$10 billion agreement in 2010, simply set an amount to be carved into projects later. As such, they may only be partially fulfilled. Still, we confirmed that for most major loans the loan tranches have been arriving on schedule, so we anticipate only minor inaccuracies due to loan cancellations. Also, we assume that World Bank and IDB loans will suffer partial and complete cancellations at similar rates.



3. Chinese Finance Terms Are Not Always So “Sweet” When There Is Access to International Capital Markets

Some have expressed concern that Chinese banks are replacing the World Bank and Western export credit agencies (ECAs) by offering lower-interest loans and generally better terms. However, we find that this is often not the case.

Melissa Graham at the Council on Hemispheric Affairs argues that Chinese state banks may be replacing Western banks in Latin America by “offer[ing] interest at rates that are lower than other competing developed countries”(Graham 2010). The *Washington Post* explains that “China is a master at low-ball financing, fashioning loans of billions of dollars at tiny interest rates that can stretch beyond 20 years... This has become a headache for Western competitors, especially members of the 32-nation Organization for Economic Cooperation and Development (OECD), which long ago agreed not to use financing as a competitive tool” (Pomfret 2010). The same article notes that the US Ex-Im Bank has complained that China Ex-Im Bank makes its exports more attractive with “below-market interest rates [and] easy repayment terms.” The *Financial Times* notes “escalating competition over loan deals” between Chinese banks and the World Bank (Dyer 2011).

At the same time, some observers praise the Chinese loans for broadening the financing options for developing countries. Antonio Castillo argues in the *China Daily* that “China is good news as a source of the much needed development loans” for Latin America (Castillo 2010). Bräutigam calls China’s entrance a “positive development” since it will challenge the “wealthy countries’ rules” that protect excessive financing costs, like upfront fees of 21 percent on US Ex-Im Bank loans (Bräutigam 2011b). She points out that the OECD banned competitive financing to benefit lenders, not borrowers (2009, 298). When Japan and OECD countries competed on financing terms to win deals with China in the 1970s and 1980s, “China saw [this competition] as

beneficial for China’s development” (2009, 50). Peter Evans also criticizes the OECD rules, pointing out that they allow developed countries to collude and maximize profits at the expense of developing-country borrowers (2005).

Our study reveals that Chinese banks differ in their use of financing. China’s development bank generally offers higher rates and China Ex-Im Bank offers slightly lower rates when compared with their IFI and Western counterparts. But these comparisons are misleading because Chinese banks package commercial financing and development aid differently than their counterparts. Regardless, it is clear that the real low-ball financing only happens within the Chinese government.

When we compare development banks, CDB offers mostly commercial interest rates that exceed the World Bank rates² (Table 5). In 2010, CDB offered Argentina a \$10 billion loan at 600 basis points above LIBOR. The same year, the World Bank Group’s International Bank for Reconstruction and Development (IBRD) granted Argentina a \$30 million loan with a spread of 85 basis points. The Chinese spread is

Chinese banks differ in their use of financing. China’s development bank generally offers higher rates and China Ex-Im Bank offers slightly lower rates when compared with IFI and Western counterparts.

more than 5 percent wider, which more than compensates for the larger size of the loan. In 2009, CDB gave Brazil a \$10 billion loan at 280 basis points. The IBRD gave Brazil a \$43.4 million loan in 2000 at a variable spread of 30–55 basis points. Again, the Chinese spread is much larger. In 2009, CDB granted Mexico’s América Móvil a \$1 billion loan at over 100 basis points. The IBRD gave Chile a \$24.8 million loan in 2007 for 5 basis points. Since Chile and Mexico have similar credit ratings, CDB’s rates again seem higher than the IBRD’s. We could not compare loans of similar sizes

² World Bank rates are not officially concessional but because the bank has an exceptional credit rating and does not often add a country risk premium, its finance is effectively concessional when compared to pure market rates at LIBOR plus country risk.

Table 5. CDB and World Bank Loan Interest Rates

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

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

in the same country in the same year because both CDB and the IBRD make every effort to keep their interest rates secret. However, it is significant that all the CDB interest rates we found exceeded IBRD's rates, including all standard rates listed on the latter's website (World Bank Treasury 2010). In other words, the CDB charges higher interest rates than IBRD, despite conventional wisdom to the contrary.

When we compare export credit agencies, China's Export-Import Bank offers slightly lower interest rates than US Ex-Im Bank. The *Washington Post* argues that China is using "low-ball financing" to make its export credits more attractive, since "China has handed out billions of dollars at less than 1 percent interest" (Pomfret 2010). However, China Ex-Im Bank is not giving out sub-1 percent loans. China Ex-Im Bank's lowest-interest loans were its 2 percent loans to Jamaica and Bolivia in 2010. Bräutigam reports similar rates for China's Ex-Im Bank loans to African countries (Bräutigam 2009, 129, 140, 173). To compare China and US Ex-Im interest rates, we subtract the OECD's "country risk" premiums to compensate for the fact that some countries are riskier than others. These premiums are substantial; they add 2.51 percent annually on loans to Argentina and Ecuador and 2.31 percent on loans to Bolivia and Jamaica (OECD 2011; OECD 2011). While the US Ex-Im Bank charged 1.5 percent to 2.5 percent above the OECD risk premium, China Ex-Im Bank's loan rates ranged from 0.31 percent below the premium to 4.4 percent above it. Other

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

The lower rates of China Ex-Im Bank stem from China's unconventional breakdown of commercial and concessional finance rather than from cutthroat competition. The IBRD and other development banks offer concessional interest rates as an official form of development aid. Despite CDB's "development bank" label, the Chinese bank generally charges borrowers the full cost of finance.³ For this reason, Bräutigam labels CDB "the development bank that doesn't give aid" (2009, 115). The IBRD is effectively offering concessional rates in relative terms for the same reasons as the World Bank (see footnote 2), while CDB is not. It is not surprising, therefore, that CDB's interest rates are higher. Instead of giving development aid through its development bank, China channels it through China Ex-Im Bank.

In order to give concessional loans, like Bolivia's loans at only 2 percent interest, China Ex-Im Bank receives subsidies directly from the Ministry of Finance (AFP 2011; Bräutigam 2011a, 756). China budgets these subsidies as official development aid, though OECD countries prohibit mixing export credits with development aid. China Ex-Im Bank's concessional interest rates fall 1 percent to 2 percent below US Ex-Im's commercial rates. China Ex-Im Bank's

³ As discussed in the previous section, CDB's commercial rates still shave hundreds of basis points off the commercial rates offered by sovereign debt lenders.

largest loans, however, are unsubsidized commercial loans at much higher interest rates. These include a \$2.4 billion loan for the Baha Mar resort in the Bahamas and a \$1.7 billion loan for Ecuador's Coca-Codo Sinclair dam (Hu 2011). China Ex-Im Bank is not undercutting US Ex-Im on these loans; it charged 6.9 percent interest on the latter, about 2 percent higher than US Ex-Im rates, even adjusting for Ecuador's high risk premium ("Embassy" 2010).

The difference between China Ex-Im Bank's concessional credits and IFI/Western ECA market-rate credits may not unduly influence borrowers. ECAs are not providing discretionary loans but, rather, lines of credit for purchases from US or Chinese companies. Thus, in addition to interest rates, borrowers have to consider the differences in product quality and pricing between US and Chinese companies. For example, in a recent high-profile case of Ex-Im bank competition in Pakistan, the *Wall Street Journal* reports that Chinese trains were "30 to 50 percent cheaper" than

US trains. Pakistan still chose General Electric trains over Dongfeng trains because they considered GE's trains to be of higher quality (Reddy 2011). Large price and quality differences outweigh a 1 to 2 percent gap in interest rates, though a 1 to 2 percent interest differential would increase total financing costs by 18 percent to 30 percent for a twelve-year loan. Bräutigam reports a similar discrepancy in the case of China Ex-Im's loans to Africa. "There is no question

"Low-ball," sub-1 percent Chinese loans exist, but only within the Chinese government.

that these subsidized loans do help... But their role should not be exaggerated... [Often,] Chinese companies are simply more competitive" (Bräutigam 2009, 98).

China may be outcompeting OECD ECAs by reducing risk exposure fees, which goes beyond the scope of this study. In addition to the risk premium, the OECD requires members to assess a substantial upfront risk exposure fee. For

Table 6. China and US Ex-Im Bank Loan Interest Rates

Year	Lender	Borrowing Country	Borrower	Interest Rate	Rate Minus OECD Risk Premium	Amount (\$m)	Payment Period	Purpose
2007	China Ex-Im	Jamaica	Government	2	-0.31	45	20	Montego Bay Convention Center
2009	China Ex-Im	Bolivia	YPFB	2	-0.31	60	20	Home gas networks, oil drilling rigs
2010	China Ex-Im	Ecuador	Government	6.9	4.39	1,683	15	Hydroelectric dam Coca-Codo Sinclair
2010	China Ex-Im	Jamaica	Government	3	0.69	340	5	Road construction
2009	US Ex-Im	Mexico	Pemex	3.81	2.04	600	10	Oil Exploration and Production Equipment
2009	US Ex-Im	Mexico	Electrica del Valle de Mexico	4.3	2.53	81	4	Clipper Windpower wind turbines
2009	US Ex-Im	Brazil	MRS Logistica	3.3	1.53	87		General Electric diesel electric locomotives
2010	US Ex-Im	Dominican Republic	Pueblo Viejo Dominicana	4.02	1.8	375		Caterpillar trucks, bulldozers, and loaders
2010	US Ex-Im	Honduras	Energia Eolica de Honduras	4.42	2.11	159	18	Gamesa Wind turbines

Chinese Sources: See Annex. US Sources: US Ex-Im Annual Reports

Argentina and Ecuador, this fee is 14.4 percent; for Bolivia and Jamaica it declines to 13.2 percent (OECD 2011). While China Ex-Im Bank claims that it charges risk exposure fees according to bank regulations, we found no information on the specific levels of these fees (Export-Import 2009). The *Washington Post* reports that US Ex-Im Bank competed with China on a Pakistan loan by reducing its exposure fee to 8.2 percent, when the OECD requirement is 14.4 percent (Reddy 2011). If China Ex-Im Bank is indeed offering exposure fees 6 percent lower than OECD countries, its exports will be more competitive, although this 6 percent pales in comparison with a 30 to 50 percent price difference.

The “low-ball” sub-1 percent loans exist, but they fall within a special third class: loans within the Chinese government. State-owned Chinese banks will grant loans at negligible interest rates to state-owned Chinese companies operating abroad since there is little risk that one branch of the government will default on another. In 2008, China Ex-Im Bank granted Chinalco Peru a \$2 billion, 15-year loan at less than one basis point above LIBOR (Gallagher 2011). In other words, CDB treats Chinalco like it would treat a trusted fellow bank. We confirmed this interest rate

Mainly because of a misconception about oil prices, Chinese loans have been criticized as harmful to Latin American borrowers.

in an interview with Chinalco company officials in Lima. The *Washington Post* reports that Chinese state banks are supplying similarly cheap financing for Wuhan Iron and Steel’s investments in the Brazilian steel and oil industries (Pomfret 2010). No sources have reported rates this low outside the Chinese government.

In sum, Chinese banks are not offering better interest rates than Western banks across the board or by large margins. CDB’s rates appear high when compared to the IBRD. China Ex-Im Bank’s rates fall slightly below US Ex-Im’s rates, but China Ex-Im’s lower rates stem from government development aid subsidies rather than competition with OECD credit agencies.

4. On China’s Terms: Commodity-Backed Loans

Chinese companies recently began arranging a new type of loan package, the loan-for-oil, for LAC (and elsewhere). Loans-for-oil with Latin America have reached \$46 billion in only three years, well over half of China’s total commitments to the region (Table 7). Venezuela has negotiated four such loans, totaling \$32 billion, since 2008. Brazil signed one for \$10 billion in commitments in 2009. Ecuador signed a \$1 billion loan-for-oil in 2009 and a second in 2010. In July of 2011, it added a third for \$2 billion.

A loan-for-oil generally combines a loan agreement and an oil-sale agreement that involves two countries’ state-owned banks and oil companies. The Chinese bank grants a billion-dollar loan to an oil-exporting country like Ecuador. Ecuador’s state oil company, Petroecuador, pledges to ship hundreds of thousands of barrels of oil to China every day for the life of the loan. Chinese oil companies then buy the oil at market prices and deposit their payments into Petroecuador’s CDB account. CDB withdraws money directly from the account to repay itself for the loan.

These agreements secure more oil than will go to pay back the loan, since it would be politically untenable for the borrowing countries to give China oil and get nothing in return. For example, Venezuela agreed on a ten-year, \$20 billion loan-for-oil in 2010. To pay this loan back with \$110 barrels over the ten-year tenor, Venezuela would only have to send 50,000 barrels per day. However, Venezuela committed to send 200,000 to 300,000 barrels per day to China, four to six times as much. By incorporating the repayment into a larger supply contract, Venezuela can truthfully say that CDB will only deduct a portion of the revenues to cover loan interest, while the rest will return to Venezuela. Today, Venezuela has signed so many loans-for-oil that it allows China to keep \$70 per barrel to pay back the loans, while China refunds the remaining \$40 or so according to market prices (Crooks and Rodriguez Pons 2011). Brazil and Ecuador retain a larger percentage of the oil revenue because they have smaller loans. In Ecuador, PetroChina deposits 79 percent of the oil revenue into Petroecuador’s CDB account

Table 7. Chinese Loans-for-Oil in Latin America

Year	Borrowing Country	Borrower	Lender	Amount (\$m)	Purpose
2008	Venezuela	BANDES and PDVSA	CDB	4,000	Funding infrastructure, other projects
2009	Brazil	Petrobras	CDB	10,000	Pre-salt oil technology
2009	Ecuador	Petroecuador	PetroChina	1,000	Advance payment for Petroecuador oil
2009	Venezuela	BANDES and PDVSA	CDB	4,000	Infrastructure, including satellite
2010	Ecuador	Petroecuador	CDB	1,000	80% discretionary, 20% oil-related
2010	Venezuela	BANDES and PDVSA	CDB	20,000	Funding infrastructure
2011	Ecuador	Government	CDB	2,000	70% discretionary, 30% oil-related
2011	Venezuela	PDVSA	CDB	4,000	Infrastructure
2011	Venezuela	PDVSA	ICBC	4,000	Housing

Sources: See Annex

and diverts the remaining 21 percent to pay back the loan (Arias Sandoval 2010). In Brazil, Sinopec pays market prices for Petrobras oil and deposits its payment in Petrobras' CDB account. Brazil must maintain a minimum account balance equivalent to six months of interest on the loan (Zissis 2009).

CDB has made headlines with its loans-for-oil, but it did not invent them. Indeed, Japan gave China loans for its oil in the 1970s. These deals meant Japanese technology for China and energy security and industrial diversification for Japan (Bräutigam 2009, 13, 47). Both countries considered these loans-for-oil successful; now that China imports oil and exports technology, it has copied Japan's deals. In fact, Japan and China both signed loans-for-oil with Venezuela in 2011 (Parraga 2011).

Loans-for-oil have received international acclaim for their benefits to China. They help China establish diverse, long-term oil supply chains, promote Chinese exports, put dollar reserves to a productive use, expand the international usage of the Chinese yuan, and win favor with borrowing governments. Jeremy Martin, director of the Energy Program at the Institute of the Americas, calls loans-for-oil the "most important arrows in Beijing's quiver" (Arnson and Davidow 2011, 17). Downs argues that as a hybrid of policy and commercial banking, CDB has designed the loans-for-oil to fulfill both policy and commercial objectives. In addition to securing oil supplies, helping Chinese companies expand abroad, and building relationships with South American governments, the oil-backed commercial loan terms lower risk and increase profits (Downs 2011, 3).

Still, some scholars also argue that China has turned to loans-for-oil as a second-best strategy. Chinese oil companies would prefer to own foreign oil by buying equity in foreign oil fields, rather than simply gaining an oil purchase agreement. However, foreign governments have blocked many of China's attempts to buy oil fields, with the most famous example being the US refusal to allow the UNOCAL merger. Unable to buy oil fields, it has been argued that China turned to loans-for-oil to secure at least its oil purchases (Chao 2010, 158; The Economist 2010; Jiang 2010, 14; Arnson and Davidow 2011, 17).

Mainly because of a misconception about the oil prices, the loans have been criticized as harming Latin American borrowers. Chinese scholars and politicians declare loans-for-oil a "win-win arrangement" and argue that they will strengthen China's image as a great power that helps other developing countries (Chao 2010, 159; Zheng 2010). But Latin American and US observers are wary of the deals. Many have made the assumption that the borrowers are simply giving the shipments of oil to China to pay back the loan. This would be equivalent to selling a fixed quantity of future oil to China at a pre-set price, and it would rob the exporters of massive revenues as oil prices rose.

The *New York Times* repeats a Venezuelan lawmaker's claim that "China locked in low prices for the oil Venezuela is using as repayment" (Romero and Barrionuevo 2009). But China cannot "lock in" low prices, since the contract requires it to purchase the oil shipments at the relevant market price on the day they are received. In an interview

with the Inter-American Dialogue, energy economist Roger Tissot argued that China can use loans-for-oil to “hedge against future price spikes” (Myers 2011). China cannot hedge using loans-for-oil because it is purchasing the oil at spot market prices. For example, Petroecuador sells to China based on West Texas Intermediate (WTI) prices. If WTI spikes, China’s prices will do the same. This misconception has given loans-for-oil a black eye. Instead, as an IMF Africa specialist noted: “It all depends on the terms” (Bräutigam 2009, 149).

Financing terms in loans-for-oil agreements seem better for the South Americans than most people believe. Some have criticized the loans in Ecuador, the only country to reveal details on its loans-for-oil. Ecuadorian oil analyst Fernando Villavicencio argued that the terms, which include crude oil differentials and deal premiums, “represent million-dollar losses for the Ecuadorian state” (El Universo, “Más” 2010). Since Ecuador’s crude is of lower quality than WTI, the deals subtract a differential of \$4.20 to \$7.20 per barrel for Oriente crude and \$7.90 to \$10.70 for Napo crude (El Universo, “Negociaciones” 2010). At the time the deals were concluded, Petroecuador’s official price for Oriente crude included a differential of \$5.67 and, for Napo crude, a differential of \$9.45 (Recent Business News 2010). These differentials seem to be in line with those in the Chinese deals.

China also pays oil premiums, or per-barrel bonus payments above market price. The 2009 deal adds \$1.25 to \$1.30 per barrel for the Ecuadorian crude (El Universo, “Negociaciones” 2010). The 2010 deal cut this premium to \$0.50, which sparked fierce controversy in Quito. However, Petroecuador has recently sought to encourage high-volume deals by offering per-barrel discounts, so even the small Chinese premiums are positive (“Petroecuador” 2008). The final component of the financial package is the loan’s interest rate. CDB set the rate at 7.25 percent for the first loan, 6 percent for the second, and 6.9 percent for the third. These rates are high because Ecuador defaulted on \$3.2 billion in government bonds in 2008 and 2009 (Mapstone 2008). Still, they are lower than the rates charged by sovereign debt lenders. According to JP Morgan’s EMBI+ Index, sovereign lenders charge Ecuador 8.45 percent above Treasury yields (JP Morgan 2011).

Brazil and Venezuela also sell the oil to China for market prices. The Brazilian and Venezuelan governments have

not released the particulars of those agreements. But the Venezuelan government recently sent documentation to the *Wall Street Journal* from which the paper concluded that “China appears to be paying roughly market prices for the oil” (De Córdoba 2011). Chao Caizhen, professor at China’s People’s University, reports that Brazil is also selling oil based on market prices (2010, 160).

If Chinese banks are not reaping large rewards from loans-for-oil, what is their purpose? First, the loans-for-oil have secured China’s access to half a year’s supply of oil. Since only a fraction of the oil payment goes to pay back the loan, for every \$1 of loans China has practically guaranteed around \$4 of oil supply. Among its seven agreements with Brazil, Ecuador, and Venezuela, China will receive roughly 1.5 billion barrels of oil over the next ten years. With China’s daily consumption at almost 8 million barrels per day, the 1.5 billion barrels constitute about 6.5 months of oil. It should be noted that the volume of deliveries will likely fluctuate on an annual basis due to the structure of the contracts. Nevertheless, this is a small but comforting share of China’s future oil needs.

Second, and perhaps more importantly, the loans-for-oil allow China to give loans to otherwise non-creditworthy borrowers by reducing the risk of borrower default. CDB can siphon interest directly out of the oil payment, ensuring that if the country wants to export oil to China, it will have to pay back the loan. Lower default risk means lower risk premiums and reduced interest rates. Thus CDB could offer Venezuela a ten-year, \$20 billion loan. While it cost a spread of 50-285 basis points, no other international lender would give Venezuela such a large, long-term loan. Still, the risk of default is higher than most people believe because the oil is not collateral for the loan. If the borrowers threaten to cut off the supply of oil, CDB cannot seize extra oil or oil revenue to compensate⁴ (EFE 2009; El Universo, “Préstamo” 2010; Chao 2010; Jacob 2010).

⁴ China can sue the borrower in international arbitration tribunals, but the Chinese government avoids arbitration. Rather than forcing the borrowers into international arbitration, it would most likely force repayment by blocking access to the borrower’s exports (Gallagher 2011). For example, when Argentina began anti-dumping investigations on Chinese manufacturing exports, the Chinese government responded by banning Argentine soybeans. Since China had been buying 75 percent of Argentina’s soybeans, the ban carried far more weight than an arbitration case. Orihuela, R. (2010). “Argentina Sets Levies and Ends Anti-Dumping Investigation on Chinese Goods.” *Bloomberg*. Retrieved 20 Dec 2011, from <http://www.bloomberg.com/news/2010-07-22/argentina-stops-china-anti-dumping-probes-after-failure-to-end-oil-spat.html>.

In sum, Chinese banks maintain some oversight over their loans by attaching either purchase requirements or oil sale agreements. Most Chinese loans require the borrowers to use a portion for Chinese technology or construction. The latest CDB innovation is the loan-for-oil, which now constitutes 69 percent of total Chinese lending to the region. The Ecuador loans-for-oil do not seem as harmful to Latin American borrowers as is commonly believed, but few financial details are available. These strings-attached loans reduce the risk of default, allowing China to loan to less creditworthy borrowers.

5. Different Development Model? China Seeks to Finance a Different, but Sometimes Overlapping, Set of Projects

Chinese loans to LAC are more concentrated in certain sectors than IFI and Western loans, although there is overlap. Some argue that this reflects the fact that China has a different development model than IFIs, favoring infrastructure and industrialization over micro-interventions in health and social services. Others argue that Chinese loans reflect Chinese interests in the region and provide access to key natural resources and markets.

Chinese banks loan money for different purposes than their IFI/Western counterparts. The Chinese loans focus on

infrastructure and heavy industry, while the Western loans span a range of governmental, social, and environmental purposes (Table 8). Chinese banks channel 87 percent of their loans into the energy, mining, infrastructure, transportation, and housing (EMITH) sectors. Only 29 percent of IDB loans and 34 percent of World Bank loans go to the EMITH sectors. Instead, the IDB and World Bank direct more than a third of their loans toward the health, social, and environment sectors, which are devoid of Chinese investment.

According to the Chinese banks themselves, they give more EMITH loans because they seek to directly support economic growth rather than social welfare. China Ex-Im Bank's website states that its projects must "be able to generate foreign exchange revenue and create jobs in the borrowing country. The [loans] focus on supporting infrastructure such as energy, transportation, telecommunication projects, and high-efficiency sectors such as manufacturing, processing, and agriculture in the borrowing country."

Bräutigam argues that in Africa, China is filling an unmet need for EMITH lending, which was all but abandoned by the World Bank decades ago. She points out that from 1946 to 1961, three-quarters of World Bank lending funded transportation and electrification (Bräutigam 2009, 133). Today, that share has plummeted owing to Millennium Development Goals that focus donors' attention on indicators of social welfare (2009, 77). Chinese banks, on the other hand, copy Japanese banks' focus on infrastructure and transportation because they credit it with spurring Chinese development in the 1970s (2009,

Table 8. Bank Loans to Latin America by Sector, 2005–2011

(\$ million)	Total	World Bank	IDB	Chinese
Health	\$17,926	\$8,463	\$9,463	\$—
Education	\$7,008	\$4,389	\$2,619	\$—
Water, Environment	\$16,144	\$7,061	\$9,084	\$—
Public Administration	\$19,105	\$11,013	\$8,092	\$—
Finance, Trade	\$18,328	\$7,170	\$9,858	\$1,300
Housing, Infrastructure	\$38,098	\$—	\$4,397	\$33,701
Transportation	\$27,693	\$7,192	\$8,821	\$11,680
Energy, Mining	\$30,061	\$2,565	\$7,576	\$19,920
Other	\$10,651	\$378	\$2,028	\$8,614
TOTAL	\$185,383	\$48,231	\$61,937	\$75,215

Chinese sources: Annex. World Bank and IDB sources: respective Annual Reports

48). Interestingly, China Ex-Im Bank's lending philosophy is showing signs of change. The bank's 2010 annual report notes: "In accordance with the Central Government's foreign investment guidelines, requiring wise and effective use of foreign investments, the Bank gave full support to projects in key areas, such as infrastructure, medical and health care, education, [and] environmental protection" (Export-Import 2010, 28). While loans targeting social indicators may be gaining ground within China, we have not seen evidence of them in China Ex-Im Bank's international portfolio.

It is possible that Chinese loans in these sectors have complemented, rather than supplanted, World Bank and IDB loans. World Bank and IDB loans to EMITH sectors rose in 2008 and 2010 despite a tenfold increase in Chinese lending over the same period (Figure 1). The share of World Bank and IDB loans going to EMITH sectors did fall by more than 50 percent in 2009. However, this relative drop in EMITH loans is misleading because, in 2009, total World Bank and IDB lending doubled as a result of financial crisis-related loans to the financial, health, and social sectors (World Bank 2009, 47). We performed a simple linear regression here and found that Chinese EMITH lending had no significant impact upon Western EMITH lending.

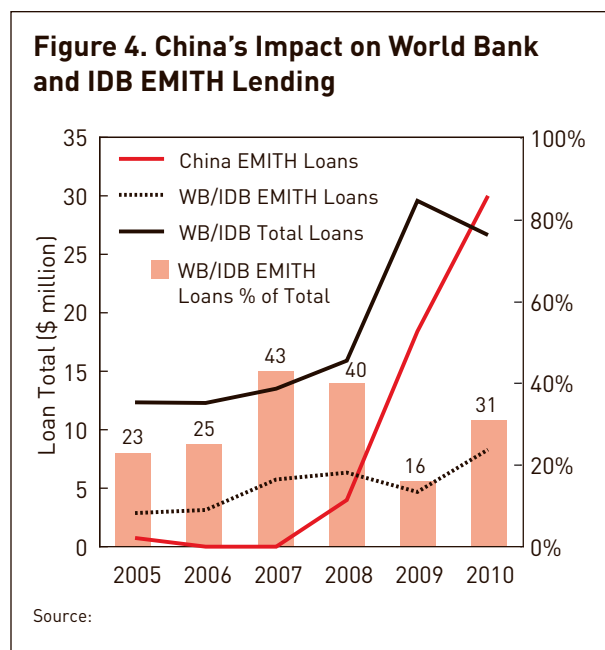
We conclude that Chinese and IFI/Western banks do not overlap significantly in Latin America because they give different size loans to different sectors in different countries.

Chinese banks have focused on loans to the EMITH sectors, but even in this area, Western banks maintain their pre-China lending.

6. No Policy Conditionality for Chinese Loans but Strings Still Attached

We compared World Bank and Chinese terms on similar loans to judge if the conditions were significantly different. While the World Bank attempts to reshape the project and even the organization receiving the loan, Chinese loans do not require that a borrower change its policies in return for financing. Instead, Chinese banks usually force borrowers to spend a share of the loan on Chinese goods.

The World Bank imposes stringent conditions on its borrowers. For example, the IBRD's \$30 million loan to Argentina in 2010 required the Argentine government to submit numerous financial statements and evaluation reports as well as hire bank-approved experts to monitor transparency and efficiency (World Bank, "Loan" 2010, 8). World Bank loan terms often go beyond administering the project to reforming the borrowing organization itself. The IBRD loaned \$485 million to the Brazilian state of Rio de Janeiro in January 2011 as "budget support" or discretionary funding. Although the World Bank did not tell Rio how to use the loan, it would not transfer the loan the state fulfilled a two-page list of conditions. To receive the first half of the loan, Rio had to integrate tariffs for intercity transportation, expand the environmental department's human resources and financing, levy a fee on water users for watershed management, implement disaster risk mitigation policy, broker an agreement on housing plans with municipal governments, increase land titling programs, establish social programs in the slums, and set up a directive committee led by the vice-governor. To receive the second half of the loan, Rio will have to restructure the Secretariat of Social Assistance and Human Rights, double land tenure regularization capacity, change the State Housing Fund's operating rules with respect to low-income families, create an integrated plan for metropolitan governance, and execute a monitoring and evaluation program (World Bank, "Loan" 2011).



Chinese banks give greater loan spending and tracking freedom to borrowers. China's ambassador to Bolivia, Shen Zhiliang, proudly said it is China's "principle" not to "impose political conditions on foreign aid"⁵ (Ministry 2011a). The *Financial Times* reports that Chinese banks "tend to impose less onerous transparency conditions" (Dyer 2011). As president of the World Bank, Paul Wolfowitz complained that Chinese companies "do not respect" the Equator Principles that set social and environmental standards for loans (Crouigneau and Hiault 2006). Former European Investment Bank (EIB) President Philippe Maystadt alleged that Chinese banks steal EIB's projects by "undercut[ing] the conditions it imposed on labour standards and environmental protection" (Parker and Beattie 2006). African officials have noted "there is a risk that some governments in Africa may use Chinese money in the wrong way to avoid pressure from the West for good government" (Swann and McQuillen 2006). As a result, Oxford professor Paul Collier declared that "the Chinese are making [governance] worse" (Bräutigam 2009, 13).

But others argue that Chinese loans offer a new, potentially liberating model of non-interventionist lending. Although a Ugandan government spokesman said "[Western lenders'] conditions are probably well intentioned, but they are humiliating" (Swann and McQuillen 2006), the Heritage Foundation pointed out that "Many African governments like the Chinese policy of 'non-interference' in their internal affairs" (Brookes 2007). Venezuelan President Hugo Chávez declared that Chinese aid "differs from other multilateral loans because it comes without strings attached, like scrutiny of internal finances" (Romero and Barrionuevo 2009). Indeed, Bräutigam observes that Chinese lending follows the nation's Five Principles of Peaceful Coexistence, which prohibit meddling in other countries' domestic affairs (Bräutigam 2009, 24). She argues that Chinese loans actually constitute a different philosophy of development assistance. Rather than forcing the borrowers to comply with Western norms, Chinese

partners treat them as equals and simply seek to do business with them (2009, 10). If Chinese lending appears to generate economic growth, developing countries may reject the World Bank's "big brother" philosophy and demand Chinese-style equal treatment from Western powers.

While Chinese banks do not seek to reform their borrowers with Western-style policy conditionality, they attach other strings in an effort to mitigate loan risks. Chinese banks almost always tie their loans to the purchase of Chinese goods. Other than a few loans-for-oil and smaller loans with

Chinese and IFI/Western banks do not overlap significantly in Latin America because they give different size loans to different sectors in different countries.

few details available, we found conditions in every loan requiring the borrower to purchase Chinese construction, oil, telecommunications, satellite, and train equipment. Some set aside only a small portion of tied funds, like CDB's \$1 billion loan-for-oil to Ecuador in 2010, which mandated 20 percent Chinese purchases. At the other extreme, China Ex-Im Bank gives 100 percent export credits, like a \$1.7 billion loan to pay a Chinese company to build the Coca-Codo Sinclair hydroelectric dam in Ecuador in 2010. Since Venezuela committed to spend the majority of its \$20 billion loan in 2010 on Chinese goods and services, CDB denominated half in Chinese yuan (De Córdoba 2011). This is the largest Chinese-currency loan to date, but China Ex-Im has also issued yuan-denominated lines of credit to Jamaica and Bolivia for equipment and construction (Urban Development Corporation 2007; *Gaceta Oficial del Estado* 2011). Whether the loans are issued in yuan, dollars, or simply establish a line of credit with a given Chinese company, the purchase requirements allow Chinese banks to reduce their exposure to default risk. It also reduces the recipient's room for corruption (Bräutigam 2009, 293).

The difference between strings attached to Chinese loans and those attached to Western loans helps explain the difference in countries borrowing from the Chinese and those borrowing from Western lenders. The leftist governments in Ecuador, Venezuela, and Bolivia avoid World Bank loans in

⁵ It should be noted that China almost never gives foreign aid to countries that recognize Taiwan (Republic of China) as the legitimate government of China. The only exception to our knowledge is Haiti.

order to free themselves from the neoliberal policies the World Bank imposes. They find purchase requirements attached to Chinese loans less objectionable because they seek to build up their EMITH sectors inexpensively using Chinese equipment. The loyal World Bank and IDB borrowers—Mexico, Colombia, and Peru—are undertaking projects outside the EMITH sectors for which Chinese purchase requirements would be a burden. They have been cooperating with the US and World Bank for decades and find the transparency

to construction projects in Latin America and Africa. Within China, environmental regulations are constantly circumvented. In 2009, the Ministry of Environmental Protection reported that 15.5 percent of projects started construction without approval, 9.6 percent of enterprises that were closed for environmental reasons resumed production without permission, and 25 percent of the main sources of pollution were not operating properly (McElwee 2009). To add to this concern, a majority of Chinese loans are in environmentally

Chinese loans do not require that a borrower change its policies in return for financing. Instead, China's banks usually require borrowers to spend a share of the loan on Chinese goods.

sensitive industries, such as mining, or on infrastructure projects in developing countries with low environmental standards.

International Rivers and Friends of the Earth, two environmental advocacy organizations, noted in July 2004 that the China Ex-Im Bank financed projects that other financial insti-

and reform requirements less costly than Chinese equipment. Brazil and Argentina accept Western loans where they find it acceptable to comply with Western standards. At the same time, they take on Chinese oil, mining, and train loans because they are willing to use Chinese inputs and have little objection to the purchase requirements.

tutions had refused to fund. For example, in December 2003, the China Ex-Im Bank financed the Merowe Dam in Sudan, a project that had attracted little funder interest in part due to the resulting displacement of 50,000 people (Bosshard 2010). In 2007, the OECD recommended that China “improve governmental oversight and environmental performance in the overseas operations of Chinese corporations” (OECD 2007, 12). Even Chinese officials have echoed these concerns. Cheng Siwei, a leading member of the People’s Congress, in January 2007 stated: “Even in developing countries, foreign companies that turn a blind eye to their social responsibilities will be kicked out of the market.” (Bosshard 2008, 11)

7. Environmental Guidelines Exist but Not on Par with Western Counterparts

Major infrastructure and heavy industry projects have the potential to create environmental problems in LAC. In response to civil society efforts to “green” the development banks, many Western banks now have significant environmental guidelines. China has developed similar environmental guidelines for its development banks. However, comparison of those guidelines finds that, despite significant progress in the past decade, China’s guidelines do not yet match those of its Western counterparts.

Environmental advocacy organizations have expressed concern about the potential for Chinese firms to transfer their lax adherence to domestic environmental regulation

Chinese-led investments in Angola and Zambia have led to documented international labor and environmental violations (Kotschwar, Moran, and Muir). In Peru, poor environmental practices factor into a nearly two-decade-long conflict between the Chinese mining firm Shougang and its workers and the local population. A 2006 inspection by Peru’s mining investment regulatory agency found that 12 percent of Shougang’s workforce had unreported lung disease. Beyond health concerns, Shougang was fined for environmental damage following the contamination of water supplies to the local community and surrounding areas (Kotschwar, Moran, and Muir 2011). According to Hermilia Zamudio, a local resident: “The Chinese see us as

little more than slaves. They deem it beneath them to talk to us, and when they need to address problems here, they do so with their thugs” (Romero 2010). The negative relationship between Shougang and the community has led other communities to fear similar practices.

Financers play an important role by ensuring social and environmental guidelines are adhered to and practiced. But the lure of large loans to needed areas has led government officials in host countries to skirt domestic regulations. In Argentina, Heilongjiang Beidahuang State Faros Business Trade Group Co. Limited and the Río Negro provincial government signed an agreement in 2010. This agreement awards Heilongjiang the lease of 320,000 hectares of land for agricultural production in Patagonia and the right to build a needed irrigation system for \$1.45 billion. However, this agreement has sparked sharp criticism from Raúl Montenegro, president of the Environment Defense Foundation. Montenegro, winner of the prestigious Alternative Nobel Prize, accused the Río Negro government of violating national and provincial environmental laws because of the loan (Hanks and Lopez-Gamundi 2011).

China’s Evolving Environmental Guidelines

It may come as a surprise to many that the Chinese government over the past five years has sought to incorporate social and environmental guidelines into its banks’ procedures to improve both domestic and international lending practices.

Environmental Guidelines⁶

Since the 1970s, the State Council has gradually pursued increased environmental protection. The 1979 “Law on Environmental Protection (Provisional)” and the 1989 “Law on Environmental Protection of the People’s Republic of China” created the framework for environmental protection and environmental impact assessment (EIA) procedures within China (Global Environmental Institute 2011). These laws were further strengthened by the State Council’s

passage of the “Environmental Impact Assessment Law of the People’s Republic of China,” effective September 1, 2003.⁷ This law specifically expanded the role of EIA from pollution assessment to overall eco-assessment and has been a critical component in encouraging change throughout China’s bureaucracy (Global Environmental Institute 2011). In addition, this guideline officially established EIA as an important factor in deciding whether to go ahead on a project (China Environment Law n.d.).

The Chinese government over the past five years has sought to incorporate social and environmental guidelines into its banks’ procedures.

In subsequent years, the State Environmental Protection Administration (SEPA) has taken a leading role in implementing the “Environmental Impact Assessment Law of the People’s Republic of China.” In February 2004, SEPA and the Ministry of Personnel jointly established a certification system for professional EIA engineers and strengthened requirements on professional EIA practitioners (Zhu and Lam 2009, 55). This effort was further strengthened when SEPA adopted the Equator Principles in January 2008 (Bräutigam 2010, 36). China’s development banks have also followed suit with their own guidelines. The most important guidelines for each are CDB’s “Guidelines on Environmental Protection Project Development Review” and China Ex-Im Bank’s 2007 “Guidelines on Environmental and Social Impact Assessment of Loan Projects” (Global Environmental Institute 2011, 61-63). Under these guidelines, lending practices at China’s leading development banks incorporate social benefits and environmental protections.

The CDB’s “Guidelines on Environmental Protection Project Development Review” focuses on client suitability review, ex-ante EIA, and ex-post environmental monitoring. The CDB conducts a client suitability review by evaluating the environmental record of the company requesting

⁶ For a complete history of the development of China’s EIA system, see: ed. Zhu, Ian and Kin-Che Lam (2009). “Environmental Impact Assessment in China.” *Nankai University Research Center for Strategic Environmental Assessment and The Chinese University of Hong Kong Centre of Strategic Environmental Assessment for China*. Retrieved 13 Jan 2012, from http://cseac.gm.cuhk.edu.hk/publications/EIA_IN_CHINA.pdf.

⁷ For a complete review of the Environmental Impact Assessment Law, see: Stender, Neal, Dong Wang, and Jing Zhou (2007). “China’s New Environmental Impact Assessment Law.” *Orrick, Herrington, & Sutcliffe, LLP*. Retrieved 13 Jan 2012, from <http://www.orrick.com/fileupload/1188.pdf>.

Table 9. Major Environmental Guidelines of Chinese Banks

State Council Regulations	When Adopted
Law on Environmental Protection (Provisional)	1979
Law on Environmental Protection of the People's Republic of China	1989
Environmental Impact Assessment Law of the People's Republic of China	1-Sep-03
Ministry of Commerce	
Provisions on the Authorization of Investment to Run Business Abroad	2005
Guidelines on Sustainable Building of Overseas Forests by Chinese Companies (With State Forestry Bureau)	27-Aug-07
Guidelines on Sustainable Management and Utilization of Overseas Forests by Chinese Companies (With State Forestry Bureau)	31-Mar-09
China Banking Regulatory Commission	
Opinion on Strengthening the Corporate Social Responsibility of Banking Institutions	Nov-07
China Development Bank	
Guidelines on Environmental Protection Project Development Review	
Environmental Impact Assessment Framework for Lending to Small or Medium-Sized Enterprises (SMEs)	
Guidelines on Special Loans for Energy Conservation and Emission Reduction	
Work Plan on Loans for Pollution Control and Emission Reduction	
Ex-Im Bank of China	
Guidelines on Environmental and Social Impact Assessment of Loan Projects	2004; Revised 28-Aug-07

Source: *Environmental Policies on China's Investment Overseas*. Global Environmental Institute (China Environmental Science Press, 2011)

the loan. Then the CDB conducts an ex-ante EIA review to ensure that resource and environmental protection costs are incorporated into the project's operational costs. After the project is completed, the CDB will also conduct ex-post environmental monitoring. This monitoring includes consultations with environmental agencies and review to see if the project's implementation methods complied with environmental protection requirements (Global Environmental Institute 2011, 62-63).

In addition to strengthening internal guidelines, the CDB engaged the international community to enhance its domestic lending practices. For example, the CDB partnered with the World Bank on loan projects, leading to creation of the "Environmental Impact Assessment Framework for Lending to Small or Medium-Sized Enterprises (SMEs)." This framework is only applicable within China, but spillover due to familiarity with such lending practices may occur. The CDB is currently considering adoption of the Equator Principle, which would further strengthen its social and environmental procedures (Global Environmental Institute 2011, 62-63).

The China Ex-Im Bank has been a domestic leader in adopting environmental policies. Shortly after passage of the "Environmental Impact Assessment Law of the People's Republic of China" in 2003, the China Ex-Im Bank drafted its own internal guidelines. The "Guidelines on Environmental and Social Impact Assessment of Loan Projects" were instituted in 2004 and later updated and released to the public in August 2007.⁸ These guidelines strengthened requirements for consideration of the environmental and social impact during the loan approval process, requiring EIA both prior and after the project, and regular review of the implementation of the project. More specifically, the guidelines stated that the EIAs must adhere to four key principles:

⁸ An excerpt (unofficial translation) of the Guidelines for Environmental and Social Impact Assessments of Loan Projects by the Global Witness can be found at: http://www.google.com/url?sa=t&src=1&resc=s&frm=1&source=web&cd=1&ved=0CB8QFjAA&url=http%3A%2F%2Fwww.globalwitness.org%2Fsites%2Fdefault%2Ffiles%2Flibrary%2FChinese%2520guidelines%2520EN.pdf&ei=kRrVTo_UHqWP0QGOkIGCAg&xusg=AFQjCNEmMR00FgHG33CvroLTdvyzYKo4pg

- 1) Conduct ante and post EIA and monitor project implementation
- 2) Base EIA on host country's environmental standards
- 3) Respect indigenous people's land and resources rights
- 4) Solicit public opinion for projects with potential for serious adverse impact on the local environment

Violations can result in the China Ex-Im Bank halting its lending or demanding early repayment from lenders (Global Environmental Institute 2011, 61-62).

The China Ex-Im Bank has also worked with IFIs in establishing international social and environmentally responsible lending practices abroad. In 2007, the China Ex-Im Bank signed two Memorandums of Understanding with the World Bank and International Finance Corporation (IFC). These agreements strengthened cooperation efforts in energy and transport projects in Africa, IFC equity investments, and advisory services on environmental issues (Bosshard 2008, 13).

This progress is due to pressure by the Chinese central government and by non-governmental organizations. In conversations between the president of China Ex-Im Bank and Deborah Bräutigam, the president stated that China Ex-Im Bank only works with Western agencies for EIAs as these organizations had better credibility. Furthermore, the China Ex-Im Bank wanted to avoid making environment the central issue, indicating both internal and external pressure to adhere to social and environmental guidelines (Bosshard 2010).

Common Social and Environmental Guidelines

Over the past twenty years, social and environmental guidelines have been incorporated into many regional and government development banks, establishing a set of internationally agreed upon lending practices. These practices have shaped the rise of social and environmental protection within the developing world by tying such values to availability of loans. These common guidelines include:

1. *Ex-ante EIA*: An EIA “involves a systematic assessment of the potential environmental impacts of a proposed project and its alternatives” (Europe Aid). Similar to international definitions, China's State Council specifically defined an EIA as “the methods and institutions for analyzing, predicting and appraising the impacts of programs and construction projects that might incur

after they are carried out so as to propose countermeasures for preventing or mitigating the unfavorable impacts and make follow-up monitoring” (Zhu and Lam 2009, 26).

2. *Project Review of the EIA*: Once the ex-ante environmental impact assessment is complete, the bank needs to make sure the EIA findings are addressed and mitigate the environmental and social impact of the project.
3. *Industry-Specific Social and Environmental Standards*: The project should adhere to the relevant industry-specific standards. These standards are generally accepted as the ones defined by the World Bank and the IFC.
4. *Ensure Compliance with Host Country Environmental Laws & Regulations*: The bank needs to ensure the project is in compliance with host country's environmental laws and regulations.
 - a. *Ensure Compliance with International Environmental Laws & Regulations*: The bank needs to ensure the project complies with international environmental laws and regulations, usually set by the World Bank or the IFC.
5. *Public Consultations with Communities Affected by the Project*: The government, borrower, or third party expert needs to publically consult with the affected communities and incorporate their concerns into the project as much as possible. Early release of relevant information regarding the project and the results of the EIA is crucial.
6. *Grievance Mechanism*: It requires that the borrower provide a mechanism to receive, facilitate, and address concerns raised by the affected communities during the duration of the project.
7. *Independent Monitoring and Review*: To ensure due diligence, an independent social or environmental expert not associated with the borrower will review the EIA, the project review, and consultation process (Equator Principles 2006).
8. *Establishing Covenants linked to Compliance*: The loans need to link environmental guidelines through covenants. Violation of the set guidelines will lead to review or possible cancellation of funds.
9. *Ex-post EIA*: Once the project is complete, the borrower will conduct a final EIA to review the project's overall impact on society and the environment.

Using the nine common guidelines listed above, we conducted two side-by-side comparisons of official guidelines to see the degree that the CDB and China Ex-Im Bank have incorporated social and environmental guidelines into their current lending practices. First, since the CDB is most similar to a development bank, we compared CDB guidelines with those of the World Bank, International Finance Corporation, and IDB. Then we compared the guidelines of China Ex-Im Bank to US Ex-Im Bank as both promote their domestic corporations abroad (Table 10).

The CDB currently incorporates four of the common social and environmental guidelines into its lending practices. These guidelines include: environmental impact assessment, project review, public consultations with communities affected by the project, and an ex-post environmental impact assessment. Interestingly, CDB is the only development bank among the three in Table 10 above (WB, IFC, and IDB) that requires an ex-post environmental impact assessment. This requirement is an improvement over current IFI guidelines in that it creates a formal review process on the project's overall effect on the community and environment, allowing for future corrective action.

The CDB has also worked to increase transparency by publishing an annual corporate social responsibility report on its website in both English and Chinese. As a result of its efforts, the CDB has won numerous domestic awards, including the “People’s Social Responsibility Award” (consecutively for the past five years), “Most Socially Responsible Bank of the Year” in 2010, and “Most Socially Responsible Corporation in 2010” (CDB 2010).

However, the CDB does not incorporate into its process four widely-accepted guidelines: a grievance mechanism, a requirement for adherence to international environmental laws and regulations, an independent review and assessment, or the establishment of covenants linked to compliance. A grievance mechanism and an independent review and assessment are important avenues for addressing public concerns and ensuring transparency throughout the process. Furthermore, the overall environmental standards applied are the host country’s standards, which are generally lower and less restrictive than the international environmental laws and regulations (Global Environmental Institute 2011, 62-63).

The China Ex-Im Bank has also incorporated EIA, project review, public consultations with communities affected by the project, and an ex-post EIA into its social and environmental

Table 10. Side-by-Side Comparison of IFIs with CDB

Environmental Guidelines	World Bank	International Finance Corporation (IFC)	InterAmerican Development Bank (IADB)	China Development Bank (CDB)
Ex-ante environmental impact assessment	X	X	X	X
Project review of environmental impact assessment	X	X	X	X
Industry-specific social and environmental standards	X	X		
Ensure compliance with host country environmental laws and regulations	X		X	X*
and international environmental laws and regulations	X			
Public consultations with communities affected by the project	X	X	X	
Grievance mechanism	X	X		
Independent monitoring and review	X			
Establishing covenants linked to compliance	X	X	X	
Ex-post environmental impact assessment				X

*The CDB requires that if the host country’s environmental standards are inadequate, the firm follow Chinese standards or international best practices.

Table 11. Side-by-Side Comparison of China Ex-Im Bank with US Ex-Im Bank*

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

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

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

guidelines. An unofficial translation of China Ex-Im Bank's 2007 "Guidelines on Environmental and Social Impact Assessment of Loan Projects" cites the requirement of an ex-ante EIA and further states that "those projects that are harmful to the environment or do not gain endorsement or approval from environmental administration will not be funded." Like the CDB, the China Ex-Im Bank requires an ex-post EIA. Based on the findings of the ex-post EIA, China Ex-Im Bank "will revise the measures taken before and during the project implementation for similar projects. If necessary, the related requirements and policies will be fully revised." China Ex-Im Bank, in contrast to other IFIs or the US Ex-Im Bank, does not cite any financial threshold to applying its EIA. This omission could broaden the EIA screening process to cover a greater number of projects (Environmental Defense 2007). China Ex-Im Bank has also made efforts to increase transparency by publishing an overview of major projects and a corporate social responsibility section in its annual report, available on its website in both English and Chinese.

China Ex-Im Bank goes beyond the CDB by requiring project review during the duration of the loan and establishing covenants linked to compliance. Therefore, the discovery of negative environmental impacts prior and during the course of the project will lead the China Ex-Im Bank to "require the implementation unit to take immediate remedial or preventive measures. Otherwise, they will discontinue financial support" (Environmental Defense 2007).

These additions are a step forward for socially and environmentally responsible loans because they directly link the loans to adherence to guidelines.

Still, despite these additions, China Ex-Im Bank's guidelines remains relatively limited. China Ex-Im Bank has yet to require adherence to international environmental laws and regulations, a grievance mechanisms, or independent review and assessment. These additional requirements would provide an avenue for mitigating any potential social and environmental concerns that emerge during the duration of the project.

Implementation of Environmental Guidelines

Although China has made significant progress over the past five years, measuring the degree with which Chinese development banks have implemented these environmental guidelines is difficult. This difficulty is most likely due to the relative newness of the laws, lax adherence to domestic environmental laws, language barriers in conducting consultations with affected communities, and lack of publicly available information.

Based on the duration of time in the development lending industry, the CDB and China Ex-Im Bank are young players and their adoption of social and environmental guidelines is relatively new. In comparison with the World Bank in the 1980s, the CDB and China Ex-Im Bank are ahead of history,

starting implementation guidelines much earlier. China has loaned Latin America \$75 billion since 2005 with more than half of that total issued after 2009. Many of these projects have long construction periods with work still ongoing. That makes it difficult at this point to evaluate the effectiveness of the guidelines on Chinese lending practices.

A complicating factor is lax adherence to domestic environmental laws. In 2004, a joint investigation by the SEPA and Ministry of Land and Resources found that only 30 to 40 percent of the mining construction projects went through the EIA procedure (Gu 2005). This investigation occurred after the implementation of the State Council's

China's environmental progress is the result of pressure from the Chinese central government and from non-governmental organizations.

new law, indicating that there are conflicting goals when it comes to rapid economic growth versus environmental protection. Casual adherence to environmental protection has continued as evidenced by the severe impact pollution has on cities across China. In Beijing, the US Embassy has assessed that air quality is unhealthy 80 percent of time, causing health concerns for the city's population (Andrews 2011). In 2010 alone, there were an estimated 171 environmental accidents within China (Rong, Ying, Yuan 2011).

Domestic and international environmental accidents have raised concern that, given weak domestic enforcement, Chinese companies' adherence to another country's environmental guidelines will remain low. This poor compliance with domestic regulations could potentially transfer to construction projects done by Chinese firms in Latin America and Africa, where a majority of Chinese loans are in environmentally sensitive industries such as mining or infrastructure.

Language barriers are an additional obstacle in measuring implementation of environmental guidelines. Language barriers can hamper efforts to conduct consultations with affected communities, can limit understanding of the host country's environmental laws and regulations, and can weaken communication between the Chinese company and the host government.

Finally, due to the sensitive nature of loans in China, there is an overall dearth of publicly available information. This is further restricted by the lack of website information: neither CDB nor China Ex-Im Bank websites list EIA findings for their major projects—in either Chinese or English.

Despite this, some Chinese firms are adhering to social and environmental practices. In Peru, Chinalco has taken steps toward following social and environmental guidelines. The company conducted an EIA and held public hearings with the local community. In December 2010, its environmental impact assessment was approved, and the company has since contracted with a Canadian firm to implement an Environmental Information Management System (Kotschwar, Moran, and Muir 2011). Moreover, China Ex-Im Bank suspended funding for a hydropower dam in Gabon after local NGO Brainforest raised environmental concerns over its location in a national park (Bosshard 2010).

Further research is needed to assess how deeply Chinese development banks have implemented these environmental guidelines, particularly on larger infrastructure and mining projects. These projects are the most environmentally sensitive and, as such, are more likely to face EIA scrutiny at home and abroad.

In conclusion, Chinese banks' adherence to international environmental guidelines is relatively new, beginning approximately five years ago. In comparison to other development-focused banks, the CDB and China Ex-Im Bank incorporate the core principles of EIA, but both have a ways to go to meet internationally established environmentally responsible lending practices. Furthermore, evaluating the overall implementation of these guidelines is hampered by the newness of the loans, lax domestic enforcement of environmental laws, language, and lack of publicly available information. China has made significant progress in incorporating social and environmentally responsible guidelines into its official guidelines, but further progress can be made.

8. Summary and Conclusions

For this paper, we estimated the volume of Chinese public financing in Latin America and the Caribbean and looked at the composition and characteristics of those loans. We then compared those estimates with LAC lending by the World Bank, Inter-American Development Bank, and Export-Import Bank of the United States. We found that China has committed approximately \$75 billion in loans to Latin American countries since 2005. China's loan commitments of \$37 billion in 2010 were more than those of the World Bank, Inter-American Development Bank, and the US Ex-Im Bank combined for that year. We also examined the extent to which Chinese loans to Latin America are more favorable, impose policy conditionalities, and have less stringent environmental guidelines than the loans of their Western counterparts. Contrary to the suggestions of other observers, we find that the terms of Chinese loans to Latin America can be more stringent than those of Western loans, that Chinese banks impose no policy conditionalities (but do impose conditions of another nature) and, to the surprise of many, we show that Chinese finance does operate under a set of environmental guidelines, although those guidelines are not yet on par with the guidelines of Western lenders.

It is our hope that this paper adds to the empirical research on Chinese finance in LAC. The investigation we performed here gives credence to some claims about China in Latin America but less so to other claims. On the positive side, it is clear that China is a new and growing source of finance for LAC countries, especially for countries having trouble gaining access to global capital markets. Moreover, from a LAC perspective, China's loans come without the

policy conditionalities of IFI and Western loans. Finally, with loans from China, LAC nations can obtain more financing for the infrastructure and industrial projects they seek to enhance long-run development—rather than the latest Western development fads.

Contrary to much of the commentary on the subject, LAC nations, by and large, pay a higher premium for loans from China. That higher premium comes in the form of interest rates, not loans-for-oil. It is commonly thought that LAC simply sends barrels of oil to China in return for financing and, as a result, may end up losing in the face of rising oil prices. But our analysis shows that such thinking misreads the evidence. The majority of Chinese loans-for-oil in Latin America are linked to market prices, not quantities of oil. Meanwhile, the loans are often tied to working with Chinese contractors and businesses, and that condition represents another cost because it reduces the “spillover” effect in terms of local contracting in LAC. Finally, although the IFI/Western banks' environmental record is far from perfect, Chinese banks do not operate on par with the environmental guidelines of Western banks. This distinction is of grave concern given that the composition and volume of Chinese loans is potentially more environmentally degrading than Western banks' loan portfolios to LAC.

As more projects move forward, this research should be coupled with on-the-ground case studies comparing Chinese-financed projects with Western-financed projects. However, even this research will be difficult to conduct given the lack of available data and China's limited experience in reporting on such activities. We hope that we have shed some empirical light on China's financial activity in LAC, and that others can deepen and expand our analysis in a policy-relevant manner.

Annex: Key Loan Sources

2005 Brazil (Gerdau Acominas, \$201 million)

Trade & Forfeiting Review (2006). TFR 2005 Deal of the Year winners. Vol 9, No 4, February 6. http://www.tfreview.com/xq/asp/sid.0/articleid.EEEBCBC-1BC8-4B7C-80C3-D8F9FDEB0862/eTitle.Deals_of_the_Year_2005/qx/display.htm. (accessed January 10, 2012).

Trade Finance Magazine (2005). BNPP and Sinosure sign Brazilian steel deal. November 1. <http://www.tradefinancemagazine.com/Article/2140264/Regions/22996/BNPP-and-Sinosure-sign-Brazilian-steel-deal.html> (accessed January 10, 2012).

2005 Chile (Codelco, \$550 million)

Codelco (2005). Memoria Anual. http://www.codelco.cl/flipbook/memorias/memoria2005/codelco_memoria_2005.pdf (accessed January 10, 2012).

Codelco (2006). Memoria Anual. <http://www.codelco.cl/flipbook/memorias/memoria2006/pdf/memoria.pdf> (accessed January 10, 2012).

El Mercurio (2005). Codelco-Minmetals: sólo falta la negociación con el banco chino. December 22. <http://diario.elmercurio.cl/detalle/index.asp?id=%7B8f45dca5-a8c5-4ba5-ad0c-f46645b01038%7D>. (accessed September 9, 2011).

2007 Jamaica (Government, \$45 million)

“Montego Bay Convention Centre” (2007). Urban Development Corporation. http://www.udcja.com/Fact%2520Sheet/Fact_sheet_MontegoBayConCnt.pdf (accessed January 10, 2012).

U.S. Securities and Exchange Commission (2011). Form 18-K: Annual Report of the Government of Jamaica. <http://marketbrief.com/jamaica-government-of/18k/annual-report-for-foreign-gove/2011/11/1/9084513/filing> (accessed January 10, 2012).

2008 Costa Rica (Government, \$300 million)

Ministerio de Relaciones Exteriores y Culto (2008). Establecimiento de relaciones diplomáticas con la República Popular China ha resultado beneficioso para el país. http://www.ree.go.cr/file-hn.php?id_file=414. (accessed January 10, 2012).

Anderlini, J. (2008). Beijing uses forex reserves to target Taiwan. *Financial Times*. September 12. <http://www.ft.com/cms/s/0/22fe798e-802c-11dd-99a9-000077b07658.html> (accessed January 10, 2012).

Bowley, Graham (2008). Cash Helped China Win Costa Rica's Recognition. *The New York Times*. September 12. <http://www.nytimes.com/2008/09/13/world/asia/13costa.html> (accessed January 10, 2012).

2008 Peru (Chinalco Peru, \$2 billion)

Chinalco Peru Manager (2011). Private interview by Kevin P. Gallagher. Lima, Peru.

China.cn (2008). Construction industry to fuel copper price rise. http://en.china.cn/content/d442348,e0850e,2849_13988.html. (accessed January 10, 2012).

Cespedes, T., and T. Wade (2008). UPDATE 1- China's Chinalco gets \$2 bln loans for Peru mine. Reuters. November 20. <http://uk.reuters.com/article/2008/11/20/apec-chinalco-peru-idUKN>

2008 Venezuela (BANDES and PDVSA, \$4 billion)

Gaceta Oficial de la República Bolivariana de Venezuela (2008). Ley Aprobatoria del ‘Convenio entre el Gobierno de la República Bolivariana de Venezuela y el Gobierno de la República Popular China sobre el Fondo de Financiamiento Conjunto’, 39019: 3-4.

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2009 Bolivia (YPFB, \$60 million)

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