

CAUTIOUS CAPITAL: CHINESE DEVELOPMENT FINANCE IN LAC, 2018

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Estimates of Chinese Finance to LAC in 2018

Chinese policy bank finance to Latin American and Caribbean (LAC) governments and state-run companies rose to roughly \$7.7 billion in 2018—slightly up from the \$6.2 billion that Chinese policy banks (China Development Bank and China Eximbank) provided to the region in 2017, the lowest year for Chinese state bank finance to LAC since 2008 (see Figure 1).

Despite relatively low levels of activity over the past two years, China's record of lending in the region continues to surpass that of other major lenders. According to estimates from the Inter-American Dialogue and the Global China Initiative at Boston University's Global Development Policy (GDP) Center, CDB and Eximbank have provided over \$140 billion in finance to LAC since 2005, when Chinese banks began lending to the region. Chinese state-to-state finance tops sovereign lending over same period from either the World Bank or the Inter-American Development Bank (IDB).

Aside from a \$600 million loan to the Dominican Republic, Chinese policy bank loans in 2018 were mostly directed toward the same, small subset of countries that have received Chinese state finance for over a decade (see Figure 2). A \$5 billion loan to Venezuela accounted for nearly two-thirds of China's lending to the region last year. Venezuela has received over 47 percent (\$67 billion) of total Chinese policy bank finance to LAC since 2005. Ecuador and Argentina, which also relied heavily on Chinese finance over the past decade, each negotiated another approximately \$1 billion in loans from CDB and Eximbank.

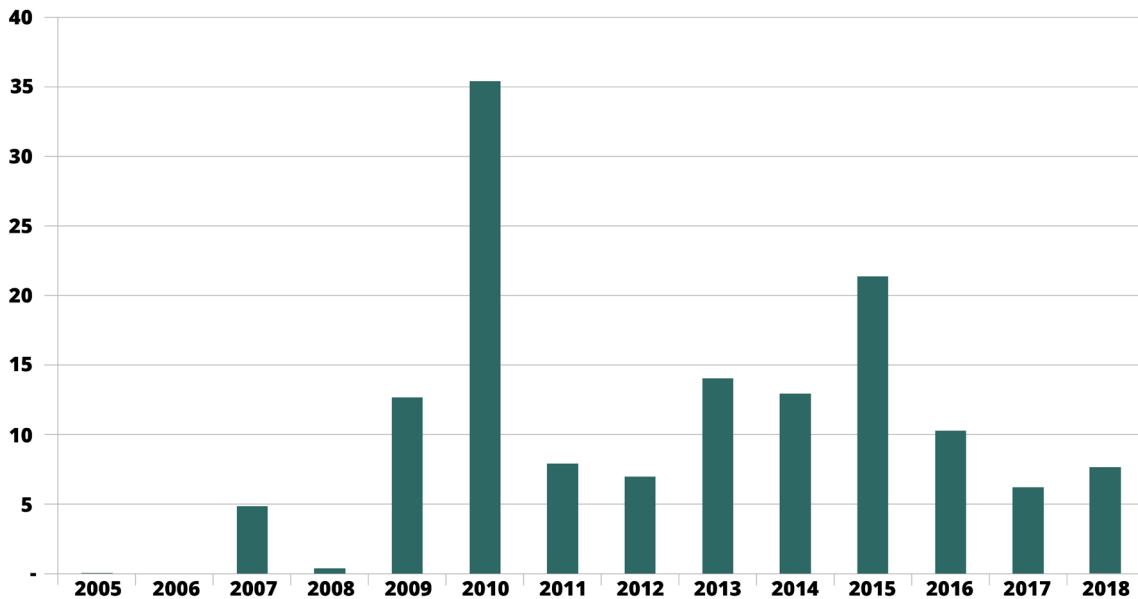
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¹ A detailed description of our methodology is available at <http://www.bu.edu/gdp/files/2018/08/Coding-Manual-.pdf>. We add new loans to the database annually, but also revise past year estimates when and if projects did not come to fruition or were for amounts of financing different than what were earlier reported. Our list of Chinese loans to Latin America from 2005-2018 is available in the online China-Latin America Finance Database (https://www.thedialogue.org/map_list/).

FIGURE 1. CHINESE FINANCE TO LATIN AMERICA BY YEAR, 2005-2018 (USD BILLIONS)

Source: Gallagher, Kevin P. and Margaret Myers (2019), "China-Latin America Finance Database," Washington, DC: Inter-American Dialogue.



As in previous years, Chinese finance to LAC in 2018 also focused extensively on infrastructure and energy sector development. China's 2018 deal with Argentina will support the renovation of the San Martín cargo line, which runs from the port of Rosario to Mendoza. Ecuador's 2018 loans will reportedly be used to reconstruct earthquake-damaged infrastructure, including the Eloy Alfaro International Airport in the northern city of Manta. And China's \$600 million loan to the Dominican Republic is aimed at building out the country's electricity grid and reducing electricity losses by 23 percent, according to the Dominican Republic's State Electric Utility (CDEEE).¹ Electricity production and distribution remains a prominent feature of Chinese engagement with the region, whether through foreign direct investment or project finance.

China's 2018 contracts refrained from imposing policy conditions on recipients but were again associated with the use of Chinese construction firms or equipment. China Railway Construction Corporation will take part Argentina's San Martín rail renovation. Chinese companies will also reportedly participate in China-backed earthquake reconstruction projects in Ecuador.² Venezuela's loan this year was accompanied by a series of deals that could increase China's overall stake in the country's oil production. According to a September 2018 statement from Nicolás Maduro, China will drill 300 wells in Ayacucho, Venezuela and extend \$184 million in financing for a joint venture between CNPC and Venezuela's state oil company, PDVSA.³

More to Come?

China has been a critical source of finance for LAC—especially for countries such as Venezuela, Ecuador, Brazil, and Argentina, which have had relatively limited access to international capital markets in recent years. It is unclear to what extent CDB and Eximbank are acting as a lifeline for the region's more fragile economies, or will continue to direct funds toward those countries with strong political or historical ties to China.

It is unclear to what extent CDB and Eximbank are still acting as a lifeline for the region's more fragile economies.

TABLE 1: CHINESE POLICY BANK LOANS TO LAC IN 2018

Source: Gallagher, Kevin P. and Margaret Myers (2019), "China-Latin America Finance Database," Washington, DC: Inter-American Dialogue.

COUNTRY	TYPE	LENDER	AMOUNT	PURPOSE
Ecuador	Infrastructure	China Eximbank	\$69 million	Reconstruction projects
Ecuador	Other	China Development Bank	\$900 million	Development assistance
Dominican Republic	Energy	China Eximbank	\$600 million	Electricity distribution
Venezuela	Energy	China Development Bank	\$5 billion	Oil sector development
Argentina	Infrastructure	China Eximbank	\$1.1 billion	San Martín Railway

Ecuador, for example, paired its new loans from China with a new sovereign bond issuance. But it is important to note that for countries such as Ecuador, China still offers competitive interest rates. Ecuador's \$900 million discretionary loan from CDB carried an interest rate between six and seven percent, while its bond issuance had nearly twice that rate at 11 percent.⁴

Despite strong bilateral ties, Venezuela continues to test the extent of Chinese banks' tolerance for risk. China opted to provide additional funding to Maduro's government in 2018, with the option to repay in oil. But Beijing simultaneously ended a grace period for Venezuela on its principal payments to China, indicating a limit to Chinese goodwill toward the current government. This decision, along with declining oil production, could place Venezuela even closer to default

on Chinese and other debt obligations.⁵ National Assembly leader Juan Guaidó's claim to the Venezuelan presidency presents yet another challenge to Chinese decision-makers, particularly if a new Venezuelan government seeks to restructure existing loans.

Chinese banks' challenges in LAC aren't limited to Venezuela. Progress on the China-backed Jorge Cepernic and Nestor Kirchner dams in Argentina is reportedly stalled following corruption allegations last year against Electroingeniería's vice president, Gerardo Ferreya.⁶ Electroingeniería partnered with Chinese company Gezhouba to obtain the contract for dam construction. In Bolivia, the China-backed Rosita dam project has been formally suspended amid protests against the project's lack of prior consultation with affected communities.⁷

FIGURE 2: DISTRIBUTION OF POLICY BANK LENDING BY COUNTRY, 2005-2018

Source: Gallagher, Kevin P. and Margaret Myers (2019), "China-Latin America Finance Database," Washington, DC: Inter-American Dialogue.

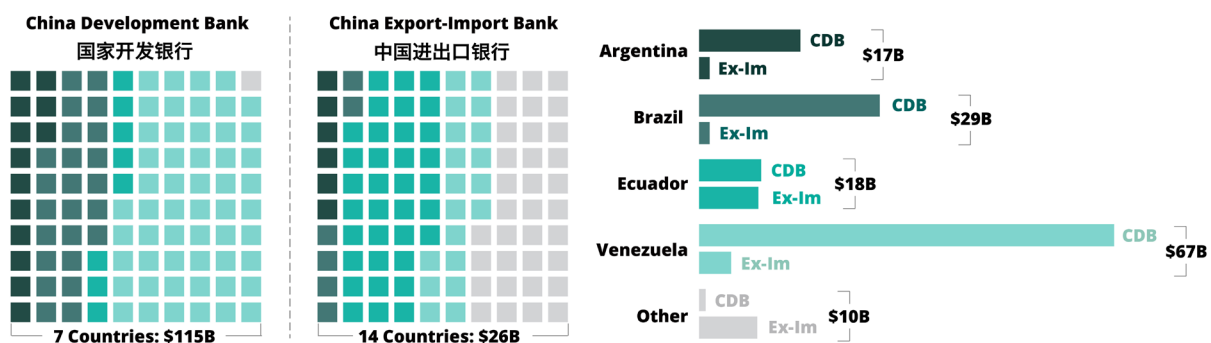
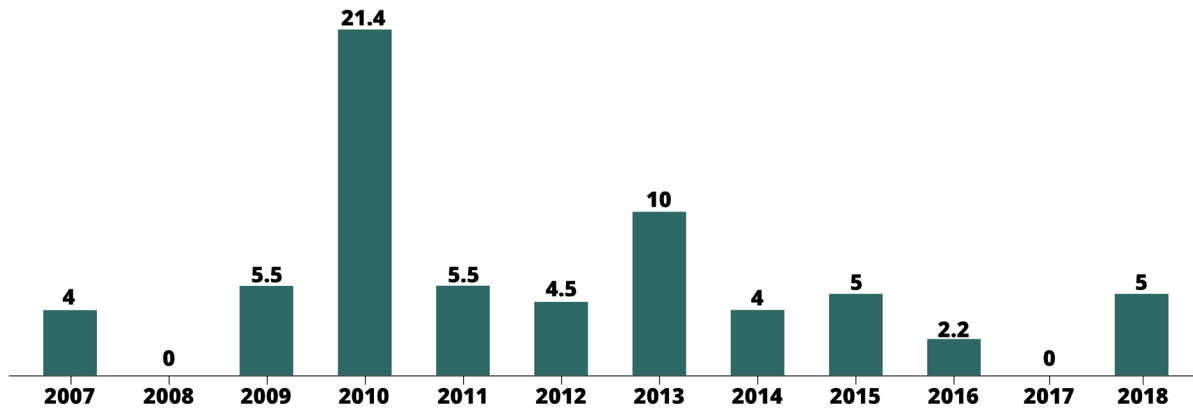


FIGURE 3: CHINESE POLICY BANK LOANS TO VENEZUELA, 2007-2018 (USD BILLIONS)

Source: Gallagher, Kevin P. and Margaret Myers (2019), "China-Latin America Finance Database," Washington, DC: Inter-American Dialogue.



These complications haven't yet clearly diminished China's interest in financing infrastructure and other projects in these countries. However, they could further ongoing efforts within Chinese ministries and supervisory organizations to improve risk assessment in overseas lending and project identification processes. Several of the high-profile infrastructure projects that LAC governments have proposed to China for financing (including Rosita and Ecuador's Coca-Codo Sinclair dam) had previously been rejected or tabled by multilateral development banks in light of environmental and social risks.⁸ China may approach these offerings with a greater deal of scrutiny in the future.

A prolonged decrease in Chinese reserves could also force Chinese banks and companies to choose overseas projects more carefully.⁹ As a newcomer to the Belt and Road Initiative, Latin America is an attractive market for Chinese state-owned enterprises (SOE) and banks, but it is the furthest away from China and, by many accounts, the least understood.¹⁰ A cap on available credit could force banks and SOEs to look for opportunities closer to home, where Chinese networks are already well established.

There is also the prospect of decreasing LAC demand for Chinese state finance in the coming years. Two of LAC's major recipients of Chinese policy bank loans—Argentina and Ecuador—have expressed interest in renegotiating the terms of their China contracts. Both negotiated approximately \$1 billion in loans with China in 2018, but aren't inclined to considerably grow their sovereign debt in the coming years. Brazil's Petrobras has maintained a strong working relationship with CDB of late, but Brazil's China policy is in a state of flux following the 2018 presidential elections. Countries such as Chile, Mexico, Peru, and Panama have generally resisted China's model of lending, which is frequently involves the use Chinese companies or equipment.

This all amounts to a possible lowering of Chinese state-to-state lending to LAC in the near-term. Even so, as an extension of the Chinese state, China's policy banks will continue to engage with LAC, especially in support of China's economic diplomacy and domestic reform agenda.

The "Multilateralization" of Chinese Finance

Although Chinese policy bank lending as slowed somewhat, other China-backed financial institutions and platforms are becoming increasingly active in the region and more engaged in private-sector deal-making. The deals made by new funds and other lending platforms are fewer and much smaller in scale than the region's policy bank loans, however.

China may approach project selection in LAC with a greater deal of scrutiny in the future.

China's three regional funds, which are managed by CDB and Eximbank, have engaged in a limited number of often Brazil-based projects in recent years. In 2015, capital was drawn from the China-LAC Industrial Cooperation Investment Fund (CLAI) by China Three Gorges Corporation, which was seeking a 30-year concession to operate two hydroelectric power plants in Brazil.¹¹ However, as a cost-cutting measure, the CLAI will soon be merged with the China-Africa Fund for Industrial Cooperation.¹² The CLAC was reportedly involved in five total projects—one in Jamaica and four in Brazil, including the acquisition of Duke Energy holdings.

Chinese and Brazilian officials also launched the \$20 billion China-Brazil Fund for the Expansion of Production Capacity in 2017, although reports indicate that 75 percent of the funding for Brazil fund will come from the existing CLAI fund, with the Brazilian government covering the remainder.¹³ Chinese and Brazilian representatives reportedly agreed on possible infrastructure investment in the amount of \$4 billion during the third meeting of the China-Brazil Fund's Technical Working Group meeting in August 2018.

In other cases, Chinese banks have partnered with multilateral banks in the region to co-finance desirable projects and, presumably, mitigate reputational risk by applying these institutions' extensive safeguard policies to shared projects. The IFC's China-Mexico Fund, started in 2014 with \$1.2 billion in capital, has so far successfully participated in a telecommunications project and an energy sector deal. In 2017, the IDB Invest-administered China Co-Financing Fund for Latin America and the Caribbean contributed 13 percent of a \$75 billion IDB package for the Solem solar photovoltaic plant in Mexico, which is currently under construction.¹⁴ A year later, the China Co-Financing Fund for Latin America and the Caribbean also partially funded construction of the Ituango hydroelectric dam in Antioquia, Colombia.¹⁵ Unfortunately, the Ituango dam collapsed in July, raising questions about the extent to which these cooperative funds are living up to their potential to combine Chinese finance with IDB risk management standards.¹⁶

The China-backed Asian Infrastructure Bank (AIIB) is also considering co-financing of infrastructure projects in the LAC region through the IDB.¹⁷ Seven Latin American nations

TABLE 2: CHINESE INVESTMENT FUNDS IN LAC

Source: Author compilation.

NAME	YEAR INITIATED	TOTAL SIZE
China Co-Financing Fund for Latin America (中国-泛美开发银行专项基金)	2013	\$2 billion
IFC China-Mexico Fund (中墨投资基金)	2014	\$1.2 billion
China-Latin American Production Capacity Cooperation Investment Fund (CLAI) (中拉产能合作投资基金)	2015	\$30 billion
Special Loan Program for China-Latin America Infrastructure Projects (中拉基础设施专项贷款)	2015	\$20 billion
China-LAC Cooperation Fund (CLAC) (中拉合作基金)	2016	\$10 billion
Brazil-China Cooperation Fund (中国—巴西扩大产能合作基金)	2017	\$20 billion (\$15 billion from CLAI, \$5 billion from Brazil)

are now prospective members of the AIIB, according to the bank's web site.¹⁸

In addition to co-financing projects and regional funds, China's four major commercial banks (ICBC, Bank of China, Agricultural Bank of China, and China Construction Bank) are increasingly active in Latin America and other regions, sometimes in cooperation with other international banks. According to a 2018 Panama media report, ICBC has plans to establish a presence in Panama now that the country is aligned diplomatically with China.¹⁹ Meanwhile, Bank of China has applied for and received a business license to enter the Peruvian market.²⁰

Even if Chinese policy banks continue to lend to LAC at relatively low levels, as they did in 2017 and 2018, the combined effect of Chinese policy bank, commercial bank, and other forms of lending will ensure a sizable Chinese financial presence in the region for years to come, potentially in a wider variety of projects. One could expect more caution from all of these entities, however, as they grapple with problematic loan agreements in the region, try to mitigate reputational risk, and navigate a shifting regulatory environment at home.

FOOTNOTES

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