Out of China: The activities of China's export credit agencies and development banks in Africa

This article was written by Handel Lee, Partner at King & Wood Mallesons, Liu Zhigang, Partner at King & Wood Mallesons, and Thomas Coles, Associate at King & Wood Mallesons.

Overview of China’s export financing system

China’s export finance infrastructure consists of three main institutions: the Chinese Development Bank (the “CDB”), Sinosure and the Chinese Import-Export Bank (“C-EXIM”).

The CDB, as China's largest outward facing development bank, advances loans to foreign projects that will acquire goods and services from China's major strategic companies (to which it also provides direct loans).

C-EXIM, as China's dedicated export credit agency, provides both traditional export credits and increasingly direct loans, again to both foreign buyers and Chinese exporters. Sinosure, as the former export credit insurance wing of C-EXIM, provides short, medium and long-term export credit and foreign investment insurance. It also offers direct credit lines to companies in strategic industries (e.g. telecoms, energy and transport infrastructure).

Together, this triumvirate of institutions works closely with the PRC Government and China's largest state-owned enterprises to assemble outbound financial deals at subsidised rates. This is all done to increase the productivity and competitiveness of Chinese companies vis-à-vis their global competitors – the so called "Go-Global" strategy.

The scale of this system's financial support is unparalleled – in 2010 the CDB and C-EXIM issued over $112 billion in foreign loans to Chinese companies doing business overseas. It is also unique in structure. No other major economy offers a programme equivalent to that of Sinosure, nor does any other major economy possess such a broad and co-ordinated export finance infrastructure that is able to offer such preferential terms.

Nowhere is this more evident than in Africa, where China's export finance institutions have arguably established a dominant position in recent years. As demonstrated by the Table below, many of the major infrastructure projects announced during President Xi Jinping and Premier Li Keqiang's recent visits to Africa will receive significant financing from China's export credit institutions.

In March 2013 China's President, Xi Jinping, visited Tanzania, South Africa and the Democratic Republic of Congo. During this visit he pledged $20 billion in lines of credit for African countries between 2013 and 2015. Xi was followed by China's Premier Li Keqiang, who attended a week-long tour of Ethiopia, Nigeria, Angola and Kenya in May 2014. Li pledged an additional $10 billion in loans and announced a $2 billion boost to the China-Africa Development Fund.

For each of China's three main export finance institutions this article will briefly summarise their history and mandate, principal financial products and overseas operations, with a focus on their operations in Africa. It will then examine the strategies and methods employed by these institutions, the reasons for their competitive advantages and the financing terms that they typically offer. Many of the observations are equally applicable to other developing regions in which the institutions operate.

China Development Bank (CDB)

History, mandate and main products

The CDB was established by the Policy Banks Law of 1994. As one of China's major policy banks, the CDB is responsible for providing debt funding to major infrastructure projects, both within and (more recently) outside mainland China. Its main objective as a state financial institution is to support the macroeconomic policies of the PRC Government. In particular this includes removing infrastructure bottlenecks and supporting strategic structural changes in the economy. In line with its mandate, the CDB reports directly to the PRC Government. At the end of 2013, the CDB had a loan book of US$1.3 trillion.

Unlike the major commercial banks, the CDB does not take private deposits but instead it issues bonds. The CDB is the second-largest bond issuer in China after the Ministry of Finance and its bonds enjoy a credit rating equivalent to PRC Government bonds. This is a major advantage as it makes the CDB's funding cheap and reliable. The CDB has also been responsible for financing much of China's urbanisation, through its lending to local-government financing vehicles. The CDB is also China's largest foreign currency lender ($292 billion). Many of the foreign currency loans that it advances draw directly on China's vast foreign currency reserves.

Prior to the restructuring of China's major banks in 1998, the CDB was poorly managed and had a large non-performing loan book. Since 1998, under Chen Yuan (and more recently Hu Huaibang), the CDB has undergone an organisational transformation into a high-quality institution which boasts a low non-performing loan ratio and prides itself on meeting international best practices. Still, unlike the Chinese commercial banks, the CDB is unlisted and hence provides very little public disclosure.

Overseas operations and strategy

In recent years the CDB (alongside C-EXIM) has pursued rapid overseas expansion. The CDB is now the world's largest international lender to developing countries, surpassing the World Bank. Part of this growth strategy has involved the provision of lines of credit to Chinese exporters, often in conjunction with C-EXIM and Sinosure. The CDB has also established a number of regionalspecific financing vehicles. For example the China Africa Development Fund, (which recently opened a branch in Nairobi, Kenya), will soon be capitalised with $5 billion.

In March 2014, the CDB entered into strategic cooperation agreements with each of the UK's Barclays Bank PLC and France's Societe Generale. Under these agreements Barclays and Societe Generale will provide the CDB with banking services (including advice on targets and financing structures) to assist it with acquiring assets in Africa. These strategic alliances are designed to enhance the CDB's (and therefore China's) competitiveness abroad.

China Import-Export Bank (C-EXIM)

History, mandate and main products

Sitting alongside the CDB and Sinosure, C-EXIM is China's primary export credit agency ("ECA"). Founded in 1994, it is mandated to "implement state policies in industry, foreign trade, finance and foreign affairs." C-EXIM does not publish figures for overseas loans, but it is estimated to provide more export financing than the ECAs of the Group of Seven industrialised nations (G7) combined.

Traditionally ECAs exist to support the export of goods and services from their home country – so-called 'tied lending'. However for C-EXIM, this is not the only policy driver. C-EXIM (similar to certain other ECAs, including Japan's JBIC) is also mandated to promote long-term access to strategically important natural resources. C-EXIM achieves this goal through a combination of conventional ECA methods (i.e. export credits – a form of subsidy in which an ECA assumes the risk of a foreign borrower's default) and unconventional ones (e.g. direct lending and credit guarantees).

While the volume of financial support extended by C-EXIM is unparalled, it has not been without controversy – often bringing C-EXIM into conflict with the US over trade subsidies and local governments over environmental and social (particularly labour) issues. For example, the Greenfield Terminal at Jomo Kenyatta International Airport (see the Table below) caused controversy when it emerged that the Kenyan Airports Authority awarded the construction tender to two Chinese firms. The project has been reported to be approximately 85% funded by C-EXIM.

Sinosure

History and mandate

Sinosure, another major state-owned enterprise, serves as the lead provider of export credit insurance to Chinese exporters. It also insures overseas investments into China. Sinosure was established in 2001 through the merger of the Export Credit Insurance Department of the People's Insurance Company of China and the export credit insurance division of C-EXIM (a requirement of China's entry into the WTO).

Sinosure is funded directly by the PRC Government. For example, in 2011 the PRC Government injected $3.1 billion into Sinosure via Central Huijin Investment (China Investment Corporation's domestic arm), designed as a clear move to bolster Sinosure's ability to support China's state-owned enterprises ("SOEs") in their export efforts.

By the end of 2013, Sinosure had supported exports, domestic trade and investment totaling $1.48 trillion. Its policies cover thousands of exporters and hundreds of projects, many involving high tech electronic and mechanical exports. It had also facilitated the lending of $180 billion by 190 banks.

However, due to Sinosure's broad exposure to a number of high risk markets, it is not immune to losses. In 2011, following the uprising in Libya, Sinosure had to pay insurance claims of over $1 billion to 13 Chinese SOEs with investments in the country.

Main products

Sinosure provides insurance coverage against political, commercial and credit risks through the following products:

- Medium and long-term export credit insurance – a 'policy' insurance designed to encourage Chinese exporters to participate in international contract bids, especially those involving export of high-tech mechanical and electronic products. Buyer's Credit Insurance underwrites payment default by a bank's borrower or by an exporter's counterparty (payment default, dishonour, bankruptcy, etc.), while Supplier's Credit Insurance underwrites an exporter's contracts
- Investment guarantees – insures Chinese exporters against economics losses caused by political events, e.g. currency and remittance restrictions, expropriation and nationalisation, sovereign breaches of contract and war
- Bonds and guarantees – designed to improve Chinese exporters' credit ratings and therefore assist them in obtaining finance

Sinosure also offers extensive information services, including country risk reports and credit reports on potential counterparties.

China’s export financing strategy

Tied lending

For China-sponsored infrastructure projects in developing regions such as Africa, the CDB, C-EXIM and Sinosure often structure the financing package, obtain export credit insurance and bring in Chinese companies to build the infrastructure. Many of their concessional loans are conditional upon Chinese enterprises being awarded construction or export contracts (socalled “tied lending”). For example, the CDB previously lent Nigeria $200 million on condition that it was used to purchase products from Chinese telecoms giant Huawei. Loan conditions often require that 50% of loan proceeds be applied towards acquiring Chinese goods and services, although in Angola’s case the figure has reportedly exceeded 70%.

Resource acquisition

Coupled with this tied-lending strategy is China’s strategy to secure long-term access to natural resources (both oil and other minerals). This strategy is achieved in part through providing credit lines to the “Big 3” Chinese energy companies (CNPC (PetroChina), CNOOC and Sinopec) to fund their overseas acquisitions and exploration & production activities.

This strategy is also achieved through financing a route-to-market for Chinabound minerals. For example, the $10 billion Bagamoyo port development in Tanzania (for which C-EXIM is providing substantial loans) is being developed partly to support exploitation of and transportation to China of major offshore gas deposits off the Mozambique- Tanzanian coast. The port will also facilitate China-bound shipments of minerals from Zambia, Zimbabwe and the DRC.

However, China’s resource acquisition strategy is most notably achieved through the socalled “Angola” or “oil-for-loans” model. Under this model loans are made to infrastructure projects in mineral-producing countries in exchange for long-term mineral supply contracts. The borrowing country’s loan repayments are typically discharged in kind with oil or other minerals. Within Africa, China has most notably used this model to promote oil exploration and production in Angola and mineral acquisitions in central Africa.

By employing these models, the CDB and C-EXIM deliver a win-win – they secure oil or other resources for China with their loans and China’s largest corporations (almost always the CDB or C-EXIM clients themselves) win export contracts. This method of acquiring resources also offers a potential discount to global market prices. However, this model is increasingly leading to allegations of resource nationalism by host countries and a consequent move towards greater regulation of Chinese investment in Africa. This topic was covered in a previous edition of this newsletter in an article by Paul Schroder (Partner, Sydney) and Jin Xiong (Partner, Beijing) entitled 'Regulating Chinese Investment in Africa.

Competitive advantages of China's export financing institutions

Relative to Western commercial lenders, the CDB and C-EXIM have been successful in securing loan mandates (and therefore promoting Chinese companies in Africa) for primarily the following reasons:

- Liquidity – they fill the funding gap left by western commercial banks that scaled down their lending following the financial crisis; with access to foreign reserves of $2 trillion they have much deeper pockets; and, being stateowned, they are able take a longer term strategic view
- Cost of capital – as with the majority of ECAs, being state-backed, their cost of borrowing is lower (see above regarding the CDB's bond programme); they are not subject to the same capital adequacy requirements; and they generally aim to only recover their operating and financial costs, rather than seeking a market return.
- Compliance and transparency – they impose fewer conditions (e.g. environmental, political, social, etc.) and disclosure requirements upon borrowers
- Preferential terms – the tenors on offer are longer and the interest rates generally lower than western financing (see discussion below).

Significantly, China is not a signatory to The Arrangement on Guidelines for Officially Supported Export Credit of 1978 (the "Arrangement"), a public international law that, amongst other things, prescribes a permitted range of Commercial Interest Reference Rates within which most OECDbased ECAs are permitted to lend. Under the Arrangement, export credit, loans, guarantees and insurance are all prohibited subsidies unless they are provided at premium rates that are sufficient to cover the cost of administering them. As C-EXIM is not bound by the Arrangement, it is able to lend at highly competitive rates compared with its OECD counterparts.

Typical financing terms offered by C-EXIM and the CDB

C-EXIM and the CDB's typical financing terms are as follows:

- The institutions often lend under so-called “Concessional Loan Programmes”. These programmes are nominally equivalent to the OECD’s concept of “official development assistance”, which requires that loans provided to developing countries contain at least a 25% grant for antipoverty projects. However, observers believe that C-EXIM and the CDB often advance these loans to projects that lack a developmental element. Such “tied aid” is prohibited by the Arrangement
- The institutions require an average interest rate of 3.6%. Interest rates have been as low as 0.25% (Angola) and are commonly 1-2%. This is despite Chinese domestic one-year lending rates standing at 6-7% and therefore implies “loss-leading” subsidies that contrary to the Arrangement do not cover their own borrowing costs. However, rates do vary considerably across countries and depend on the strategic importance and political sensitivity of the deal. Less strategic deals may offer terms closer to international standards than those strongly backed by the PRC Government
- The institutions offer an average grace period of 4 years and repayment period of 12 years. However, grace periods can range from 2-10 years and repayment periods from 5-25 years. This is considerably longer than commercial bank financing and longer even than financing offered by OECD ECAs, which under the Arrangement is restricted to 20 years
- As noted above, loans are often conditional on the recipient using 50% + of the funds to purchase Chinese goods and services.

The above is confirmed by the World Bank’s Debtor Reporting System.

Positive implications for Africa-based sponsors

Despite growing discontent over certain negative issues described above, China’s export credit institutions offer a number of advantages to Africa-based project sponsors. Although Chinese ECAs are sometimes criticised for crowding out local banks, they generally benefit local banks by (a) making projects viable and (b) vetting borrowers through due diligence. Their participation also gives other lenders comfort, thereby lowering the perceived risk profile and improving a project’s bankability.

More importantly however, as discussed above, the CDB and C-EXIM generally provide longer-term loans and more competitive interest rates than typical Western commercial lenders. To some extent they also use their political influence, market penetration and sheer financial firepower to impose their terms upon African borrowers. For these reasons, as demonstrated by the following Table, China’s export financing institutions will continue to play a central role in financing infrastructure projects in Africa for the foreseeable future.

Representative examples of recently announced Chinese export financing in Africa

Project Name / Description	Value ($ Million)	Chinese companies involved	Details of debt financing provided / to be provided by Chinese institution
Ethio-Djibouti Railway, Ethiopia	4,000	China Railway Engineering Corp. / China Civil Engineering Construction Corp.	C-EXIM - 70%; Ethiopian government - 30%.
Light-rail Transit System (LRT), Ethiopia	475 (1st phase)	China Railway Engineering Corp.	C-EXIM - 85%; Ethiopian government - 15%.
Coastal Railway from Lagos to Ibadan, Nigeria	13,100	China Railway Construction Corp.	Chinese export financing expected; still to be announced
700 MW Zungeru hydroelectric power plant, Nigeria	1,293	China National Electric Equipment Corp/Sinohydro	C-EXIM - 75%; Nigerian government -25%.
Nairobi-Mombasa standardgauge railway line, Kenya	3,600	China Roads and Bridges Company	C-EXIM - 90%; Kenya Railways -10%
4G mobile infrastructure	N/A	ZTE Corp.	ZTE will likely provide loans

Project Name / Description	Value ($ Million)	Chinese companies involved	Details of debt financing provided / to be provided by Chinese institution
expansion, Kenya.			(drawing on its credit lines with the CDB)
Greenfield Terminal at Jomo Kenyatta International Airport, Kenya	654	China National Aero-Technology International Engineering Corp. / Anhui Construction Engineering Corp.	C-EXIM - 85%; Kenyan Airports Authority - 25%
180 MW Isimba hydroelectric power plant and transmission line, Uganda	570 (debt component)	China International Water & Electric Corporation.	C-EXIM -$570 million.
Bagamoyo port and industrial zone, Tanzania	10,000	China Merchant Group	C-EXIM - $500 million in 2013 for first construction phase; subsequent phases planned
The 534km-long Mtwara-Dar es Salaam natural gas pipeline, Uganda	1,200 (debt component)	China Petroleum Technology Development Corp. / Engineering Corp.	C-EXIM - $1.2 billion loan.

Note: It is difficult to assess the full extent and nature of the CDB and C-EXIM's overseas activities because they do not publish figures for overseas loans in their annual reports. Statistics presented in this article are therefore obtained from public sources.

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