Is Beijing a predatory lender? New evidence from a previously undisclosed loan contract for the Entebbe International Airport Upgrading and Expansion Project

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Key findings

- AidData's publication of the final, unredacted version of a controversial loan contract between China Eximbank and the Government of Uganda for the Entebbe International Airport Upgrading and Expansion Project reveals that the airport itself—a physical, illiquid asset—is not a source of collateral that the lender can seize in the event of default.

- Instead, China Eximbank required its borrower to provide a fully liquid source of collateral: a cash deposit in an escrow account that the lender can unilaterally seize in the event the Government of Uganda defaults on its repayment obligations.

- The lender also took the extraordinary step of demanding that all revenues generated by Entebbe International Airport—a public infrastructure asset that existed prior to the loan issued by China Eximbank—be used to repay the loan on a priority basis for 20 years.

- At the same time, the Government of Uganda's efforts to renegotiate with China Eximbank demonstrate that those who borrow from Beijing have agency and can successfully push back on lender conditions that they consider to be overly intrusive. China Eximbank initially demanded the right to approve or reject the spending decisions of the government agency responsible for the Entebbe International Airport. However, when the Ugandan authorities protested, China Eximbank agreed to a less intrusive arrangement, which grants the lender the right to monitor but not control the spending decisions of the Uganda Civil Aviation Authority.

Box 1: Media coverage

Uganda

The Independent

Entebbe Airport gone or not?

12/13/2021

The Daily Monitor

Uganda to surrender Entebbe International Airport over Chinese cash

11/26/2021

International

Reuters

China rejects allegations it may grab Ugandan airport if country defaults on loan

11/29/2021

Wall Street Journal

Uganda Finds China's Leverage Is in the Fine Print of Its Lending

12/27/2021

Financial Times

China applies brakes to Africa lending

01/11/2022

Introduction: Confidentiality and controversy

A $200 million loan contract between China Eximbank and the Government of Uganda for the Entebbe International Airport Upgrading and Expansion Project—sight unseen until today—has become a major source of international controversy. A flurry of reports in Ugandan and international media (see Box 1) have raised questions about whether the contract provides legal grounds for the lender to seize Entebbe International Airport if the borrower fails to meet its repayment obligations. *The Daily Monitor*, a local newspaper in Uganda, suggested that the loan contract might "expose the airport and other government assets to potential attachments and take-over by China upon arbitration awards in Beijing." *The East African* warned of contract clauses that were "unfriendly and as good as mortgaging the airport to China."

The controversy has renewed debate about whether Beijing is engaging in "debt trap diplomacy."[1] However, in the absence of the contract itself, it has proven difficult to separate fact from fiction.[2] The Chinese Embassy in Uganda tried to put the controversy to rest by issuing a public statement that says "[n]ot a single project in Africa has ever been confiscated by China because of failing to pay Chinese loans." But it did not disclose the specific terms and conditions in the loan contract, which generated even more speculation.

Beijing has taken active measures to prevent contracts like this one from spilling into public view by imposing expansive confidentiality obligations on borrowers.[3] However, the shield of confidentiality can be pierced. AidData recently obtained the final, unredacted version of the loan contract for the Entebbe International Airport Upgrading and Expansion Project through the implementation of its Tracking Underreported Financial Flows (TUFF) methodology (see Box 2).

The contract can be accessed in its entirety via www.aiddata.org/publications/uganda-entebbe-airport-china-eximbank.

How is collateralization implemented?

One of the most important questions that has arisen is whether Entebbe International Airport is a source of collateral that Beijing can seize in the event of default. The contract clearly shows that *it is not*.

The airport—a physical, illiquid asset—is not identified as a source of collateral that the lender can seize in the event of default. Instead, the borrower agreed to maintain a minimum cash balance in a lender-controlled bank account (known as a "Repayment Reserve Account").[4] This arrangement effectively gives China Eximbank access to a fully liquid source of collateral. If the Government of Uganda defaults on its repayment obligations, China Eximbank can unilaterally debit this bank account; it does not have to initiate judicial proceedings to try to recover an overdue debt by seizing or liquidating a physical asset. This finding is consistent with one of the major takeaways from the *How China Lends* report: that Chinese state-owned lenders prefer to collateralize on foreign currency deposits in bank accounts that they control.[5]

Section 6.12 of the contract also contains a "surprise." We knew from previous studies—including *Banking on the Belt and Road* and *How China Lends*—that Chinese debtors are often asked to deposit all project-generated revenues into a separate,

[1] The idea that China is a predatory lender engaging in "debt trap diplomacy" has quickly become an article of faith in Western capitals. Chinese state-owned lenders, according to the conventional wisdom, ensnare and subordinate foreign governments by following a simple playbook: first ply a senior politician with easy access to credit for a big-ticket infrastructure project, then negotiate a loan contract (with unsuspecting bureaucrats and second-rate lawyers) that requires the borrowing institution to surrender a physical asset—like a seaport, airport, or electricity grid—in the event of default.

[2] *The Independent*, a newspaper in Uganda, has characterized the situation in the following manner: "the loan agreement for the Entebbe Airport [...] has not been made public. The result, as seen in this case, is that citizens of countries that borrow from China cannot know for a fact what is true and what is false about the debt. That means even parliament cannot hold the government accountable."

[3] The *How China Lends* study demonstrates that Chinese loan contracts impose unusually expansive confidentiality obligations on debtors but not creditors. The loan contract between China Eximbank and the Government of Uganda for the Entebbe International Airport Upgrading and Expansion Project is no exception. It includes the following confidentiality clause: "The Borrower shall keep all the terms, conditions and the standard of fees hereunder or in connection with this Agreement strictly confidential. Without the prior consent of the Lender, the Borrower shall not disclose any information hereunder or in connection with this Agreement to any third party unless required by applicable law."

[4] More specifically, the borrower is required to maintain a minimum cash balance in the "Repayment Reserve Account."

[5] This does not mean that Chinese state-owned lenders never ask their borrowers to pledge physical sources of collateral. They do—and we have contractual evidence to prove it. However, Chinese state-owned lenders have a preference for sources of collateral that do not require liquidation through a costly, time-consuming, and uncertain judicial process.

lender-controlled bank account (known as a "Sales Collection Account").[6] But this contract provides evidence that, in some cases, China Eximbank will go further to protect its balance sheet. The lender in this instance demanded that *all of the revenues generated by the underlying public infrastructure asset*—Entebbe International Airport—be used to repay the loan on a priority basis for 20 years.

It is important to keep in mind that the lender expects the borrower to use the proceeds of the loan to expand and upgrade an existing airport that was already generating public revenue prior to the loan-financed project. Therefore, the lender effectively made a claim on a Ugandan Government revenue stream that would have existed even in the absence of the project.

By almost any standard, this is a remarkably intrusive condition for a foreign government to impose upon a sovereign borrower. In an analysis of 142 sovereign debt contracts issued by 28 bilateral, multilateral, and commercial creditors outside of China, AidData, the Center for Global Development, the Kiel Institute for the World Economy, and the Peterson Institute for International Economics found no evidence of any other foreign lender imposing an analogous arrangement upon a sovereign borrower.[7]

To gauge whether China Eximbank's first priority claim on all revenues from a public infrastructure asset is extraordinary, AidData reviewed several other collateralized loan contracts between China Eximbank and the Government of Uganda—for the Isimba Hydropower Project, the Isimba-Bujagali Interconnection Project, the Karuma Hydropower Dam and Associated Transmission Lines and Substations Project, and Phase III of the National Transmission Backbone and e-Government Infrastructure Project—that include clauses specifying how the lender expects the borrower to meet its repayment obligations. All of these contracts, which again were identified through AidData's implementation of the TUFF methodology, include some version of the following boilerplate clause: "All the revenues (proceeds) *generated from the Project* shall be applied in priority to payment of any and all amounts due and payable under this agreement" (our emphasis added).

Can borrowers renegotiate terms that they consider to be lender overreach?

In two separate agreements with the Government of Uganda (identified in the loan contract as the Escrow Account Agreement and Repayment Mechanism Agreement), China Eximbank negotiated the right to reject or approve the annual operating budgets of the Uganda Civil Aviation Authority (UCAA), which is the government entity responsible for Entebbe International Airport.

However, the decision to grant China Eximbank budget approval authority subsequently became a major source of disagreement and conflict inside the Government of Uganda. On March 6, 2019, the Government of Uganda dispatched an 11-member delegation (consisting of UCAA officials, Ministry of Finance, Planning and Economic Development officials, the Deputy Solicitor General, and Uganda's Ambassador to China) to Beijing to negotiate a "softening" of this condition and other conditions. They reportedly won some concessions from China Eximbank that are codified in a confidential memo (known as the "Minute of Resolutions"). In particular, the lender relinquished the right to approve the spending decisions of UCAA, while retaining the right to monitor its expenditures. In November 2021, UCAA told a parliamentary oversight body that granting spending approval authority to China Eximbank and keeping all of the airport's revenues in lender-controlled escrow accounts was "not palatable for an international airport of a sovereign state whose operations are dynamic and sometimes unpredictable." Uganda's Office of the Auditor General flagged the same concern in December 2019. It criticized the Ministry of Finance for agreeing to the terms and conditions in the loan contract, and noted that the lender-controlled escrow account requirements were placing "financial strain [on] the cash flows of the country." It also called upon the Ministry of Finance to "in the future avoid loans with such unfavourable terms or negotiate to have such terms softened." Six months later, David Kakuba, the Director General of UCAA, acknowledged that it was a mistake to give China Eximbank approval authority over his organization's spending decisions. He warned that, unless this arrangement was revised, it would "expose UCAA to risk of failure to deliver its mandate." He also emphasized that this arrangement "infringes on [the] State's effective control over UCAA." More recently, a confidential source told The Daily Monitor, a newspaper in Uganda, that this arrangement would have "expose[d] the [organization] to risk of failure in service delivery and bankruptcy."

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[6] The Repayment Reserve Account and the Sales Collection Account are collectively referred to as "escrow accounts" in the loan contract.

[7] However, China is not the only foreign lender or donor that has ever demanded expenditure approval authority. During the 1980s, an IMF adviser in Liberia's Ministry of Finance had co-signatory authority over public expenditures. More recently, USAID placed "Internationally Recruited Financial Controllers (IRFCs) with co-signatory authority as controllers" in four of Liberia's state-owned enterprises. However, these types of arrangements are only used in exceptional circumstances—in particular, when there are major concerns about foreign funds being misused. We owe a debt of gratitude to Deborah Bräutigam for sharing these insights.

Conclusion

What have we learned from this new source of contractual evidence? Is Beijing's lending program under the Belt and Road Initiative (BRI) motivated by a desire to seize strategic assets like seaports, airports, and electricity grids? Certainly not. At the same time, no one should harbor any illusions that Chinese state-owned lenders are looking out for anyone's interests other than their own.

Our analysis of the terms and conditions in the contract does not support the allegation that Beijing engages in predatory lending. We instead find that Beijing is a shrewd negotiator who is willing to impose intrusive conditions upon sovereign borrowers to protect its own balance sheet.

The terms and conditions that govern the loan contract for the Entebbe International Airport Upgrading and Expansion Project highlight the fact that Chinese state-owned lenders want to be repaid on time and and with interest, and they have no compunction about asking sovereign borrowers to accept intrusive conditions if doing so will maximize their repayment prospects.

Beijing claims that it strictly adheres to a policy of non-interference in the internal affairs of other countries. But developing countries should be careful not to take this rhetorical commitment at face value; the "caveat emptor"—or "buyer beware"—principle still applies. Borrowing institutions are ultimately responsible for doing their own due diligence and negotiating contractual terms and conditions they consider to be reasonable and acceptable.

Box 2: A note on sources

In March 2021, AidData partnered with the Center for Global Development (CGD), the Kiel Institute for the World Economy, and the Peterson Institute for International Economics (PIIE) to publish a study called *How China Lends*. It introduced new methods for identifying and analyzing loan contracts from foreign creditors—such as China Eximbank and China Development Bank—who use stringent confidentiality provisions to keep their contracts outside of the public domain. The authors of that study include Anna Gelpern (PIIE and Georgetown Law), Sebastian Horn (Kiel Institute for the World Economy), Scott Morris (CGD), Brad Parks (AidData), and Christoph Trebesch (Kiel Institute for the World Economy). AidData supported the study by developing and implementing a set of systematic search procedures that enable the retrieval of Chinese loan contracts from debt information management systems, official registers and gazettes, and repositories of legal acts in borrower countries. AidData also launched a searchable online repository of 100 loan contracts between Chinese government institutions (and state-owned banks) and 24 low- and middle-income countries. In September 2021, AidData documented these methods in greater detail when it published the 2.0 version of the Tracking Underreported Financial Flows (TUFF) methodology. Since then, AidData has obtained more than 35 additional Chinese loan contracts through the ongoing implementation of the TUFF methodology. All of these loan contracts—including the China Eximbank loan contract for the Entebbe International Airport Upgrading and Expansion Project—were obtained from publicly available sources. AidData plans to publish all of these contracts—as well as a broader set of loan, grant debt forgiveness, and debt rescheduling contracts—when it releases the next version of its Global Chinese Development Finance Dataset.