Belt and Road Reboot

Beijing's Bid to De-Risk Its Global Infrastructure Initiative

Executive Summary

November 2023

Bradley C. Parks, Ammar A. Malik, Brooke Escobar, Sheng Zhang, Rory Fedorochko, Kyra Solomon, Fei Wang, Lydia Vlasto, Katherine Walsh, and Seth Goodman

AIDDATA
A Research Lab at William & Mary

Executive Summary

The *Belt and Road Reboot* report provides myth-busting evidence about the changing nature, scale, and scope of China's overseas development program. It also reveals new insights about Beijing's ongoing bid to de-risk its flagship global infrastructure initiative—and outflank its competitors. The report draws upon AidData's uniquely comprehensive and granular dataset of international development finance from China, which captures 20,985 projects across 165 low- and middle-income countries financed with grants and loans worth $1.34 trillion over a 22-year period.[1]

Is China still the single largest official source of aid and credit to the developing world?

Four key takeaways

1. Contrary to the conventional wisdom, Beijing's annual international development finance commitments have not plummeted to nearly zero.[2] It remains the world's single largest official source of international development finance. China's aid and credit (ODA and OOF) commitments to low- and middle-income countries are now hovering around $80 billion a year.[3]

2. Washington is beginning to close the spending gap with Beijing. Due in large part to the U.S. International Development Finance Corporation (DFC)'s financing of private sector projects, which has led to a fifteen-fold expansion in U.S. OOF, Washington now provides approximately $60 billion of development finance each year to low- and middle-income countries.

3. In the short-run, the G7 is also stepping up its efforts to compete with Beijing through the Partnership for Global Infrastructure and Investment, the India-Middle East-Europe Economic Corridor, and other initiatives. After failing to match China's annual ODA and OOF commitments during the early years of the Belt and Road Initiative (BRI), the G7 outspent China by $84 billion in 2021.

4. However, in the long-run, it is not clear that the U.S. and its allies have the financial firepower to compete dollar-for-dollar with Beijing. The G7 has a history of over-promising and under-delivering net increases in international development spending. Beijing, by contrast, has a real source of financial strength that allows it to avoid making promises that it cannot keep: foreign exchange reserves that are vastly larger than the official, foreign currency reserve holdings of its central bank.[4]

How has the risk profile of China's international development finance portfolio changed?

Three key takeaways

1. Repayment risk: Beijing is navigating an unfamiliar and uncomfortable role—as the world's largest official debt collector. 55% of its loans to low- and middle-income countries have already entered their principal repayment periods and this figure will increase to 75% by 2030. Total outstanding debt—including principal but excluding interest—from borrowers in the developing world to China is at least $1.1 trillion and potentially even as high as $1.5 trillion (in nominal USD).[5] Beijing is finding its footing as an international debt collector at a time when many of its biggest borrowers are illiquid or insolvent. AidData estimates that 80% of China's

[1] The latest (3.0) version of AidData's Global Chinese Development Finance (GCDF) dataset captures projects over 22 commitment years (2000-2021) and provides details on the timing of project implementation over a 24-year period (2000-2023). It can be accessed via aiddata.org/china.

[2] For example, the latest version of the China's Overseas Development Finance (CODF) database produced by Boston University's Global Development Policy Center suggests that overseas development finance commitments from China have plummeted by 96% since 2016, reaching an all-time low of $3.7 billion in 2021.

[3] Based upon OECD-DAC definitions and measurement criteria, AidData categorizes each project/activity in its dataset as Official Development Assistance (ODA) or Other Official Flows (OOF). ODA mostly consists of grants and highly concessional loans for development projects and activities that are financed by official sector institutions. OOF mostly consists of non-concessional loans that are issued by official sector institutions. More than 90% of China's annual international development finance commitments consist of OOF.

[4] As of 2023, the official, foreign currency reserve holdings of China's central bank (the PBOC) amounted to $3.1 trillion. However, this figure excludes foreign currency reserves that the PBOC has moved off of its balance sheet by, among other things, entrusting them to the country's state-owned policy banks, state-owned commercial banks, and state-owned funds. Brad Setser of the Council on Foreign Relations argues that these "hidden reserves" may be worth an additional $3 trillion.

[5] Total outstanding debt from borrowers in developed and developing countries to China exceeds $2.6 trillion (in nominal USD).

overseas lending portfolio in the developing world is currently supporting countries in financial distress. Overdue repayments to China are also soaring—in absolute terms and as a proportion of total overdue loan repayments to official (i.e., bilateral and multilateral) creditors.

2. Project performance risk: The cumulative number of Chinese grant- and loan-financed infrastructure projects in the developing world with significant environmental, social, or governance (ESG) risk exposure skyrocketed from 17 projects worth $420 million in 2000 to 1,693 projects worth $470 billion in 2021. The cumulative percentage of China's grant- and loan-financed infrastructure project portfolio in the developing world with significant ESG risk exposure increased from 12% to 53% over the same 22-year period. Infrastructure project suspensions and cancellations have also mounted—from nearly zero at the turn of the century to 94 projects worth $56 billion in 49 countries. However, Beijing is stepping up ESG risk mitigation efforts to shield its overseas infrastructure portfolio from the types of problems that have previously plagued the BRI.

3. Reputational risk: Beijing's public approval rating in the developing world plunged from 56% in 2019 to 40% in 2021. Washington, on the other hand, has seen its public approval rating rise and opened up a 14 percentage point advantage over Beijing. Across the developing world, China has also struggled to maintain a razor-thin lead over the U.S. in media coverage favorability. Yet it has proven very capable of winning and retaining the foreign policy support of governing elites. Across all U.N. General Assembly votes cast between 2000 and 2021, the governments of low- and middle-income countries aligned their foreign policy positions with China 75% of the time—as compared to 23% with the U.S. Those who vote with China are richly rewarded: on average, if a foreign government chooses to increase the alignment of its U.N. General Assembly voting with China by 10%, it can expect to see a 276% increase in aid and credit from Beijing.[6]

Does the G7 understand the difference between BRI 1.0 and BRI 2.0—or how Beijing's reboot of its "project of the century" has altered the competitive landscape?

Three key takeaways

1. Beijing has launched a far-reaching effort to de-risk the BRI by refocusing its time, money, and attention on distressed borrowers, troubled projects, and sources of public backlash in the Global South. It is learning from its mistakes and becoming an increasingly adept international crisis manager.

2. Neither the U.S. nor its G7 allies seem to have a good understanding of how China is recalibrating its lending and grant-giving practices in response to changing conditions on the ground. Consequently, those who make and shape policy in Washington, London, Paris, Berlin, Tokyo, Rome, and Ottawa increasingly run the risk of competing with a version of the BRI that no longer exists—BRI 1.0 rather than BRI 2.0.

3. The G7 should not underestimate the ambition of China's ongoing effort to future-proof its flagship, global infrastructure initiative. Beijing is focused on giving leaders in the developing world exactly what they want: rapid delivery of large-scale infrastructure projects without unreasonably high levels of ESG risk. If the G7 cannot compete on this basis, its Partnership for Global Infrastructure and Investment may face a crisis of relevance.

What measures has Beijing taken to reduce its exposure to distressed debt in the developing world?

Seven key takeaways

1. In recognition of the fact that BRI 1.0 did not have sufficiently robust risk management guardrails in place, Beijing is fundamentally altering the composition of its overseas lending portfolio. It is ramping down dollar-denominated infrastructure project lending, while ramping up RMB-denominated emergency rescue lending to financially distressed

[6] This finding is derived from a statistical model in Dreher, A., Fuchs, A., Parks, B. C., Strange, A., & Tierney, M.J. 2022. *Banking on Beijing: The Aims and Impacts of China's Overseas Development Program*. Cambridge, UK: Cambridge University Press.

borrowers.[7] Beijing's strategic objective is to ensure that its largest borrowers have enough cash on hand to service their outstanding infrastructure project debts.

2. Beijing's policy banks (China Eximbank and China Development Bank) have particularly high levels of exposure to non-performing loans in low- and middle-income countries. Instead of reforming these institutions from within, Beijing is ratcheting down its use of the policy banks, while ratcheting up its use of state-owned commercial banks, such as ICBC and Bank of China. In previous years, approximately three-quarters of China's lending to low- and middle-income countries was channeled through the policy banks. However, this figure has now plummeted to less than one-quarter (22%). The annual lending commitments of China's state-owned commercial banks to low- and middle-income countries are now on par with those of its policy banks.[8]

3. Rather than relying on its own banks to vet borrowing institutions and proposed transactions, Beijing is increasingly outsourcing risk management to lending institutions—such as the International Finance Corporation, the European Bank for Reconstruction and Development, Standard Chartered Bank, and BNP Paribas—with stronger due diligence standards and safeguard policies. It is dialing down its use of bilateral lending instruments and dialing up the provision of credit through collaborative lending arrangements with Western commercial banks and multilateral institutions. 50% of China's non-emergency lending portfolio in low- and middle-income countries is now provided via syndicated loan arrangements—and more than 80% of these arrangements involve Western commercial banks and multilateral institutions.

4. Beijing is putting in place increasingly stringent safeguards to shield itself from the risk of not being repaid. At the turn of the century, only 19% of China's overseas lending to low- and middle-income countries was collateralized. This figure now stands at 72%.[9] The ability to access cash collateral without borrower consent has become a particularly important safeguard in China's bilateral lending portfolio. When illiquid or insolvent borrowers fall behind on their repayments, the policy banks are "paying themselves" overdue principal and interest by unilaterally sweeping foreign currency out of the escrow accounts of their borrowers. These cash seizures are mostly being executed in secret and outside the immediate reach of domestic oversight institutions—such as the auditor general and the public accounts committee within parliament—in low- and middle-income countries. After making withdrawals that substantially deplete the balance of a borrower's escrow account, an increasingly common practice is to require that the borrower replenish the account as a condition for any short-term cash flow relief. Escrow account replenishment has become a major sticking point in debt rescheduling negotiations with the policy banks, yet it is shrouded in secrecy because of strict confidentiality requirements.[10]

5. As the number of borrowers facing liquidity and solvency crises has soared, Chinese state-owned creditors have introduced stronger penalties for late repayments. The average penalty interest rate doubled between the early BRI period (2014-2017) and the late BRI period (2018-2021). The maximum penalty interest rate also increased from 3% to 8.7% between these two time periods. These findings contradict those of a previous study, which claimed that there is no evidence of penalty interest rates in China's overseas lending to developing countries.

[7] In the first full year of BRI implementation (2014), 65% of Beijing's lending to low- and middle-income countries supported infrastructure projects. By 2021, this figure plummeted to 31%. Emergency rescue lending represented only 13% of Beijing's loan portfolio in low- and middle-income countries in 2014. However, this figure soared to 58% by 2021.

[8] On average, during the pre-BRI period (2000-2013), Beijing channeled 15% of its annual lending commitments to low- and middle-income countries through its state-owned commercial banks. This figure increased to 18% during the early BRI (2014-2017) period and 22% during the late BRI period (2018-2021).

[9] Beijing is taking special precautions with high-risk borrowers. At the turn of the century, 0% of its collateralized lending commitments to low- and middle-income countries were directed to developing countries in financial distress. By 2021, this figure increased to 74%.

[10] When a sovereign borrower signs an escrow account agreement or debt rescheduling agreement with a Chinese lender, it is not unusual for the parties to agree upon an expansive set of confidentiality obligations that go beyond those in its original loan agreement. The implementation of AidData's Tracking Underreported Financial Flows (TUFF) methodology has facilitated the retrieval and publication of a significant number of unredacted escrow account and debt rescheduling agreements. The 3.0 version of AidData's GCDF dataset makes these agreements available via stable URLs.

6. The repayment risk mitigation measures that Beijing is putting in place present new challenges for borrowers in the developing world. Those who seek to refinance their maturing debts to China by accepting emergency rescue loans with high interest rates and short repayment periods must be mindful of the danger of swapping less expensive debt for more expensive debt. Those who seek to reschedule their debts to China must be prepared to ring-fence foreign currency for some creditors but not others. Those who contract new debt from Beijing must be aware of the danger of compounding arrears due to penalty interest.

7. Beijing's go-it-alone efforts to mitigate repayment risk may undermine the international community's efforts to provide coordinated debt relief to sovereign borrowers in financial distress. In November 2020, China agreed to participate in the G-20 Common Framework for Debt Treatments and abide by the so-called "comparable treatment" principle (i.e., reasonable burden-sharing in the way that financial losses are distributed across creditors). However, Beijing's latest actions suggest that it is muscling its way to the front of the repayment line by demanding that borrowers provide recourse to cash collateral that others lack. Paris Club, multilateral, and commercial creditors fear—with some justification—that they are becoming junior creditors whose loans will be repaid on a lower-priority basis. If Beijing insists upon being treated as a senior creditor whose debts should be given first priority, then coordinated debt reschedulings with non-Chinese creditors will likely become more difficult to negotiate. The biggest losers in this scenario will be ordinary people in the developing world who are denied basic public services because of a collective action failure among foreign creditors.

What measures has Beijing taken to reduce its exposure to ESG risk? How are its infrastructure projects with strong ESG safeguards faring during implementation?

Seven key takeaways

1. Beijing has earned a reputation for implementing brick-and-mortar projects with lightning speed. Irrespective of ESG safeguard stringency, the average infrastructure project financed with Chinese aid or credit takes approximately three years to complete.

2. Beijing's rivals and critics claim that it has not taken meaningful steps to subject its overseas infrastructure project portfolio to more stringent ESG safeguards. This claim is false. By 2021, 57% of China's grant- and loan-financed infrastructure project portfolio in low- and middle-income countries had strong de jure environmental, social, and governance safeguards in place. This represents a major departure from past practice: at the turn of the century, China's entire grant- and loan-financed infrastructure project portfolio in low- and middle-income countries had weak de jure environmental, social, and governance safeguards in place.

3. The pace of ESG safeguard reform accelerated during the BRI 2.0 era—from 2018 to 2021.[11] Over the same four-year period, the annual ESG risk prevalence rate in China's grant- and loan-financed infrastructure project portfolio sharply declined from 63% to 33%.

4. Beijing has de-risked the country's overseas infrastructure project portfolio by reining in the activities of development finance institutions that lack strong ESG risk management guardrails, increasing the provision of infrastructure financing via institutions that have strong ESG safeguards in place, unwinding aid and credit relationships with countries that present high levels of ESG risk, and redirecting new infrastructure financing to countries that present low levels of ESG risk.

5. Chinese grant- and loan-financed infrastructure projects with strong de jure ESG safeguards have substantially lower levels of ESG risk exposure in a de facto sense than those without such safeguards. They are also less vulnerable to suspension and cancellation.

6. A particularly important finding is that Chinese grant- and loan-financed infrastructure projects subjected to strong de jure ESG safeguards do not face

[11] In 2018, 26% of China's grant- and loan-financed infrastructure project portfolio in low- and middle-income countries had strong de jure environmental, social, and governance safeguards in place. By 2021, this figure had increased by 31 percentage points (to 57%).

substantially longer implementation delays than those subjected to weak de jure ESG safeguards.[12] Squaring the circle between speed and safety is at the center of Beijing's BRI 2.0 strategy.

7. Beijing enjoys a stronger position in the global infrastructure financing market than its bilateral and multilateral competitors realize. The fact that China has put in place increasingly stringent ESG safeguards—without damaging its reputation for speed—could undermine G7 efforts to outcompete it on quality or safety grounds. Developing countries prefer to work with lenders and donors that bankroll big-ticket, high-impact infrastructure projects with reasonably robust ESG safeguards but without excessive implementation delays. Beijing is taking measures to meet this challenge. Whether the G7—and the multilateral development banks—will do the same is an open question.

What measures has Beijing taken to reduce its exposure to reputational risk?

Six key takeaways

1. In a tally of the annual number of soft power "gains" and "losses" that China has experienced vis-à-vis the U.S. in low- and middle-income countries since the first full year of BRI implementation (2014), Beijing's losses outnumbered its gains—by a substantial margin.[13] It experienced more losses than gains vis-à-vis Washington on three different measures of soft power: public opinion, media sentiment, and elite support.

2. Across all three measures of soft power, Beijing devoted nearly two-thirds of its entire international development finance portfolio to "toss-up" countries—i.e., competitive jurisdictions where neither China nor the U.S. opened up an insurmountable lead vis-à-vis its principal rival.

3. Beijing seeks to maintain and build upon momentum. In jurisdictions where it recently made reputational gains at the expense of the U.S., it doubled down by providing more aid and credit.

4. China has a relatively low level of tolerance for risk in its pursuit of soft power. It devoted only 16% of its international development finance portfolio to "moonshot" countries—those where its principal rival had momentum on its side.[14] A separate, but related, finding is that when reputational assets become reputational liabilities, Beijing tends to disengage from discussions about new projects and financial commitments and refocus on managing risks within its existing portfolio of grant- and loan-financed projects.

5. Political transitions in host countries are critical junctures when the nature, level and pace of China's engagement can change significantly. If a new leader comes to power and takes a less adversarial posture toward China, Beijing typically springs into action and seeks to cement bilateral relations by helping incumbents take credit for high-profile infrastructure projects.

6. Given that Beijing tends to disengage rather than double down in countries where there are strong indications of BRI backlash, Beijing's competitors may be able to lure such countries back into the West's orbit. However, doing so would require that the G7 act quickly when these windows of opportunities arise and adapt their programming to address the unmet needs of partner countries.

[12] As a point of comparison, World Bank projects subjected to the organization's most stringent environmental and social safeguards take more than 7 years, on average, to move from the proposal stage to the commencement stage. On average, it takes World Bank projects another 6 years to move from the commencement stage to the completion stage.

[13] We measure the *relative* gains and losses experienced by China on a country-by-country basis between 2014 and 2021 on three different measures of soft power (public approval, media sentiment, and elite support). For example, to measure the relative gains or losses in public approval, we (1) calculate the difference between the public approval rating for China in a given year and the prior year; (2) calculate the difference between the public approval rating for the U.S. in a given year and the prior year; and (3) calculate the "double difference" between (1) and (2) to determine if China experienced a greater gain or loss in public support than the U.S. in the same country-year.

[14] Similarly, Beijing has assigned a lower level of priority to "toss-up" countries where momentum recently shifted in favor of the U.S.

About AidData

AidData is a research lab at William & Mary's Global Research Institute. We equip policymakers and practitioners with better evidence to improve how sustainable development investments are targeted, monitored, and evaluated. We use rigorous methods, cutting-edge tools and granular data to answer the question: who is doing what, where, for whom, and to what effect?

AidData
Global Research Institute
William & Mary
427 Scotland St.
Williamsburg, VA 23185

WILLIAM & MARY
GLOBAL RESEARCH INSTITUTE