Debt Distress on China's BRI: Who Gets Bailed Out and Why?

Sebastian Horn, Bradley C. Parks, Carmen M. Reinhart, and Christoph Trebesch (2023). **Debt Distress on China's Belt and Road.** *American Economic Association Papers and Proceedings.*

By 2020, China's state-owned creditors issued over $800 billion in loans to over 150 countries, with a large share going to low- and middle-income borrowers as part of the so-called Belt and Road Initiative (BRI). However, many of the countries that borrowed from China are facing debt repayment difficulties or are in outright default. How have China's state-owned lenders dealt with the growing repayment difficulties on their overseas loans?

The data. The authors construct a novel dataset tracking China's debt restructurings and rescue lending from 2000 to 2022, drawing from sources that include: 1) China's state-owned bank lending records (primarily China Development Bank and the Export-Import Bank of China); 2) reports on the People's Bank of China (PBOC) currency swap usage and foreign reserve deposits; 3) public reporting; 4) project-level datasets; 5) specialized case studies on commodity prepayment facilities (e.g., oil-for-loan deals); and 6) public databases like the World Bank's International Debt Statistics and AidData.

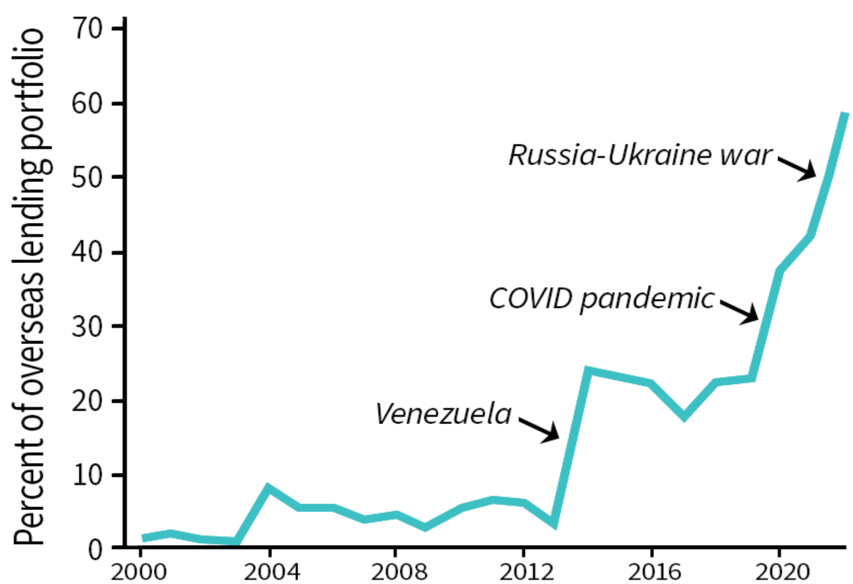
The end of risky lending. In 2022, 60% of China's overseas lending portfolio was owed by borrowers in distress, such as those: with payment arrears; in a default or restructuring (with China or private external creditors); participating in the 2020–2021 Debt Service Suspension Initiative (a pandemic-era debt relief program); and/or at war.

INSIGHTS

- 60% of China's overseas lending is owed by distressed borrowers (countries in arrears, restructuring, or at war).
- Debt distress stems from commodity price crashes, Russia's invasion of Ukraine, rising interest rates, and China's risky lending to sovereigns like Pakistan and Venezuela.
- China tends to extend rescue lending to middle-income countries with larger loans (80% of distressed debt) so they can service debts and avoid defaults that would hurt China's lenders.

• • •

Share of China's overseas lending to borrowers in distress



The growing share of China's overseas debt in distress is the result of a variety of global and domestic factors, including: the commodity price crash of 2015; the COVID-19 pandemic; Russia's invasion of Ukraine; and tighter global liquidity conditions and rising interest rates. For some developing countries, a deteriorating domestic economy or the political environment has added to debt servicing challenges. However, growing debt distress also reflects China's expansive lending strategy during boom years, including to high-risk sovereigns such as Pakistan, Sri Lanka, and Venezuela. Total debt servicing to China's banks now exceeds total new lending by these same banks. In other words, China's overseas lending boom to sovereign borrowers has ended.

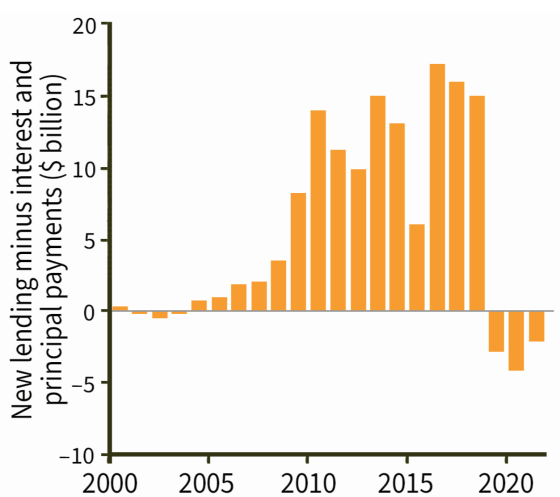
■ China provides grace periods, but no new loans or other support to smaller, poorer borrowers (20% of distressed debt) that have less impact on the balance sheets of China's lenders.

■ Total debt servicing to China's banks now exceeds their total new lending, suggesting China's appetite for risky lending has come to an end.

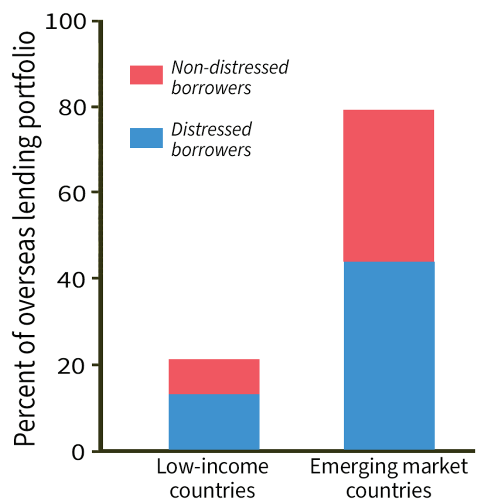
Bigger borrowers get bailouts to protect China's lenders. Emerging market countries with bigger loans outstanding account for nearly 80% of China's total overseas loans. For these borrowers, China has commonly resorted to rescue lending — i.e., bailouts — that take several forms: short- and medium-term loans by state banks to developing countries explicitly for budgetary and balance of payments support ("bridge loans"); PBOC currency swap drawdowns that allow distressed sovereigns to use or convert renminbi to service debt; and commodity prepayment facilities through which China's state-owned oil and gas companies provide large cash advances for commodity exporting countries that are in distress.

The use of these tools is likely due in part to the composition of China's lending portfolio and balance sheets. China's banks with large BRI debt claims have a strong interest in ensuring that the borrowing countries are sufficiently liquid to continue servicing their outstanding debts, at least over a shorter horizon. This lending is likely not meant to solve long-term solvency problems, but rather to buy time, keeping borrowers afloat and protecting China's lenders by preventing immediate defaults.

China's lending reversal



China's debt exposure by country groups



Smaller borrowers get grace periods but few improvements on lending terms. China's debt claims toward low-income countries are much smaller, accounting for about 20% of the total overseas lending portfolio. So far, debt restructurings have been far more common for these borrowers. Debt restructurings typically involve maturity or "grace period" (delay-in-repayment) extensions, but no face-value reductions or improvement in other terms of lending, specifically interest rates. This country group is of less relevance to the health of China's financial institutions engaged in overseas lending, which means fewer incentives to keep these countries afloat via bailout lending.

Shifting from risky lending to damage control. The researchers conclude that China's era of high-risk sovereign lending has come to a halt, replaced by a more cautious and defensive posture. With 60% of its overseas portfolio now distressed, China's primary focus has shifted to protecting its own financial institutions. Bailouts are selectively extended to middle-income countries with large exposures, while poorer countries receive limited relief without fresh funding. This approach suggests that crisis management is now driven less by borrower need than by the need to safeguard the balance sheets of China's lenders.