REPORT

China Is a Loan Shark With No Legs Left to Break

Beijing's conversion into a major creditor has upended international finance—and not in a good way.

By Christina Lu

MAY 9, 2023, 9:00 AM

In the messy world of international development finance, no country has disrupted the existing setup quite like China, which in the past decade has eclipsed both the World Bank and the International Monetary Fund (IMF) as the world's largest creditor by lending out hundreds of billions of dollars.

Beijing now, for the first time, has the keys to the car. The problem is that the car is jacked up, on blocks, and the key doesn't actually work. China's gamble on checkbook diplomacy turned out little different from a Las Vegas weekend, except none of it stayed in Vegas.

Debt woes have plagued governments for centuries. Hapsburg Spain had more defaults than branches on its family tree. The rise of national banks in the 17th century, first in Holland and later in England, helped. But it wasn't really until after World War II that the world got a lender of last resort. Or first.

Rather than turning to wealthy private lenders, for decades debt-ridden governments have largely sought help from the Paris Club, an informal group of major creditors, alongside the IMF and World Bank, multilateral institutions that were set up after the war. China didn't join that particular party, but it is crashing the wedding all the same.

China's emergence as a major lending power is now upending that system, forcing everyone involved to navigate a changing landscape in which the new heavyweight shuns the old playbook. Beyond following different criteria in lending, China has also favored a bilateral approach to debt renegotiations that clashes with the Paris Club's coordinated framework. Efforts to include China have flopped, too: Beijing has repeatedly refused offers to join the group while questioning the norms that have underpinned international debt-restructuring practices.

"The world has changed," said Adnan Mazarei, a former IMF deputy director who is now at the Peterson Institute for International Economics. "There is a new huge player called China. You cannot tell a huge new player that you have to play by my rules or the highway."

The Paris Club emerged in the wake of World War II as a group of mostly Western creditors that have long played an influential role in global lending and could respond collectively to cash-strapped countries' calls for debt relief. In the decades since, the group has acted on hundreds of requests in coordination with the World Bank and the IMF. But China's economic rise has challenged that dominance. Once a debtor nation, since launching its Belt and Road Initiative (BRI)—a sweeping infrastructure development initiative designed to export China's industrial overcapacity and extend its global influence—in 2013, Beijing has doled out hundreds of billions of dollars in loans.

China laid a big bet on the red numbers. The roulette ball didn't tilt its way. "There was the assumption that these countries would align themselves with China on other geopolitical issues as well and China could make a good return when it was building a stronger set of geopolitical alliances," said Eswar Prasad, a former head of the IMF's China Division who is currently a professor at Cornell University. "Both of those have not borne fruit."

China has since scaled back its lending, but the consequences of years of its risky, even economically questionable deals are now catching up. As China's borrowers fail to pay up, Beijing has resorted to handing out more than $230 billion in emergency loans—a reflection of the competing pressures it faces to both recoup its money and preserve the goodwill it has tried to build through the BRI.

China spent the 1950s and 1960s courting the developing world. Only lately did it really start opening its wallet. This may be a "truly unprecedented moment," said Scott Morris, a senior fellow at the Center for Global Development and former U.S. Treasury official. "I'm not sure there was ever a period of time, going back to the 1950s, where any government was as big as China is today in these debt dynamics."

The problem is that a lot of the countries that China is loaning money to are broke. Sri Lanka has offered up a major port and 100,000 endangered monkeys to keep Chinese kneecappers at bay. Beijing needs the vig, and the countries it bet on can't come up with the goods. With a growing number of countries now pushing for debt relief, the key issue is now who bears the burden of the losses. China has insisted that if it takes losses, multilateral lenders should, too—contradicting the traditional process of global debt restructurings.

It's "a clash of who deserves to suffer more," said Yun Sun, the director of the China program at the Stimson Center.

One key effort was the G-20's Common Framework for Debt Treatments, a 2020 initiative that would allow Beijing and other creditors to act jointly on debt relief requests as countries buckled under the economic pressures of the COVID-19 pandemic. But nearly three years in, progress has been slim.

"There was a lot of hope that [the Common Framework] would be the new architecture for debt restructuring and debt relief," largely because Beijing was at the table, Morris said. But the framework's broad principles left a lot of room for interpretation, he added, and "really did not present any kind of fully formed blueprint."

China is ill-equipped to respond to a debt challenge of this scope. Bradley Parks, the executive director of William & Mary's AidData research group, said that while Beijing has experience with bilateral debt rescheduling, it isn't used to working with others. Further complicating matters is the fact that it's not just Beijing that needs to sign on; negotiations involve an uncoordinated, fragmented system of Chinese banks, financial institutions, and regulators, all of which are looking out for their own bottom lines. Chinese officials may also be concerned about being seen as accepting a package crafted by the international community, Prasad said.

"There is no single China when it comes to debt renegotiations," said Matthew Mingey, an expert on China's economic diplomacy at the Rhodium Group. "It's a question of not just bringing China together with the rest of the world—it's a matter of bringing China's lenders and regulators and institutions together."

Facing mounting economic and political pressures, China appears to have softened its demands in recent weeks, reportedly weighing plans to stop calling for multilateral lenders to also take losses, according to the *Wall Street Journal*.

"I think this has been a very painful process of watching China be socialized to a set of long-standing rules and norms that they were previously not accustomed to," Parks said. "Now we're watching them learn why the rules and norms exist, and it's sort of excruciatingly slow and painful, but they're so, ever so, so slowly starting to come around."

Past crises can offer lessons for what lies ahead when debt crises metastasize. In the 1980s, crushing debt burdens across Latin America sparked painful hyperinflation and plunged millions of people into poverty. "There is a fear that just as Latin America had a lost decade following the '80s debt crisis, that those other countries will also have many years of low growth," said Mazarei, the former IMF deputy director.

If negotiations remain in deadlock, said Carmen Reinhart, a former World Bank chief economist who is now a professor at the Harvard Kennedy School, the already vulnerable debtors are the ones who will stand to lose the most.

“The longer it goes on, the more the cumulative toll it takes on these borrowers, which are the canary in the coal mine—they’re the frailest of the countries,” she said. “The delay has real humanitarian consequences.”

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