EXAMINING BELT AND ROAD: THE LENDING PRACTICES OF THE PEOPLE'S REPUBLIC OF CHINA AND IMPACT ON THE INTERNATIONAL DEBT ARCHITECTURE

VIRTUAL HEARING

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EXAMINING BELT AND ROAD: THE LENDING PRACTICES OF THE PEOPLE'S REPUBLIC OF CHINA AND IMPACT ON THE INTERNATIONAL DEBT ARCHITECTURE

Tuesday, May 18, 2021

U.S. HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON NATIONAL SECURITY,
INTERNATIONAL DEVELOPMENT
AND MONETARY POLICY,
COMMITTEE ON FINANCIAL SERVICES,
Washington, D.C.

The subcommittee met, pursuant to notice, at 10 a.m., via Webex, Hon. Jim A. Himes [chairman of the subcommittee] presiding.

Members present: Representatives Himes, Torres, Lynch, Dean, Garcia of Illinois, Auchincloss; Hill, Zeldin, Williams of Texas, Davidson, Gonzalez of Ohio, and Taylor.

Ex officio present: Representative Waters.

Also present: Representative Sherman.

Chairman HIMES. The Subcommittee on National Security, International Development and Monetary Policy will come to order. Without objection, the Chair is authorized to declare a recess of the subcommittee at any time. Also, without objection, members of the full Financial Services Committee who are not members of this subcommittee are authorized to participate in today's hearing.

As a reminder, I ask all Members to keep themselves muted when they are not being recognized by the Chair. The staff has been instructed not to mute Members, except where a Member is not being recognized by the Chair and there is inadvertent background noise. Members are also reminded that they may only participate in one remote proceeding at a time. If you are participating today, please keep your camera on, and if you choose to attend a different remote proceeding, please turn your camera off.

A quick note of personal privilege, I want to announce to the subcommittee that Chairwoman Waters has appointed the gentleman from New Jersey, Josh Gottheimer, to be Vice Chair of this subcommittee. I have known Josh for a long time, and I am excited to have him on board on the subcommittee. You know Josh; he is always willing to hear from lots of different perspectives, so I invite you to give Mr. Gottheimer your ideas on what else the subcommittee could do in this Congress.

Today's hearing is entitled, "Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture."

I now recognize myself for 4 minutes to give an opening statement.

Even before the Coronavirus besieged the world, there were worrying signs of sovereign debt distress in developing countries, and much of that debt is owed to the People's Republic of China. In the last 20 years, China has become the single-largest official lender to developing countries, dwarfing other multilateral institutions like the World Bank, the International Monetary Fund (IMF), and the countries that make up the Paris Club. Exactly how large of a lender China is, however, remains unknown because the country does not publicly disclose its foreign lending. In addition, very little about the specific terms of the debt contracts have previously been made public.

The groundbreaking work of three of our panelists today—Professor Gelpern, Dr. Horn, and Mr. Morris—provides the most complete look at the terms of Chinese lending to date. Their report, "How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments," is a first-of-its-kind study examining sovereign debt contracts between Chinese entities and sovereign governments in their entirety. The paper lays out, in detail, how China has developed standardized contracts containing extreme provisions squarely aimed at the dual goals of protecting its investment and exercising its sovereign power.

China seeks to climb the seniority ladder through strict nondisclosure agreements and so-called, "No Paris Club clauses," tying borrowing countries' hands in restructuring debts, or even acknowledging that debts exist. The contracts contain provisions requiring collateral accounts that are held offshore and off the government's books. And China seeks to expand its sphere of influence by using acceleration and cross-default clauses to impose their policy preferences on borrower nations, going as far as cancelling unrelated loans when borrowing nations make policy decisions that China opposes.

Given that lack of clarity around exactly how much is owed to Chinese entities and the terms of those agreements, other lenders face uncertainty about their level of seniority and the full extent of the borrowing country's debt servicing costs. This lack of transparency makes future debt restructuring efforts, many of which we are seeing get underway right now, that much more difficult.

The Debt Service Suspension Initiative (DSSI) and the Common Framework are both positive developments in ensuring international cooperation in addressing sovereign debt issues. Most notably, the Common Framework brings China closer to agreeing to Paris Club-style coordination. However, there remain significant hurdles to putting developing countries on a sustainable debt path.

As China continues to expand its lending throughout the world, it is more important than ever that the United States and our global partners lead in setting durable global norms for official bilateral lending. With that, I would like to thank our panel of witnesses whose expertise in this field is unparalleled. I sincerely appreciate your assistance in tackling these difficult issues, and I look forward to your testimony.

I now recognize the ranking member of the subcommittee, Mr. Hill, for 4 minutes for an opening statement.

Mr. HILL. Chairman Himes, thank you.

Chairwoman Waters, it is good to have you in our discussion today. We appreciate your leadership on the bipartisan agenda as it relates to reviewing China's engagement as the world's largest creditor. It is a bipartisan concern, and our committee has made that clear through enacting legislation like the Export-Import Bank's most recent reauthorization, as well as my Ensuring Chinese Debt Transparency Act that was passed last Congress.

Multilateralism means bringing Beijing into compliance with international rules of the road, including those of the Paris Club. Recent research, including some by our witnesses today, has filled many important details in on the scope, opacity, and conditionality of Chinese lending, which clearly runs counter to the mission of the International Monetary Fund, the World Bank, and other multilateral lenders. This is unacceptable.

Let me highlight three policy implications I believe result from China's Belt and Road lending. First, the U.S. and our allies need to be much more serious about pushing for real concessions from Beijing. Many know that I have raised questions about the Treasury's recent plan to allocate $650 billion in special drawing rights (SDRs), which could facilitate directly or indirectly, Belt and Road repayments. This could also make it more challenging to force China to the negotiating table.

Even if you support an SDR allocation, we should all be able to agree that the Treasury should use its leverage to obtain meaningful agreement on debt before signing off at the IMF meeting this summer, and not afterwards, when China could end up leading us into endless talks with zero results. Thirty years of failure to protect intellectual property and the recent suspension of 8 years of fruitless discussions by Treasury and our allies on the transparency of China's export credit market should remind us just how typical and real that danger is.

A meaningful agreement on debt would entail specific long-term concessions on transparency and appropriate coverage of all of China's official creditors, not just the ones they claim are arms of the government. We also must consider whether or not the G20's Common Framework for debt treatment should expand to cover additional borrowers. The time for the U.S. and its allies to nail down these formal commitments is right now, not after an allocation, when the urgency of the COVID-19 economic downturn begins to fade.

Second, we need to find an alternative to developing countries' acceptance of Chinese lending. Much of the Chinese credit to low-income countries is at relatively high rates with short maturities, and in some cases requires onerous collateral requirements and cross-default provisions. Loans may be also linked to a country's diplomatic treatment of Taiwan or some other policy at odds with U.S. interests, and the IFI's Treasury needs flexibility to weigh these kinds of considerations strategically and use the mandates it has to make the IFIs as nimble and effective as possible.

Finally, Beijing's resistance to international lending rules, not to mention the abuse of basic human values in Shenzhen and Hong Kong, once again highlights that it does not deserve more of a voice in the international financial institutions. Shareholding is not just about a country's size of economy. It is about the commitments and contributions to multilateral cooperation. We can't wish this away by believing that the IMF quota for China or the status of the RMB in the SDR basket are things that can entice Beijing into better behavior. It simply hasn't worked, and we must adopt by focusing more countries on the interests that align with ours.

I look forward to our panel today, and I yield back to you, Mr. Chairman.

Chairman HIMES. I thank my friend, the ranking member, and I now recognize the Chair of the full Financial Services Committee, the gentlewoman from California, Chairwoman Waters, for one minute.

Chairwoman WATERS. Thank you so very much, Chair Himes. I am so pleased about your leadership on this issue and your bipartisan efforts. Today, we will discuss how we can prevent a pandemic-induced series of sovereign debt crises, and how we can bring international norms and principles to China and its investments around the world.

Last Congress, I had the benefit of learning about China's Belt and Road Initiative directly from our military leadership in the United States Africa Command, when I traveled to Germany. The conclusion I drew was that addressing these challenges can only be accomplished with United States leadership through coordinated and thoughtful multilateral action. I am pleased we finally have that leadership in the White House with President Joe Biden, and I hope this hearing is informative to not just the public, but to his Administration as well. Thank you so very much, and I yield back the balance of my time.

Chairman HIMES. Thank you very much, Madam Chairwoman.

I am told that the ranking member of the Full Committee, Mr. McHenry, is not present, and doesn't claim his minute. Let me give him a second to object or forever hold his peace. Okay. It sounds like Mr. McHenry is not there.

Today, we welcome the testimony of our distinguished witnesses: Scott Morris, a senior fellow at the Center for Global Development; Odette Lienau, the associate dean for faculty research and intellectual life at Cornell University Law School; Jaime Atienza, the debt policy lead at Oxfam; Anna Gelpern, the Anne Fleming Research Professor at Georgetown Law and non-resident senior fellow at the Peter G. Peterson Institute for International Economics; and Sebastian Horn, an economist at the Kiel Institute for the World Economy.

Witnesses are reminded that their oral testimony will be limited to 5 minutes. You should be able to see a timer on your screen that will indicate how much time you have left, and a chime will go off at the end of your time. I would ask that you be mindful of the timer and quickly wrap up your testimony if you hear the chime, so that we can be respectful of both the witnesses' and the committee members' time. And without objection, the witnesses' written statements will be made a part of the record.

Just as a reminder, it is the practice of the subcommittee to allow witnesses to finish their answers, but we do not permit Members to go much beyond their 5 minutes to finish a question or to elicit a response.

Mr. Morris, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF SCOTT A. MORRIS, SENIOR FELLOW, CENTER FOR GLOBAL DEVELOPMENT

Mr. MORRIS. Chairman Himes, Ranking Member Hill, Chairwoman Waters, thank you for the opportunity to testify today. Twenty-five years ago, this committee was instrumental in putting forward the Heavily Indebted Poor Countries Initiative or HIPC to relieve the debt burdens of 37 low-income countries. At the time, the U.S. Government was one of the leading creditors to these countries, while China was a smaller creditor than Costa Rica. Today, nearly all of the HIPC countries are again at risk of debt distress with vulnerabilities that have been greatly exacerbated by the pandemic, but on the creditor side, the picture has changed dramatically.

The U.S. Government today is one of the smallest creditors to these countries, while China, on the other hand, is a bigger creditor than all other government creditors combined. So when we consider how best to address a potential widescale debt crisis, we have to grapple with China's dominant position, not just how much China lends, but how China lends. I will focus the balance of my remarks on the findings of a new report on China's lending practices as evidenced by their debt contracts as well as U.S. responses to these practices. I co-authored this report, "How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments", with Anna Gelpern and Sebastian Horn, who are both also on the panel today, as well as Brad Parks and Christoph Trebesch.

Four main insights emerge from our research. First, Chinese contracts contain unusual confidentiality clauses that bar borrowers from revealing the terms or even the existence of the debt. These restrictions are problematic. They impede budget transparency, they hide the borrower's true financial condition from its other creditors, and they can serve as an obstacle to timely and orderly debt restructurings.

Second, Chinese lenders seek advantage over other creditors through collateral arrangements such as lender-controlled revenue accounts. Accounts of this sort encumber and scare foreign exchange and fiscal resources of developing country governments. And when the accounts are hidden through strict non-disclosure requirements, they can distort the overall economic picture for a country in the eyes of the IMF and other creditors. Again, such arrangements may serve as a barrier to timely and efficient debt restructurings.

Third, Chinese lenders also seek advantage over other creditors through requirements to keep the debt out of collective restructuring efforts. Such clauses unambiguously seek to set Chinese creditors apart from and ahead of other creditors in restructuring situations.

Fourth, cancellation and acceleration clauses in Chinese contracts have broad scope and imply significant policy leverage over the borrowing country. These provisions enable the Chinese lender to accelerate payments or cancel a loan due to a wide array of policy conditions in the borrowing country or in China.

With these findings in mind, let me turn to the U.S. Government's policy agenda. In responding to China, I would urge you to keep the interests of developing countries in mind, particularly during the current crisis. These countries need an extraordinary amount of support right now, and the U.S. Government should work with partners to mobilize as much aid and concessional financing as possible. The U.S. is already stepping up with direct support for COVID relief and access to the vaccines for these countries, and the faster we can move on these measures, the better.

We should continue to support institutions like the World Bank and the IMF in their efforts in these countries. Our financial contributions to these institutions are critical. The U.S. should have clear objectives when it comes to China's role in debt relief. As the largest of the government lenders to indebted countries, the Chinese government should bear the largest cost of any debt relief initiative, but that outcome will not be automatic. The U.S. should work with other countries on a more comprehensive definition of government creditors such that Chinese governmental lenders are not shielded from debt relief commitments.

The U.S. should also insist that the Chinese government disavow contractual provisions that impede debt relief efforts. Our government should lead by example when it comes to government contract transparency. The degree of secrecy we observe in Chinese contracts is unusual, but the reality is that secrecy is the prevailing norm among government lenders. While the burden of transparency has fallen almost exclusively on borrowing countries to date, the U.S. could lead in expanding this agenda to creditor governments as well. That should start with a commitment to publish government-to-government debt contracts where the U.S. Government is a creditor.

Finally, as the U.S. seeks to compete with China in offering development finance, our government should be vigilant about avoiding China's mistakes and lending imprudently into vulnerable environments. There is no doubt the U.S. Government could be doing more to support infrastructure projects in developing countries, but doing so in a manner that protects the U.S. taxpayer and benefits these countries will require focusing on measures of project quality and safeguards, financing terms that are appropriate to the country's circumstances, and strong alignment with the IMF and the World Bank and their financing frameworks. Thank you.

[The prepared statement of Mr. Morris can be found on page 65 of the appendix.]

Chairman HIMES. Thank you, Mr. Morris.

Ms. Lienau, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF ODETTE LIENAU, PROFESSOR OF LAW AND ASSOCIATE DEAN FOR FACULTY RESEARCH, CORNELL UNIVERSITY LAW SCHOOL

Ms. LIENAU. Chairman Himes, Ranking Member Hill, Chairwoman Waters, and members of the subcommittee, thank you for the opportunity to testify. The United States faces a turning point in the international debt architecture for two reasons.

First, pandemic-related debt distress will be a multi-year issue. This means that the international community is currently paying closer attention to these problems. There may be a greater appetite to put in place necessary changes.

Second, the global balance of economic power is likely to shift in the coming decades. The U.S. has been the central actor in international finance for 50 years. This will not necessarily be the case forever, so it should act today to cement its values, going forward.

In the remainder of my remarks, I want to emphasize three ways that the problematic elements of Chinese lending practices fit into broader sovereign debt concerns.

First, these lending practices do not exist in a vacuum. They reflect and amplify general and endemic issues. These include a lack of transparency of loan terms and conditions, insufficient concern for whether debt actually benefits a country's underlying population, and a lack of comprehensive creditor participation. The practices of certain Chinese creditors take these general defects to the extreme.

Still, the best way to constrain troublesome practices by one country is to establish norms relevant to all countries. Otherwise, efforts to constrain problematic actors are unlikely to stick. This has been a key principle of the post-World War II global order, and it remains essential. Therefore, any efforts to improve Chinese lending practices must be part of broader progress in the debt architecture.

Second, if the U.S. is concerned with China's increasing role in international capital flows, it should work now to solidify values of transparency, accountability, public benefit, and comprehensive participation. As with any path, this begins with an initial step. The U.S. should commit to supporting a swift, stable, and equitable public health and financial recovery from the pandemic. This will be essential to a full, global economic recovery and also help to forestall follow-on consequences such as political instability and disruptive migration patterns.

In the medium term, the U.S. should implement widely accepted lending and restructuring principles across multiple tracks, including contract term improvements, domestic legislation, and international initiatives. This matters whether creditors are private investors or government actors, especially when these categories are starting to blur.

For long-term progress, the U.S. should consider the establishment of an independent authority to facilitate these improvements. Especially given the potential changes in the global balance of power, an independent authority committed to broadly acknowledged principles could be helpful.

My third and final point involves corruption and mismatched financial incentives in a number of borrowing countries. Greater tolerance of corruption may be a problem in some Chinese contracts, and again, this issue implicates broader and long-standing dynamics in international finance where the decisions of borrower elites may not always reflect the interests of their citizens.

This means two key things. First, we should not punish countries' populations when dealing with a pandemic and the related debt crisis even if elites have made financial mistakes. It makes sense to promote transparency and responsible lending now, but the most vulnerable will suffer the most from inaction.

Second, U.S. and other international actors must take the lead in implementing and modeling new norms and practices. We sometimes hear that debtor countries are primarily responsible for transparency and other reforms, and that is true, but ruling elites in these countries may prefer to drag their feet while their citizens often do not have the information or the power to take action. So, given the power imbalances and information asymmetries on the ground, more needs to be done at the external level. U.S. support for strong creditor-focused rules on transparency and lending could, over time, help undermine troublesome internal dynamics in sovereign borrowers.

To conclude, I should note that meaningful reforms may not be fully embraced by all U.S. stakeholders. Some American affiliates have also benefited from deficiencies in the international framework. So, if the U.S. is serious about curbing problematic debt practices, it will have to make that commitment clear to domestic constituencies as well. This will not always be an easy choice. Thank you again for the opportunity to testify.

[The prepared statement of Professor Lienau can be found on page 48 of the appendix.]

Chairman HIMES. Thank you, Ms. Lienau.

Mr. Atienza, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF JAIME ATIENZA, DEBT POLICY LEAD, OXFAM

Mr. ATIENZA. Chairman Himes, Ranking Member Hill, Chairwoman Waters, and members of the subcommittee, good morning, and thank you for the opportunity to testify today. My name is Jaime Atienza, and I come to this committee as the global debt policy lead of the Oxfam Confederation. The timing of this session is critical as we have seen the debt situation, especially of the poorest countries, worsen significantly in recent years, and even more after COVID hit.

In February 2020, before the pandemic was declared, the IMF stated that over half of low-income countries in Africa were either in debt distress or at high risk of being so, and things have only worsened since. Debts, both with China and with private creditors, represent the largest threat to their economic options for recovery, so both need to be tackled to bring in effective solutions.

The human impact of a debt crisis is often overlooked. Higher spending on debt means lower spending on public services, which means fewer teachers, health care workers, and hospital beds for hundreds of millions of citizens in need. It also means further entrenching the cycle of poverty for many, the impacts of which fall particularly hard on women, as unpaid care work must often fill the gaps.

The impact of COVID-19 in Africa has been profound, with a 10-year setback in poverty, a steep rise in hunger, and desperation leading to more migration. Small island states, among them, some in the Caribbean, have lost an average 13 percent of their GDP, a wartime loss that is boosting poverty. In large part because of their debt burdens, poor countries are unable to redeploy their resources to the most urgent needs. In advanced economies such as the United States, the use of expansive monetary policies or large debt purchasing programs allow a wide range of policy actions to cope with the crisis, protect those worse off, and prepare for the future stage of recovery.

On the contrary, in the poorest countries, the situation is dire and options are scarce. In April 2021, one month after the pandemic was declared by the WHO, a global initiative called the DSSI was launched by the G20. It allowed for up to 23 countries to receive, upon request, a temporary suspension of their bilateral debt repayments from China to the United States. But this initiative left voluntary mechanisms any debt relief from private creditors, which has not materialized at all, and simply invited IFIs to find ways to contribute more.

The IMF did mobilize resources to cover debt repayments that 29 low-income countries owed to the fund, something the World Bank has yet to accomplish. However, Oxfam research shows that 84 percent of COVID-era loans by the fund encourage or require austerity measures, which strike at the very physical space needed for recovery. Overall design flaws with DSSI have meant that only 46 of the 73 eligible countries requested any debt suspension, and at the end of 2020, only $5.7 billion of debt repayments were suspended, with almost 90 percent of those repayments still flowing out of poor indebted nations. The moratorium has failed to give enough fiscal space for the poorest nations in response to COVID and essentially has postponed the crisis.

The Common Framework holds more promise, but it has yet to be tested, and the kind of debt relief it will deliver is unclear. It excludes middle-income countries, and the prospects for the comparability of treatment clause to deliver debt relief by private creditors remains uncertain at best.

The situation for developing countries, and specifically for low- and low-middle-income African economies on small island states, in particular those in the Caribbean, is very urgent, and at a minimum, we need to take the following actions: ensuring debt cancellation options under the Common Framework for DSSI countries as well as middle-income countries in deep trouble; ensuring legal protection to debtor countries from the potential risks of debt holdouts after debt restructuring; accelerating new grant and concessional financing to countries that are unable to use their own resources or use new debt as advanced economies can; bring forward truly collaborative efforts under the G20 umbrella of the Common Framework between major creditors including China and the U.S., IFIs, and private bondholders and banks; upgrade transparency and disclosure of all debt contracts in collaboration with the Organisation for Economic Co-operation and Development

(OECD), including civil society and public oversight; and finally, agreeing to sustainable borrowing and lending standards to be applied to new operations and include catastrophic clauses in needed contracts to avoid situations as the current.

Again, thanks very much for this opportunity.

[The prepared statement of Mr. Atienza can be found on page 34 of the appendix.]

Chairman HIMES. Thank you, Mr. Atienza.

Ms. Gelpern, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF ANNA GELPERN, ANNE FLEMING RESEARCH PROFESSOR AT GEORGETOWN LAW, AND NONRESIDENT SENIOR FELLOW AT THE PETERSON INSTITUTE FOR INTERNATIONAL ECONOMICS

Ms. GELPERN. Thank you very much, Chairman Himes, Ranking Member Hill, Chairwoman Waters, and members of the subcommittee. It is a privilege to be here and talk about both the next steps for financial architecture reform as well as the role of China, and I am happy to answer questions, along with my co-authors, about the China Lending Paper.

COVID-19 is both an alarm bell and an opening for meaningful reform of international financial architecture and debt architecture in particular. And this is one of those few times where the word, "architecture" actually means "architecture" and not sort of frittering around with interior decoration and changing the doorknobs. Today's crises are quite different from the crises we saw 2 decades ago, when there was another flurry of architecture conversations. This is not the last pandemic. We are going to see climate disasters, and public health, and financial shocks that are going to call for very different kinds of responses than what we have seen so far.

The actors are very different today. Many of them have no experience and at best provisional commitment to multilateral crisis resolution. And here, I think, Chad, for one random example—it is the first Common Framework country. Its biggest creditor, almost half of the debt, is Glencore, a mining company. Its biggest official creditor is China, followed by, of all countries, Libya, France, Angola, India, and Saudi Arabia. This is not the old bonds versus banks, hedge funds versus city conversation. Debt stocks are much bigger, more fragile, and much more complex. There is more collateralized debt, and it is inexcusably untransparent.

Against this background, the Common Framework is real progress. It is a real architectural move. It is a new room. It is a turret perhaps. It does need support. It is worth investing in. It also needs oversight to live up to its potential.

Now, China found it in its interest to participate, as did India, as did other big creditors, and I think that, above all, is a really hopeful sign. I am, on balance, optimistic. I am testifying here purely in my personal capacity, but I did want to highlight for the members some takeaways from a Group of 30 report on sovereign debt and financing for post-COVID recovery, which does focus on next steps in debt architecture reform.

In particular, I think many of us are on the same page. The Common Framework should be open to any country in debt distress, not just the poorest. It is a problem to have just the poorest countries be eligible, both because it marginalizes, kind of, the Common Framework as a mechanism, but also because it creates a stigma that I think would be very undesirable going forward in the architecture project. The Common Framework has to establish a record of transparency, equity, and consistency from the very start. This means that creditors have to renounce the debt terms that conflict with their Common Framework commitments.

Now, you can always waive the contract terms if you're a creditor, right? There is nothing magical about the G20 standing up and saying, we are not going to enforce these terms that my colleagues and I have found, particularly the non-Paris Club term and certainly confidentiality provisions.

Comparability, which Mr. Atienza mentioned, is essential and that, by the way, should make this whole distraction of a conversation about who is an official and who is a private creditor—it should make it go away. I don't care if you're official, I don't care if you are private. Everyone has to contribute to comparable debt relief and that, I think, is essential. Going forward, we are going to see a lot more hybrid creditors and we don't want to waste time on this sort of thing.

There should be public disclosure and there has to be something like a standing consultative coordinating body to ensure that this ad hoc restructuring is not seen as illegitimate, and is not conducted behind closed doors.

My colleagues already mentioned, and I agree wholeheartedly, that the U.S. and other G20 have to lead by example and disclose our bilateral contracts. And my very last point is that my big fear from the China Lending Paper is that we are going to see an arms race where every creditor is going to want some collateral, and everyone is going to want priority. We have to nip this in the bud. We have to start with a multilateral agreement that we are not going to dismember distressed countries and engage in an asset grab race. That is not a way to build an architecture. Thank you very much.

[The prepared statement of Dr. Gelpern can be found on page 41 of the appendix.]

Chairman HIMES. Thank you, Ms. Gelpern.

Dr. Horn, you are now recognized for 5 minutes to give an oral presentation of your testimony.

STATEMENT OF SEBASTIAN HORN, ECONOMIST, KIEL INSTITUTE FOR THE WORLD ECONOMY

Mr. HORN. Chairman Himes, Ranking Member Hill, Chairwoman Waters, and members of the subcommittee, thank you for the opportunity to testify today. I would like to use my time to highlight findings from a recent research project with Carmen Reinhart and Christoph Trebesch. I would also like to share my personal views on why I believe that greater debt transparency needs to be a cornerstone in all efforts to reform the international debt architecture.

Over the course of the past 15 years, the Chinese government and its state-owned enterprises and banks have lent at least 500 billion U.S. dollars to developing and emerging market countries. This lending boom has turned the Chinese government into the world's largest official creditor, with outstanding claims surpassing those of the IMF, those of the World Bank, or those of all Paris Club members combined. Chinese overseas lending has filled a void left by traditional development donors and has contributed to meeting the enormous funding gap for infrastructure and reliable energy sources in the developing world. This has potentially large positive effects on economic growth and development

At the same time, outstanding debt to Chinese creditors has risen fast and has contributed to debt servicing difficulties in multiple developing and emerging countries. For the 50 most-indebted developing countries to China, we estimate that outstanding debt stocks have risen from almost zero in 2005 to an average of more than 15 percent of GDP in 2017. In more than two dozen developing countries, outstanding debt stocks to China now exceed 10 percent of recipient country GDP. The large majority of loans have been extended at commercial terms, meaning with interest rates that are close to those in private capital markets and with comparatively short grace periods and maturities. As a result, Chinese creditors are going to play a dominant role in debt service payments of many low- and middle-income countries for years to come.

Furthermore, the opacity surrounding Chinese lending practices has made it difficult to assess the exact debt burdens of recipient countries. Our analysis reveals that around 50 percent of Chinese lending to developing country public sector recipients has gone unreported, meaning that these debt stocks do not appear in the most widely used data sources provided by the World Bank and other international organizations. The unreported lending from China has grown to more than 200 billion U.S. dollars as of 2016. Most of these liabilities are held on the books of state-owned enterprises and special purpose vehicles and are, therefore, outside the often narrowly drawn perimeter of public debt statistics.

Hidden debt problems are widespread and not exclusively linked to Chinese lending, however, the opacity of the Chinese lending process has fueled the build-up of the problem, which Chinese authorities so far have done little to address. The issue is that the Chinese government does not publish detailed statistics on its outstanding claims and lending activities and does not share information with the OECD Creditor Reporting System or the Paris Club. Furthermore, Chinese state-owned banks often exclude expansive confidentiality undertakings in their loan contracts, and thus, prevent adapters from revealing the terms or even the existence of the loans.

Failing to account for unreported debts distorts the views of the official and private sectors in significant ways. Uncertainty about the amount in terms of outstanding claims undermines that sustainability analysis and asset pricing and leads to longer and ultimately more costly debt restructuring processes. These problems are aggravated by the fact that a substantial share of Chinese loans relies on formal and informal means of collateralization so that Chinese creditors may be treated preferentially in case of repayment problems.

Maybe most importantly, the lack of transparency prevents citizens in both the borrower and lender countries from holding their governments accountable for their borrowing and lending decisions. Exposing public debt to public scrutiny can help to reduce the risks of unsustainable debt buildups and helps to mitigate the severity of recurring cycles of debt and crisis.

The COVID-19 crisis has exposed those vulnerabilities in developing countries along with the deficiencies of the international debt architecture. Broad action on that is needed to ensure that developing countries can mobilize the resources they require to address the ongoing health crisis. While greater debt transparency alone cannot overcome on issues, it is a prerequisite to broader attempts to reform the international debt architecture. The best way for advanced countries to support such efforts is to lead by example. Thank you, and I am looking forward to answering your questions.

[The prepared statement of Dr. Horn can be found on page 45 of the appendix.]

Chairman HIMES. Thank you, Dr. Horn. I now recognize myself for 5 minutes for questions.

Ms. Gelpern, let me start with you. My experience is that underwriting docents and contracts usually includes representations and warranties that forbid a borrower from assuming additional debt that is senior to that debt and creates a technical default if that occurs. My understanding is that at a minimum, a lender will expect to be asked for consent for a borrower to take on debt that is senior to that debt.

So my questions are: first, do you have any sense for how widespread Chinese lending that may actually be creating technical defaults is; and second, how do both the Chinese and the borrowers who are presumably knowingly getting into a technical default think about undertaking that kind of activity?

Ms. GELPERN. What a fantastic question. Sorry, I am a contracts ethics professor, so I am loving this. The clauses you are talking about, pari-passu and negative pledge clauses, are very widespread, but their formulation varies tremendously. So while I think it is a healthy assumption that a lot of this debt violates traditional negative pledge clauses, there the carveouts are so broad, and the variation is so wide, that it is not entirely clear how much of this lending triggers technical default.

Also, what we found, and my colleagues can elaborate, is not so much formal collateralization as just a contractual promise to route funds in a certain way. You may recall we did this when we did an emergency loan for Mexico in the United States in the mid-1990s, and it is just a contractual commitment. Now, ours was in the open and politically very controversial in both countries. The trouble here is that these bank accounts are—many of them are behind the veil of confidentiality, so people don't know. The answer is probably the—

Chairman HIMES. Thank you, Ms. Gelpern. Not to be rude here, but I want to get one or two more questions in before I run out of time.

Dr. Horn, you intrigued me with the last thing you said, which is that one thing we could do is actually set a good example. The Chinese are famously resistant to moral suasion or to abiding by otherwise generally accepted international norms. I would love to get a more broad answer. What leverage does the rest of the world really have? I am not talking again about just moral suasion, I am talking about what leverage do we really have to bring the Chinese into a more multilateral framework for this sort of lending?

Mr. HORN. None. In addition to leading by example, I think the most powerful way in this regard would be to work to the debtor countries and require them to have robust debt disclosure laws in their domestic laws that requires them to publish lending contracts if they themselves take them up as part of the of the debt disclosure process. I think that would be beneficial for the borrowers and would have this effect of creating a standard that the debt needs to be public in order to enter into effect.

Chairman HIMES. Any other thoughts on leverage that the rest of the world may have to achieve that end?

Mr. MORRIS. Mr. Chairman, I think I share, to some degree, your skepticism. I do think it is about using the multilateral settings that we have, as Ms. Gelpern noted, the G20 Common Framework is a step forward. So it is a matter of, how do we build on that? And this agenda, which I think all of us have pointed to around transparency, really is a critical piece of the next steps.

And, no, I agree there's no guarantee that China is going to get on board quickly, but I do think part of the process is that we demonstrate a willingness ourselves to take this on, and then we push very aggressively, certainly in the G20 but also in the IMF, and the World Bank. These are institutions where China is the third largest shareholder, and I think we can rightly point to the obligations of the leading shareholders to do the right thing here.

Chairman HIMES. Thank you. Mr. Atienza, very quickly, the equilibrium clauses that Professor Gelpern, and Mr. Morris, and Dr. Horn wrote about, would appear to have perhaps a chilling effect on the implementation of new environmental and labor laws in countries that borrow from China. Do you share that concern?

Mr. ATIENZA. I think I really believe that what my colleagues state is a true concern that needs to be factored in, and I just want to say that it is important to try and find frameworks where China will join others, but leading by example is not enough. I made the point that we need the privates to be part of the mix. And Dr. Gelpern mentioned, too, if we want them to be part of efforts that are broader, it is not only about bilateral. They, for their size, compete with others that are in this mix and it is not just governments. So I think that's a direction to take, ensure that everybody is sitting around the table, and then there will be a better option of pushing China forward as well.

Chairman HIMES. Thank you. Thank you, Mr. Atienza.

I now recognize the distinguished ranking member of the subcommittee, Mr. Hill, for 5 minutes of questions.

Mr. HILL. Thank you, Chairman Himes, and again, thank you for this very constructive panel.

And I thank all of the witnesses for their excellent commentary. I have shared my concerns time and time again about, is China really going to come forward and be a constructive partner in the debt relief efforts? In speaking with the Treasury Secretary and others, people, including today, have celebrated that China has said well, we will participate in the Common Framework, and I am not saying that is not encouraging. That is certainly a good, small step. But as with so many things with China, trust but verify is important.

In the very good study that our witnesses have drafted today, there is a reference to a contract with Argentina, between Argentina and the China Development Bank. And it says, "The borrower shall under no circumstances bring or agree to submit the obligations under the finance documents to the Paris Club for restructuring or into any debt reduction plan of the IMF, World Bank, or any other multilateral international financial institution to which the state, Argentina, is a part of or the government of the PRC without prior written consent of the lender."

Mr. Morris, does that sound like somebody who is ready to participate in the Paris Club?

Mr. MORRIS. Congressman, that provision in particular is clearly at odds with what the Chinese government has committed to under the Common Framework, which is why I think, for the U.S. Government, it ought to be a priority to get a very explicit disavowal of those kinds of provisions both in the existing contracts, but also a commitment not to use those kinds of provisions going forward. But you are absolutely right. This creates a clear conflict and particularly a burden for the borrowing country here where they are making a contractual commitment to a Chinese lender that is at odds with their own obligations to other creditors and to the multilateral institutions.

Mr. HILL. Right. And it is not in their long-term interest. The Chinese loans might be expedient by rate or shortness of terms, but they come with these unprecedented non-disclose features that we have seen turn into an utter disaster in Zambia, in Ecuador, in the Maldives, in Sri Lanka, and the list goes on and on, which everyone here certainly knows.

Would you say that the G7 countries, our finance ministers, and our leaders, including President Biden, should have that as a part of the G7 meeting where they say that they will together press China for this kind of transparency?

Mr. MORRIS. I agree with that completely. While ultimately, we aim for progress in the G20 because China would make commitments there, I think to get there, we need very coordinated and cohesive efforts by the G7 countries, which are going to be much more like-minded on these issues.

Mr. HILL. Yes, I agree. I just don't see how, within the IMF framework, there is any real enforcement capability here. I see transparency, and I like the idea of a register on the SDR's transfer, for example. But we have to educate our friends in the developing world on what is a good loan versus a bad loan.

Dr. Horn, in your paper, you show this non-disclosure chart, which I found very interesting. And the red bars are, of course, after 2013, and 2013 is a seminal year as the Chinese communist leader Xi Jinping began Belt and Road in 2013, and suddenly, we have all these non-disclosure arrangements in every aspect of your 100-loan sample. Dr. Horn, what are your suggestions for enforcement and how we can encourage Chinese behavioral change? What can the IMF do specifically?

Mr. HORN. I am going to repeat myself in a sense, but I think with respect to the confidentiality clauses, again, the most powerful way would be to strengthen the debt management capacity, the statistical capacity in the debtor countries and make use of the carveouts that these clauses have. These confidentiality clauses are written in a very broad way, but they usually include a carveout that allows the debtor countries to publish the contracts and the terms in case there is a domestic law in place that requires them to do so. I think giving them the capacity to put these laws in place would be the most powerful instrument to create transparency.

Mr. HILL. Thank you, Mr. Chairman, and I yield back.

Chairman HIMES. The gentleman yields back.

The Chair of the Full Committee, the gentlewoman from California, Chairwoman Waters, is recognized for 5 minutes for questions.

Chairwoman WATERS. Thank you so very much, and I am appreciating this discussion. And I am very thankful that our witnesses are here today.

Professor Gelpern, some people have referred to recent sovereign debt restructurings in which countries like Argentina and Ecuador have had the terms of their debt amended by their creditors to be a success. Continuing with this restructuring argument, however, I think touting these restructurings as successful ignores the pain and suffering that any sovereign debt crisis inflicts on a country's citizens, especially the poor.

And let me just say what I think I have learned about some of these agreements that these countries get into. They are desperate. Many of them want to increase their infrastructure. Some of them are trying to increase tourism as an effort to shore up the economy in their countries. And so, while they are desperate and they sign on to these agreements, they don't really anticipate that they are not going to be able to repay the debt, and that has caused harm to their citizens.

So, what do you say about their plight and the restructuring, et cetera, et cetera?

Ms. GELPERN. Chairwoman Waters, thank you for your question. And I agree wholeheartedly, and not just that you can't measure a restructuring's success by its speed; you also have to look at actual human beings' well-being. But also, just the durability of them. Argentina and Ecuador are in distress weeks after they restructure.

And I think reiterating and amplifying some of what my colleagues said, building better capacity and agency in the borrowing countries that do need tremendous infrastructure investment, I think should be an absolute priority. I know transparency can sound like meaningless sort of pablum, but if you have standardized terms that everyone is aware of, if you know when terms deviate from the standard, if there is multilateral capacity building, I think that we are going to be way better off if countries have these domestic laws that my colleague mentioned.

By the way, the carveouts include laws in other countries. If anybody passes a law requiring disclosure, I think that is going to embarrass a whole lot of creditors into at least somewhat less abusive terms.

Chairwoman WATERS. Thank you very much. What can be done to incentivize the borrowing countries to seek some help in dissecting the agreement to see if it is in their best interest and perhaps get some advice before signing off on these agreements?

Ms. GELPERN. I think there is tremendous demand, and this is completely in my different capacity. We have this initiative called the Sovereign Debt Forum, where we have done training sessions with developing country debt managers, and the attendance is very high. I think having standard contracts out there, because everybody who gets a contract put in front of them is told, "Oh, this is perfectly normal." And just like a homeowner who borrows from a bank and on abusive terms, everybody thinks they are going to repay.

And there is genuine humanitarian need, so we can't say we will just stop borrowing.

Chairwoman WATERS. That is right.

Ms. GELPERN. And we need concessional surge capacity and multilaterals. Maybe Mr. Morris can talk some more about that, but there needs to be affordable funding for basic human needs so that countries aren't driven into abusive terms.

Chairwoman WATERS. Thank you very much.

Let me take a moment here to direct a question to Mr. Morris. In the G20's Debt Service Suspension Initiative, which temporarily suspends the debt service payments of poor countries to G20 nations, China did not suspend service payments to the China Development Bank (CDB), asserting that the CDB is a commercial entity, despite the fact that it is under the control of the Communist Party state council. Some of China's contracts that you examined in your report contain false default and acceleration clauses to which one defaulted China loan in a country would trigger a default across-the-board on all China loans in the country. Linking all China investments in a country this way suggests, as a matter of contract, that China is presenting itself as a unitary entity. Mr. Morris, isn't this inconsistent with the Chinese government's propaganda in debt discussions, and not all loans, such as those by the China Development Bank, are centrally controlled?

Mr. MORRIS. Thank you, Chairwoman Waters. I think this is a real challenge, and I think our research provides additional evidence that if we are looking at the China Development Bank, not only is it unambiguously owned by the Chinese government, but it is a policy lever for the Chinese government, and that ought to add to the burden on China to continue—the argument that it is a commercial bank with no policy ties to the government just doesn't hold up. And so, I think the U.S. ought to be pressing aggressively on this point.

And as Anna Gelpern said, in principle, it shouldn't matter if we have an agreement that all creditors have to be on board, but we know in practice that commercial creditors haven't been participating. So, that gives CDB room to sit on the sidelines on these discussions.

Chairwoman WATERS. I want to thank you. My time has long since expired, and as we go on with the hearing, perhaps we can get more involvement in this aspect of it. Thank you very much.

I yield back to the Chair, Mr. Himes. Thank you.

Chairman HIMES. The chairwoman's time has expired.

The gentleman from Texas, Mr. Williams, is recognized for 5 minutes.

Mr. WILLIAMS OF TEXAS. Thank you, Mr. Chairman. And I am glad we're having this hearing today because we need to find a way to properly counter the growing influence of China around the world. However, China's centrally controlled command economy is going to make it impossible for the United States to compete in terms of spending. By some estimates, the Belt and Road Initiative is estimated to have funded over 3,000 projects, with a total value of over $4 trillion, since it began. We should not be looking to try to outmatch China in terms of dollars and cents.

But what I hope we pay attention to is how China is currently taking advantage of the international financial institutions and examine how we can close some of the loopholes that are being exploited. If we can better understand how China is using these institutions to their benefit, we will be able to counter some of their influence without breaking the bank.

So my first question, Dr. Horn, is to you. Can you talk about some of the ways China is taking advantage of international financial institutions?

Mr. HORN. I am not exactly sure what you are referring to.

Mr. WILLIAMS OF TEXAS. How is China taking advantage of international financial institutions?

Mr. HORN. I think that one problematic element that comes back to what Mr. Morris just said is the ability of Chinese lenders, and I think that it is a flaw of the general international architecture to self-select into specific categories depending on the situation and to seek structural advantages. The self-identification of CDB as an official lender when it comes to mapping international capital markets, but then as a commercial creditor when it comes to burden sharing under the DSSI, I think is one example where this sort of discretion is harmful.

Mr. WILLIAMS OF TEXAS. Okay. Thank you.

Mr. MORRIS. I can speak to that.

Mr. WILLIAMS OF TEXAS. COVID-19 has been devastating to every country across the globe, but particularly for less-developed nations. For poorer countries that are in need of financing and desperate need of outside investment, this opened up a great opportunity for China to step in and offer assistance. Even though China knows they might not get all of their money back, they are investing and they realize that they will be able to assert influence over the borrowing country.

So, Dr. Horn, again, can you talk about how China has been exploiting the COVID-19 pandemic to expand their influence across the globe?

Mr. HORN. I think this is not necessarily specific to the COVID pandemic, but I think as a general point, foreign assistance always comes with some form of foreign influence. That is also true in the case of Chinese official lending overseas. My colleagues have already mentioned a variety of examples of how this sort of political influence plays through the contract. I think a key issue here is the writing, the inclusion of fraud acceleration and cancellation clauses that allow you to give a lot of bargaining power to the creditor and allow it to impose influence on certain domestic or foreign political issues. I think these sort of contractual provisions are an issue in that context.

Mr. WILLIAMS OF TEXAS. Okay. We have heard how China is not transparent with disclosing the details of their lending practices and the problems that are created within the international system. This is not surprising, given China's track record of covering up human rights violations, stealing IT, and theft from companies across the world, and silencing descending voices across the government.

Finally, Dr. Horn, with our inability to affect China's behavior in these areas, why do you think that this time will be different as we push for greater transparency in their financial dealings?

Mr. HORN. Again, I share some of the skepticism that has already been voiced, that repeated commitments might not really make a material difference this time. So again, I think that the most powerful way to try to create transparency, if the creditors and buildings are unwilling to do so, is to really enable the debtors to put out the contracts and the debts and their terms into the public space.

Mr. WILLIAMS OF TEXAS. Okay.

Thank you, Mr. Chairman, and what time I have, I yield back.

Chairman HIMES. The gentleman from Texas yields back.

The gentleman from Massachusetts, Mr. Lynch, is recognized for 5 minutes.

Mr. LYNCH. Thank you very much, Mr. Chairman. This is a great topic, and I appreciate your good work on this.

Just before this pandemic, we had an opportunity to travel to quite a few countries in Africa. We went to Mali, Somalia, Ethiopia, and Nigeria. And the onerous terms of some of the lending by the Chinese Communist Party, by the Chinese government was not only egregious in in terms, but in many cases, as a number of the witnesses will point out, those loans were backed by collateral, and in many cases, it was the maritime ports of these countries. So it really controlled the—well, not Mali, but in the other countries, it was really almost a sale of part of their maritime ports, which in the long term really affects the long-term interest and the national security of those individual countries.

We also visited Darwin, Australia, where a private investor with close ties to the Chinese communist government effectuated a 99-year lease, basically a purchase of the Port of Darwin, not very far, about 2 miles from the United States Marines' facility there in northern Australia.

Is there a way that we might adopt within the Common Framework a policy or requirement that that we discourage or deny the opportunity for the Chinese government to actually acquire this infrastructure, especially when it is so essential to the future of these countries? Many of these countries, especially in Africa, are so desperate for capital, for lending, some of them—obviously there is a level of corruption there, but it I would just ask any of the witnesses, are there any opportunities that we might have using the IMF, using some of our international organizations and lending platforms, is there any [inaudible]—a requirement that we disallow or we prevent the acquisition of these major ports by the Chinese communist government? Mr. Atienza?

Mr. ATIENZA. Thank you for the question. I think the way in which we should look at this issue is to try to think about how to turn things around, so if there are capital needs, why is it the Chinese that are providing? Who else can provide and in which terms that will help support? So, that is a way of turning it around. And if they benefit from the lack of transparency and from the lack of rules, why not set a rules-based system?

Even the Paris Club, that we know has clear rules and all members work well with each other, it is just an informal club. My colleagues, Dr. Gelpern and Dr. Lienau, already spoke to the need to have an architecture that is strong enough so that everyone will have to abide. I think moving in these two directions in the provision of finance for the right things and in the right terms and in the provision of a rule set, a strong set of rules including a system for debt management and debt restructuring, would be direct ways to go. That would be my take on this one. Thank you.

Mr. LYNCH. Thank you.

Ms. Gelpern, could you add to that?

Ms. GELPERN. Sure.

Mr. LYNCH. Thank you.

Ms. GELPERN. If I may amplify? First of all, multilateral banks have negative pledge clauses that prohibit debtors from pledging collateral or at least restrict it heavily without going to the banks. They have to be made more uniform and revisited and taken more seriously. And then, the IMF and the World Bank put out a paper before COVID hit on the rise in collateralized debt where the collateral is unrelated to the revenue generated project and discouraging that. I think that we can be a lot more muscular in the institutions, the multilaterals can be a lot more muscular in encouraging collateral only when it is a revenue-generating project that actually has returns in terms of human development.

Ms. LIENAU. Could I jump in on that as well, quickly?

Mr. LYNCH. Ms. Lienau?

Ms. LIENAU. Yes. I would also point out, and I am sure that you realize this in your travels, that these types of terms are very unpopular on the ground once they become well-known. Emphasizing, again, transparency from both the debtor side and also the creditor side, especially because some range of these contracts might have been eased in the—facilitated by side payments, I think this means that we need transparency from both sides so that these types of things become known on the ground by the broader citizenry, and they can object to it at the time.

Mr. LYNCH. Thank you.

Mr. Chairman, I yield back. Thank you for your courtesy.

Chairman HIMES. The gentleman's time has expired.

The gentleman from Ohio, Mr. Davidson, is recognized for 5 minutes.

Mr. DAVIDSON. Thank you, Chairman Himes. And thank you to our witnesses for spending time discussing this important and prevalent issue with us today.

China's economic infiltration across developing countries has grown very worrisome. We have known for some time that the Chinese RMB is prone to manipulation, and this means that we must look to ensure that anything the RMB touches is not undermined by activity from the Chinese Communist Party and the People's Bank of China.

To address these concerns, I am now working on the Chinese Currency Accountability Act. The IMF's special drawing rights are comprised of five of the world's largest currencies, including the RMB. The bill would require that the United States oppose and vote against any increase in the RMB inclusion of the SDR currency basket unless the Treasury Secretary can provide a report to this committee and to the Senate Banking Committee that certifies China is abiding by fair monetary practices. Effectively, this would ensure that there would be no RMB increase in the currency basket unless China adheres to the principles of the Paris Club. I look forward to working with the subcommittee and my colleagues on holding China accountable to the same standards that the rest of the world is abiding by.

A question for Mr. Morris, in your testimony, you state that suggesting that that these borrower countries could selectively default on their legal obligations to Chinese lenders is misguided and would ultimately be damaging to the countries. Could you explain a little more as to why this is a bad idea for those countries to selectively default on debt?

Mr. MORRIS. Thank you, Congressman. I think as much as we do view China as a singular actor and certainly just in the scale of its lending for a lot of these countries it stands out. Nonetheless, it is a creditor among creditors, and I think the challenge for borrowing countries is if you default on a single creditor, whether it is China or any other, it is going to make your life more difficult, more generally as a borrower for all creditors, because you are violating the terms of a contract you made. And maybe, I will leave it at that. I know that Dr. Gelpern can speak to this issue from deep expertise.

Mr. DAVIDSON. Yes. So just to pick up there, and I will open it up, but what kinds of tools could the U.S. use more effectively in our kit bag, and how could developing countries interact with the United States—they have already gotten caught in the snare that China laid for them when they have taken some of these debt instruments. What kind of tools do we have and how could we work with some of these countries?

Mr. MORRIS. Thank you. If I could just emphasize, in my recommendations I started by emphasizing the financing these countries have during this crisis, which is a little bit odd. We are talking about the debt vulnerabilities they face, so it seems odd to be thinking about new financing coming in. But I think we have to find ways to get money into these economies as they grapple with this crisis and that means financing terms that are appropriate to their circumstances.

I think the best way to do that is to give our full support to institutions like the World Bank and the IMF so that they can be stepping up at a time, by the way, that Chinese lending has actually fallen off a lot. For a lot of these countries, on a net basis, they are paying a lot more back to the Chinese than they are receiving in new loans. So, that is all the more a drag on their economies, and I think all the more reason why the lenders that reflect our values and our way of doing things could be stepping up right now.

Mr. DAVIDSON. Yes. So, I will open it up to the panel. There is already a problem within countries that have taken on too much debt. What, short of just pumping U.S. dollars into other countries, frankly, at a time when they are needed in our own, what kinds of tools could we use to work with these countries?

Mr. ATIENZA. If I can speak to that? I would just say that there are some obvious ones. We have lost the chance, in my view, in this 2020 year of providing debt cancellation to countries that were already under strong debt distress. And I think that is a road to go. It is not new cash. Of course, it has some impact, but it is much cheaper than postponing the crisis and putting a new pile of resources on countries.

And second would be, the countries need ODA. They need additional aid, and they need concessional financing. Concessional financing can allow them to cope with repaying back, but with a grace period and with low interest rates, and that can make the matching.

Mr. DAVIDSON. Yes. Thank you, and my time unfortunately has expired.

Chairman HIMES. The gentleman's time has expired.

The gentlewoman from Pennsylvania, Ms. Dean, is recognized for 5 minutes.

Ms. DEAN. Thank you, Chairman Himes, and I also thank the ranking member.

And thank you, Chairwoman Waters.

I do want to say to our expert witnesses, thank you. I hope you will forgive me for moving between this important subcommittee hearing and a markup in the Judiciary Committee. So, don't take my in and out as anything other than trying to do two jobs at once. But I do thank the witnesses.

Professor Gelpern, I wanted to start with you. Could you go into greater depth as to the opaqueness of Chinese foreign lending policies and what concrete steps we can take for greater transparency?

Ms. GELPERN. This is probably something that I should share with Dr. Horn, who has looked at the numbers, and I've looked at the contracts. What the contracts have is inordinately expansive confidentiality terms, and more so in recent years. The really interesting thing to me is that there are carveouts for disclosure required by law. Well, then, let's require disclosure by law. My preference is to start with the borrowing countries, because, as Professor Lienau has said, there needs to be accountability to the people whose work is repaying the debt. But I think that any legal statutory requirement of disclosure would actually take the wind out of a lot of these contractual terms.

And just to flag, and I think this connects to the G7, the French have very similar confidentiality clauses. So, going through the G7 actually is a very good idea because China can always point to AFD and say, hey, we are no different.

Ms. DEAN. Dr. Horton, do you want to add to that?

Mr. HORN. I fully agree with what Professor Gelpern said. Maybe just to add one additional suggestion, I am fully in favor of having a global debt census in which we try to create a global database that has detailed and comprehensive long-level data on sovereign debt, and that, of course, requires information sharing from both the debtors and the creditors. But having that in place, perhaps hosted by an international organization such as the World Bank, I think will help to raise the pressure on those creditors that refuse to disclose.

Ms. DEAN. That is really helpful. Thank you.

Professor Lienau, could you please offer us a little greater detail about the concern you raise in your testimony regarding the corruption in Chinese lending practices in addition to simple bribery? And that seems like a crazy oxymoron, "simple bribery." Are there other criminal aspects that we should be considering when talking about Chinese sovereign debt deals?

Ms. LIENAU. On the specific issues of Chinese lending, I think that some of my fellow witnesses might be able to speak more fully on particular issues. But I think, in general, you are highlighting that corruption is an issue and it can distort the way sovereign lending is done.

In particular, sovereign debt terms is a major problem. Of course, this is not just Chinese entities. This is a broader issue in the international financial architecture. So, I think we need to think about dealing with that problem, and again, embedding our response to Chinese issues in a more broader international approach, because I think that is much more likely to stick. I think that has been one of the themes of this hearing, and I want to emphasize that.

So if you're thinking about this broader approach in which you are enmeshing Chinese lending, I think you need to remember that it takes two to tango, or sometimes more than two to tango, so you really need a multi-pronged approach. First, we want to think about constraining the capacity of corrupt officials in these borrowing countries to hide funds.

And because that's going to limit incentives for the type of corruption that we are thinking about, both straight-up bribery and also the use of sort of side accounts and middlemen and these other types of more hidden mechanisms that are not pay-for-play direct bribery, but are akin to that. So, we want to make sure that any of these types of funds become more easily discoverable, so, strengthening efforts to target tax havens and to discover ultimate beneficial owners of shell corporations would help.

In addition, I think we need to make clear that bad faith creditors can't recover on debt. They should be sure that the debt signing authority actually exists in these countries. And so, this emphasis on clarifying laws and making sure that there are laws in place in the borrower countries for this, I think would help a lot.

And again, I think creditor-side transparency in lending is very important, especially when there are debtor-side corruption concerns. So, I think you really need to think about this as a whole package in which Chinese actions are embedded.

Ms. DEAN. Thank you.

I see my time has expired. Thank you, Mr. Chairman. I yield back.

Chairman HIMES. The gentlelady's time has expired.

The gentleman from Ohio, Mr. Gonzalez, is recognized for 5 minutes.

Mr. GONZALEZ OF OHIO. Thank you, Mr. Chairman, and thank you to our great panel. This is an awesome and very timely discussion, so I do thank the chairman and the ranking member and the witnesses.

I want to start my questions with Dr. Horn. When we talk about, how do we combat this and what sort of counter do we have, I think the instinct is to say, okay, let's look at our multilaterals as a counterweight to what China is doing. And I think that makes sense in some respects. Having said that, I am skeptical that the World Bank and the IMF are equipped to do that, only because my impression, from speaking with former executive directors at the World Bank and folks who are very familiar with the World Bank, is that China in many ways has blocked any attempt at getting the transparency that we want, because of their shareholder rights and their ability to build coalitions inside the World Bank.

And by the way, I say that as somebody who supports the World Bank. I think these multilaterals are necessary, despite their frustrations, so I think we do need to support them. But that being said, Dr. Horn, my first question is, one, do you agree with the perspective that the World Bank has not been as effective as we might hope vis-a-vis transparency because of China's influence? And then, if yes, should we be looking to create an alternative either through the D10 or the G7 or some sort of alternative financing mechanism that can push back on this stuff?

Mr. HORN. I am not familiar with the internal discussions within the World Bank on debt transparency and what has slowed the progress. My personal observation is that there has been progress over the course of the last couple of months. One specific example is the publication of creditor compositions of the international public debt data, which I think is the first time that an official institution has really put quantities out there and has tried to sort of publish the actual debt stocks that I think these countries owe to China. So, I think that that has been a significant step forward.

I also share your initial statement that these multilateral institutions will need to play a very important role in making offers to these countries that lessen their dependence on China when it comes to spending for infrastructure and energy. I think one more general point that I would like to make is that part of the attractiveness of Chinese lending for these countries over the course of the past years and the past decades has really been the lack of alternatives when it comes to financing large-scale projects in high-risk countries. And I think to do that and to offer these countries alternatives, the multilateral institutions will need to play a key role.

Mr. GONZALEZ OF OHIO. Thank you.

Professor Gelpern, do you have any thoughts on that? Is your perspective that China has not—or I guess, what would you say to the initial claim that the World Bank and the IMF have largely been blocked due to Chinese influence from demanding the type of transparency that we would need?

Ms. GELPERN. I wouldn't say, "blocked." I would say, "occasionally gummed up." And it is a meaningful distinction in my mind.

I do want to refocus attention on something Mr. Morris said, which is that Chinese lending is going down, their net repayments. And the really interesting question now is what is going to replace that? Right at the time when countries accumulated unprecedented amounts of debt in 2020, we haven't had defaults. Why? Because countries that maybe shouldn't have borrowed, borrowed up a storm.

And so, we are facing a delicate moment right now, and I do think that is where multilaterals can come in. IDA can borrow. IDA is enormously conservative. They can borrow and that would diminish any given shareholders' influence in some sense.

Mr. GONZALEZ OF OHIO. Yes.

Ms. LIENAU. May I speak to something that you said, Representative Gonzales? You began by expressing concern about the possible politicization of the World Bank, and I agree with Professor Gelpern that, "gumming up" is more accurate than "blocked." I would emphasize that I think the U.S. needs to maintain its voice in these institutions rather than withdrawing, because I think withdrawing from these institutions is not the way to go. I also do think that given the changing balance of power over time, the U.S. should consider support for an independent expert institution, because experts from every country basically agree on what is needed. And so, if we want to be supporting that, then an independent institution, even a consultative one, is not a bad idea.

Mr. GONZALEZ OF OHIO. Thank you. I am not as sanguine about the world. I agree we absolutely need to be at the table and we need to be leading at the World Bank to the extent that we can. But absent that, I do hope we consider alternatives.

But with that, I yield back. Thank you.

Chairman HIMES. The gentleman's time has expired.

The gentleman from New York, Mr. Torres, is recognized for 5 minutes.

Mr. TORRES. Thank you.

I guess my first question is about the G20 Common Framework. My understanding is that China agreed to participate in the G20's Common Framework. How does one reconcile China's participation in the Common Framework with China's insistence on no Paris-Club clause? Professor Gelpern?

Ms. GELPERN. I think that also, Mr. Morris may have more economy color to add, but look, the clauses all predated last November. Some of them very recently predated. Yes, we have some contracts of 2020 that have these clauses, but we don't have anything since the Common Framework. It is embarrassing. They need to get up and say—they and we—need to get up and say, now that there is the Common Framework, nobody is going to ask for this and nobody is going to enforce what is there now. Otherwise, it is just—why would you sign up for something just to be publicly embarrassed? I am being simplistic here.

Mr. TORRES. Your organization did a data report, if I understand correctly, and what is China's endgame? Is China seeking repayment or is debt a means to an end? I am thinking of the case of Sri Lanka, which could not repay the debt. And instead of repaying the debt, Sri Lanka ceded control of a port to China or an entity of China. And I am wondering, is it more important to China to be repaid or is it more important to leverage debt financing as well as integrated project delivery to secure control of other countries strategic assets? What is the end game here?

Mr. MORRIS. Congressman, I think I will come in on that question. I think our interpretation, as authors of this study, is that we view these features as very aggressive measures to get repaid, that basically—and there are different interpretations. But I think ours would be that particularly lending in the high-risk debt environments, measures like these cash accounts, and other kinds of offshore accounts, are features that the lender is using to protect itself.

But that is one interpretation and it can exist alongside other interpretations about broader strategic goals that the Chinese government might have, which is why the other features that we point to, these very broadly written provisions that implicate policy issues in the two countries. There's a lot of room for maneuverability there on the part of the Chinese government. And it is interesting that they would write those features into the contracts.

I think it does speak to legitimate concerns we can have from a U.S. perspective about the degree of leverage that the government might have in these situations. And they don't need to be blending countries into default deliberately in order to find sort of avenues for strategic influence in these countries.

Mr. TORRES. This might be a challenging question to answer, but China has an ever-expanding web of debt contracts with collateral clauses and confidentiality clauses, and all of these contracts contribute toward a lack of debt transparency. And it seems to me that these loans are structured to undermine multilateral institutions and the debt restructuring initiatives of those institutions. How close are we are to reaching the point of no return, where these contracts are just so widespread that it will derail the debt restructuring initiatives of multilateral institutions like G20 and others?

Ms. GELPERN. Contracts are not the ten commandments. And at a certain point, they backfire. If you have a really brittle contract all that happens is your debtor defaults, and then what? I think we need to leverage the self-interest here. Now, Congressman, you are exactly right. Sovereigns are—

Mr. TORRES. But if you are a low-income country, the cost of defaulting and alienating a country as powerful China can be quite high, so—

Ms. GELPERN. You are right, but—

Mr. TORRES. —you can lose access to markets and—

Ms. GELPERN. But today, we have very diverse lenders and lots of them. So in some ways, putting creditors against one another can play against us or in favor of a more constructive financing model, and I think really it is about turning the ship around rather than a point of no return. I don't think we are there.

Mr. TORRES. Thank you.

Chairman HIMES. The gentleman's time has expired.

The gentleman from Texas, Mr. Taylor, is recognized for 5 minutes. Did we lose Mr. Taylor?

Okay, hearing nothing from Mr. Taylor, the gentleman from Illinois, Mr. Garcia, is now recognized for 5 minutes.

Mr. GARCIA OF ILLINOIS. Thank you, Mr. Chairman, and Ranking Member Hill, for convening this very important hearing.

And of course, thank you to all of the witnesses who came to shed light on this complicated topic. I know it is easy to get abstract when we talk about the impact of global debt, but my constituents know we are talking about people's lives too. I am from Chicago and when our interest rates go up in Chicago, in Cook County, we worry about pension cuts.

I have a large Puerto Rican community in my district. Their loved ones are trying to rebuild the island while needed investments are going to bond holders on Wall Street. So if countries around the world have to cut their budgets to make that payment, whether it is to China or Wall Street, I worry that it will be impossible for us to recover from this pandemic.

Mr. Atienza, your testimony painted an alarming picture of the global economy during COVID-19, but many of the existing debt relief programs are only focused on small or very low-income countries. Are larger economies like Mexico or Nigeria also likely to run into debt issues due to COVID-19, and does that jeopardize recovery for all of us?

Mr. ATIENZA. Thank you for your question, Representative Garcia. Definitely, there are middle-income countries that are in debt trouble. I wouldn't mention Mexico in that stance at this point, but definitely Nigeria is part of this initiative; it is a large economy with deep troubles. And what we are seeing is that problems with debt are quite widespread, but we are finding or ways are being found of providing new liquidity that hides, to some extent, the depth of this crisis and postpones it.

Our take is that we are going to need to set new mechanisms to protect countries from the worst in these debt storm—are going to need that cancellation. It is a bit of a lost opportunity that nothing else was done under DSSI, just postponing with the crisis going deeper payments to 2022–2026 is not good enough, and we need to include mechanisms that allow for debt cancellation for middle-income countries that are under severe debt stress, and there are plenty of those.

And definitely protecting and setting provisions to protect the citizens in countries in these situations is going to be an important step forward. And I want to add that you need civil society oversight, and you need the eyes and the testimony of ordinary people to speak to the impacts of this debt crisis and to the reality that this COVID crisis is not going to get better yet, because the uncertainties and the slow path of vaccination in developing countries is not allowing for that. So, all of our provisions and all of the numbers that we are reading are too optimistic, currently. We need to be ready for things getting worse and for action coming forward urgently.

Mr. GARCIA OF ILLINOIS. Thank you for that.

Professor Lienau, in your testimony you mentioned the importance of a fair, transparent restructuring process. We see in Puerto Rico how difficult restructuring can be and how important it is to get the process right. Can you talk about international efforts underway to create a fair restructuring mechanism for sovereign debt, and what Congress can do to support them?

Ms. LIENAU. Yes. Thank you for the question. There are important mechanisms or processes underway to try to improve debt restructuring. I think the current discussion, the move toward the Common Framework, including a broader range of countries and creditors, is very important. I think that, in addition though, we need to take broader steps, because I believe that this is just an initial step, and we need to take additional steps on both the sort of transparency side and on the actual fair restructuring side.

We need to think more broadly about including not just public creditors but also private creditors, as you pointed out, because different countries and different entities like Puerto Rico are differently exposed to public as opposed to private approaches. I think comparability of treatment in the Common Framework is one way to try to encourage the collaboration and coordination that is so essential, but it is not going to be sufficient. Because, as you point out, a very small range of countries are covered, and also because it is very difficult to encourage private creditors, in addition to public creditors, to participate in that.

We need to think a little bit more broadly both in terms of improving contract mechanisms to make sure that they are not just within a certain type of contract like bonds, but also include a broader range. We need to think about domestic legislation including legislation that, I believe, is under consideration in New York. And we just think we need to think more seriously about international mechanisms, even beyond the ones that are under consideration right now. I think it takes a multi-track approach.

Mr. GARCIA OF ILLINOIS. Thank you so much.

Mr. Chairman, I yield back.

Chairman HIMES. The gentleman's time has expired.

The gentleman from Massachusetts, Mr. Auchincloss, is recognized for 5 minutes.

Mr. AUCHINCLOSS. Thank you, Chairman Himes, for convening this hearing today. I found this really, really edifying.

I want to focus on China's practices as they relate to the Association of Southeast Asian Nations and the effect on geostrategy in the South China Sea. After World War II, the most important alliances and stabilization for the Pacific were the United States' relationships with Japan, with South Korea, with implicit security guarantees for Taiwan, our relationship with Australia, and now, the Association of Southeast Asian Nations. The Asian states are some of the fastest growing economies in the world. Their political heft is growing, and they have become the next battleground to be won in terms of influence in the in the Indo-Pacific. Partly because of the United States' failure to join in the trans-Pacific partnership, we left a vacuum in Asia, and China has filled that with more than $100 billion worth of infrastructure loans and investments.

I will leave this question open for any of our witnesses who wish to answer it. Can you explain how China has been using cancellation acceleration stabilization contracts to influence the foreign policy of the Asian states in regards to its aggressive actions in the South China Sea, and what the United States might be able to do in working with Asian debtors to push back on these aggressive actions in the South China Sea?

Mr. MORRIS. Congressman, maybe I will come in on this. I guess, I would say two things. One, is just to observe, entirely separate from these loan contracts, we do have to appreciate the nature of influence that comes with the scale of lending that you just described. This volume of financing just inherently creates significant leverage when it is between two governments, as it is in many of these cases. And as you said, while we are looking at China lending globally, there is no question that there is a particular concentration in southeast Asia and it is inextricably linked with a broader range of objectives on the part of the Chinese government that isn't strictly commercial or economic.

With all of that in mind, it is particularly striking then to be able to look at these debt contracts and see that on top of all that, the Chinese lenders, government-owned lenders, have taken that step of making explicit this kind of leverage that basically, by writing pretty aggressive, broad terms to enable cancel cancellation-acceleration in ways that we can read into a lot of different kinds of behavior to be honest, speculative on our part because it is hard to observe in practice what this looks like. It is not transparent. But it is striking that these are written into the contracts.

Mr. AUCHINCLOSS. And, Mr. Morris, are we seeing already evidence that the Asian states, as a coordinating body, are not particularly muscular yet in the Indo-Pacific affairs? Are we seeing evidence that they are being muted in their response to Chinese actions in the South China Sea because of the investments in the loans they are getting from China?

Mr. MORRIS. Maybe I will avoid speaking directly to that, but more broadly, I would say that I am actually struck by how there is an opportunity here for the United States. The degree to which there is political blowback in the region, certainly to China's lending behavior. There is a desire to diversify sources of financing, and I think, as we heard from the other witnesses, that at the citizen level there is discomfort and resistance to their own governments as they have taken on these commitments that feel like there are strings attached and broader implications. So, I think there is an opportunity for us.

Mr. AUCHINCLOSS. How can the United States use the potential for re-entry into the Trans-Pacific Partnership or some updated version of that to provide a counterbalance in Asian states?

Mr. MORRIS. I do think the trade agenda is an important instrument. One thing I would say though is that if you look back historically, the U.S. has emphasized trade agreements as sort of a leading instrument of our foreign policy. That has fallen off a lot in recent years, obviously. What we have not emphasized that the Chinese have is financing, direct investment lending, equity stakes. And I think we have to grapple with that as part of our toolkit.

Mr. AUCHINCLOSS. I yield back, Mr. Chairman.

Chairman HIMES. The gentleman from Massachusetts' time has expired.

The gentleman from California, Mr. Sherman, is recognized for 5 minutes

Mr. SHERMAN. Thank you, and Mr. Chairman, thank you for letting me participate in this subcommittee. I was Chair of the Asia Subcommittee back on May 8, 2019, when we had hearings focused on very much on the same subject. I want to observe that China providing capital to poor countries to help them develop is often a good thing. These loans are risky for China, and the most important loans, the most important financing in the world is when lenders aren't willing to take a risk. But we need to be concerned about three areas. One is when the loan is unfair, particularly when it is a trap designed, as it may have been in Sri Lanka, to make the loan not with the idea that it would ever be repaid, but as a way to seize the underlying security.

The second issue that arises is aid, or concessionary loans, or financing a foreign policy bribe encouragement, and we do that too. We give aid and concessionary loans to countries hoping that they will support American foreign policy. And if we're going to compete with China around the world, I would much rather the competition be who can do the most to help poor countries and to compete for their votes at the U.N. or diplomatic support than it be a competition as to who can build the most aircraft carriers.

A third issue that arises is the confidentiality. And that particularly concerns me because if I gather what our witnesses are testifying, China insists that the borrower not disclose the debt, which makes it impossible then for the borrower to be honest with its citizens and to be honest with other lenders. Do I have this right, that countries agree or even companies agree not to disclose their debts to China or Chinese entities to their citizens or to others they may be seeking credit from?

Ms. GELPERN. Congressman, the answer is yes, but—

Mr. SHERMAN. Isn't that fundamentally illegal? If you then go to another lender and you say, here is a list of all of my debts, do you then put a little note at the bottom and say, except for the ones to China, which I am not disclosing to you? And fraud doesn't count. "I promised China that I would defraud the next lender, so the fraud is good fraud because I did it at Beijing's request."

Ms. GELPERN. Sir—

Mr. SHERMAN. But, no, what is the good fraud here?

Ms. GELPERN. There is no good fraud. I think there is broad-based agreement on that. I think the only thing, the only qualification to all of this is that we have the agreements either because— we have 100 that are 5 percent or however much—either because they are legal requirements or because somebody leaked. These are all from public sources. What we need is an international—

Mr. SHERMAN. If I can interrupt for a second, the response of America should be, please, if you enter into an unfair contract with China, or a contract where you are required to conceal it from other debtors, including us, then please don't repay. And in order to encourage you not to repay, we will instruct all of the lending agencies under our control not to count it against your credit.

Many countries will repay China because they want to maintain a good relationship with China. But at some point, the debt to China will be so enormous that the opportunity to just stiff them completely and not have it count against their credit rating anywhere else will be very inviting, or the opportunity to use that opportunity to negotiate with China will be helpful.

When we evaluate a country's credit and count defaults to China, we are acting, in effect, as China's debt collector [inaudible].

Ms. GELPERN. The trouble is that we don't have that leverage. We are not in a position to tell private creditors not to call a default or rating agencies to downgrade.

Mr. SHERMAN. You don't know the power of our committee. We do have control of the agencies.

I yield back.

Ms. GELPERN. Well—

Chairman HIMES. Ms. Gelpern, I will give you a few seconds to respond, as you were starting a sentence there.

Mr. SHERMAN. Thank you.

Ms. GELPERN. Well, just that the victims are going to be the countries. That is my concern. That if we had all of the control and all of the money, and if we could replace all of the liquidity, I suppose we could consider that. But we are—Paris Club creditors are 5 percent, including us, of a lot of these countries' debt. So, who are we talking to? Who is the audience?

Chairman HIMES. Okay. The gentleman's time has expired.

Thank you, Ms. Gelpern.

The Chair does not see any more Members seeking time. Going once, going—

Mr. SHERMAN. If I could seek 30 seconds?

Chairman HIMES. Mr. Sherman, you are recognized for 30 seconds.

Mr. SHERMAN. I just want to respond. What I am suggesting would just be an option for a country to use. And if they thought it wasn't in their interest, they wouldn't use it. And I will yield back.

Chairman HIMES. The gentleman yields back.

Seeing no additional Members, I would like to extend a hearty thanks to all of the witnesses for a fascinating conversation and a lot to follow up on today.

The Chair notes that some Members may have additional questions for this panel, which they may wish to submit in writing. Without objection, the hearing record will remain open for 5 legislative days for Members to submit written questions to these witnesses and to place their responses in the record. Also, without objection, Members will have 5 legislative days to submit extraneous materials to the Chair for inclusion in the record.

With that, I thank our witnesses once again, and this hearing is adjourned.

[Whereupon, at 11:46 a.m., the hearing was adjourned.]

A P P E N D I X

May 18, 2021

Testimony of Jaime Atienza

Debt policy lead, Oxfam

Before the House Committee on Financial Services

Subcommittee on National Security, International Development, and Monetary Policy

Hearing on
"Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture"

10:00 a.m., Tuesday, May 18, 2021

My name is Jaime Atienza, and I come to this Committee as the global debt policy lead of the Oxfam Confederation. Oxfam is a non-profit composed of 20 national level organizations that works to fight inequality and poverty through humanitarian and development actions, as well as research, knowledge and policy work. It is an honor to testify in front of this Committee and alongside globally recognized experts.

Debt Situation Prior to the Pandemic

The timing of this session is critical, as we have seen the debt situation, especially of the poorest countries, worsen significantly in recent years. In February 2020, the IMF stated[1] that over half of low income countries in Africa were either in debt distress or at high risk of being so. The region was in serious trouble with debt repayments growing and eating up social investments from the countries´ budgets.

The human impact of a debt crisis is often overlooked. Higher spending on debt means lower spending on public services—which means fewer teachers, health workers, and hospital beds for hundreds of millions of citizens in need. It also means further entrenching the cycle of poverty for many, the impacts of which fall particularly hard on women, as unpaid care work often must fill the gaps.

According to a report by JDC and Action Aid International published in April of 2020, debt service as a share of Government revenues grew by 85% between 2010 and 2018, from 6.6% to 12.2% of such revenues.[2] They examined 60 low and middle income countries that exceeded the mid-point of what the IMF would call a 'moderate' debt risk (countries that spend more than 13% of their revenue on debt servicing). 21 countries were already spending over 20% of their government revenue on debt service in 2019; with Angola and Ghana both spending over 55%. In the 30 countries (half the total) with the highest debt

[1] International Monetary Fund, "The Evolution of Public Debt Vulnerabilities In Lower Income Economies," February 10, 2020, https://www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/05/The-Evolution-of-Public-Debt-Vulnerabilities-In-Lower-Income-Economies-49018.
[2] Actionaid, "Who Cares for the Future: Finance Gender REsponsive Public Services!", April 2020, https://actionaid.org/sites/default/files/publications/Who%20Cares%20for%20the%20future%20Summary.pdf

payments (over 13% of government revenue) — real public spending per person (taking inflation into account) fell by 6% between 2015 and 2018. In the 30 countries with debt payments under 13% of government revenue, public spending per person grew by 14%.

Kenya's debt servicing costs skyrocketed between 2015 and 2019, after a steep growth in both Chinese and private debt, while its government spending fell by nearly four percentage points of GDP, and both trends are expected to continue.[3] Congo-Brazzaville's debt servicing rose even faster than Kenya's between 2015 and 2019 and its spending plummeted by 32 percentage points in the same period. Sudan, that is now awaiting to benefit from late HIPC debt relief, has the highest debt servicing to government revenues of all countries surveyed, with a projection that it would hit 165.78% in 2022, unless action led by France allows for a heavy debt restructuring. Its government spending levels, already by far the lowest of any country surveyed at 7.39% in 2019, could fall to 3.89% in 2022.

Despite having market access and a relatively stable and growing economy, Ghana is also undergoing very serious challenges.[4] With a population of 29 million, Ghana spent in 2019 almost four times more on servicing its external debt than it is on public healthcare for its people: 39.1% of its government revenue is spent on debt servicing, 10.8% is spent on healthcare. The Central African Republic had 3 ventilators in a country of almost 5 million people, yet it was due to spend $25 million on external debt payments in 2020 (10% of the government revenue, according to the IMF's Debt Sustainability Analysis).[5]

Impacts of COVID-19

The impact of COVID-19 in Africa has been profound –with a ten years setback in poverty, a steep rise in hunger according to the World Food Program, and desperation leading to more migration.[6] The financial stress for the region is falling on the backs of ordinary people, especially women, as well as on businesses, and it is weakening the capacity of Governments to provide support to people and companies.

The pandemic made the debt situation in many countries even worse, with African countries losing over 3% of GDP, and Small Island States experiencing decreases of over 13% of their GDP on average—levels that approach war time numbers.[7]

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[3] Id.

[4] Oxfam, "G20 must cancel debt to stop coronavirus "third wave" devastating developing countries", April 2020, https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/2020-04/Debt%20media%20briefing%20ahead%20of%20G20.pdf.

[5] Oxfam, "G20 must cancel debt to stop coronavirus "third wave" devastating developing countries", April 2020, https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/2020-04/Debt%20media%20briefing%20ahead%20of%20G20.pdf.

[6] United Nations, "UN report finds COVID-19 is reversing decades of progress on poverty, healthcare and education," July 2020, https://www.un.org/development/desa/en/news/sustainable/sustainable-development-goals-report-2020.html

[7] International Monetary Fund, "World Economic Outlook, October 2020: A Long and Difficult Ascent," https://www.imf.org/en/Publications/WEO/Issues/2020/09/30/world-economic-outlook-october-2020

The impact in Latin America has been even more profound than that in Africa, with a 7% drop in GDP, and with Caribbean and weak Central American countries suffering the worse consequences as a result of the combined effect of climate related events (with a terrible 2020 hurricane season) and tourism restrictions, when they are highly dependent on that sector.[8]

COVID-19 has also resulted in a heavy impact on countries´ revenues. Low income countries experienced losses over 20% in revenue collection, as well as a steep drop in Foreign Direct Investment and remittances. At the same time, the investment and the resources needed to protect families and millions of people have grown. A perfect storm had been set, with hundreds of millions of jobs being lost, trade routes interrupted and an uncertain calendar for recovery.

Meanwhile, the World Bank reported that extreme and relative poverty numbers would grow in the hundreds of millions, with women and girls especially affected. In addition, progress toward vaccinating the populations is slow in most developing countries, and new uncertainties are everywhere for developing countries´ recovery. The move towards an IP waiver of COVID vaccines and treatments should *be followed by actions* that promote broader production capacity and help change this dramatic trend, but more is needed.

Before the pandemic hit, there was already a shortage of 17.4 million health workers worldwide, mostly in low- and lower-middle income countries, according to the WHO. Oxfam analysis has shown that debt cancellation for a full year could provide three years' worth of salaries for: (a) The 14,000 extra nurses needed in Malawi, currently with only a quarter of the nurses it requires, (b) The 24,500 extra doctors needed in Ghana, currently with less than one fifth of the doctors it require, and (c) The 47,468 extra nurses needed in the DRC, currently with less than half the number of nurses it requires.[9]

In large part because of their debt burdens, poor countries are unable to redeploy their resources to the most urgent needs, or are having to cut their own public spending. In advanced economies such as the United States, the use of expansive monetary policies or large debt purchasing programs allowed a wide range of policy actions to cope with the crisis, protect those worse off, and prepare for the future stage of recovery. On the contrary, in the poorest countries the situation is dire and options are very scarce. For that reason, very soon into the COVID-19 crisis, providing debt relief and allowing developing countries flexibility in their debt repayments was considered a critically important way to increase liquidity and response capacity.

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[8] Id.

[9] Oxfam, "G20 must cancel debt to stop coronavirus 'third wave' devastating developing countries," April 2020, https://oi-files-d8-prod.s3.eu-west-2.amazonaws.com/s3fs-public/2020-04/Debt%20media%20briefing%20ahead%20of%20G20.pdf

Multilateral Efforts to Address the Looming Crisis

In April 2020, just one month after the WHO declared the pandemic, a global initiative called the DSSI (Debt Suspension Initiative) was launched by the G20 with strong endorsement from the IMF. It allowed for 73 countries to receive, upon request, a temporary suspension of their bilateral debt repayments. But the DSSI left to voluntary mechanisms any debt relief from private creditors –which has not materialized—and simply invited IFIs to find ways of contributing more, which remain to be seen for the World Bank (which is not providing any debt relief, rather more loans). Most Sub-Saharan African countries were included under the initiative, as well as some Small island States included in the IDA-only list.

Only 46 out of the 73 eligible countries requested the debt suspension for several reasons. The assessment of the World Bank in its April 2021 debt report is spot on: it states that, of the 27 countries that did not request debt suspension, "some fear participation may convey the wrong signal to bondholders and other private creditors while others note the amount of eligible bilateral debt service is negligible, and savings do not justify the administrative expenses incurred by deferral. Because the DSSI only defers payment to a later date, some policymakers worry longer term debt sustainability may be sacrificed for short-term financial flexibility".[10]

The fact is that up to the end 2020, only $5.7bn of debt repayments were suspended for 46 countries. That just 10% of all the debt repayments owed by the group of 73 countries. Meanwhile, over $30bn were still being repaid by that same group of countries to global institutions, private banks and investment funds, emptying their coffers, limiting their response capacity to the crisis, and putting additional pressure on the lives of millions of citizens and on the public accounts and reserves of developing countries. The moratorium was extremely weak and limited and did not allow for enough breathing or fiscal space for the poorest nations to face the crisis, as was its supposed intention.

On a more positive note, we must recognize that for the first time in history we are seeing a coordinating effort of all major economies to deal with a debt crisis: from advanced Western economies, to emerging economies with China, Saudi Arabia or India as part of the G20 Common Framework for debt restructuring, agreed and launched in November 2020. However, the Common Framework's effectiveness is yet to be tested, and the kind of debt relief it will deliver is unclear. It excludes Middle Income Countries with debt problems, and the prospects for the "comparability of treatment clause" to deliver debt relief by private creditors remains uncertain at its best.

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[10] World Bank, "Debt Report 2021," https://pubdocs.worldbank.org/en/247471617652072581/Debt-Report-2021-Edition-II.pdf.

The evolution of new debt and debt repayments in 2020 is an essential piece to get right. We have seen that for the most part, financial markets have continued to finance low and middle income countries through new debt issuances. Those issuances have grown in Latin America and the Caribbean during 2020, increasing by 9%.[11] Meanwhile, for Sub Saharan Africa, private finance has almost frozen after the declaration of the pandemic, with a 70% reduction as compared to 2019. With debt relief being very limited, and new resources from private creditors decreasing, the need for multilateral funding has grown. The need for additional ODA is also worth noting, as for countries most in need it should pay directly for the social investments to protect the most vulnerable.

A more concerning trend is exposed in a recent report by Eurodad that shows how most regions entered in 2020 in what is known as "net negative transfers" – paying back more than they are receiving in their debt balance.[12] Only Sub Saharan Africa is still on positive terms, but those have reduced dramatically.

Comparing Previous Debt Crises

There are two main reasons that this debt crisis cycle is different from the previous that was resolved through the HIPC initiative.

The first one is that China is now the most important bilateral lender to developing countries, and specifically to African countries. China is the #1 lender and #1 bilateral creditor, dwarfing the Paris Club as a whole. After the previous debt ended with HIPC implementation, the U.S. and most Western lenders retreated from large lending operations, shifting their international support to developing countries to grant form (a trend that is now again shifting), so their exposure has progressively been decreasing. As a result, the fact is today that there is no option of reaching any successful agreement on bilateral debt relief treatments without China leading part of it. While China can be seen as part of the problem, it needs to be part of any possible solution. Thus the relevance of the new "common framework".

A second element equally relevant as the first is the size and role of private lending through sovereign bond issuances in African economies. These operations grew to unprecedented levels in a region that had traditionally been excluded from market attention and financing, except that associated to extractive projects.

While for Africa, China is the largest bilateral creditor by far, Eurobonds (a majority of which have been issued in U.S. dollars and under UK legislation) absorb the largest amount of

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[11] World Bank, "Debt Report 2021," https://pubdocs.worldbank.org/en/247471617652072581/Debt-Report-2021-Edition-II.pdf.

[12] Eurodad, "A debt pandemic: Dynamics and implications of the debt crisis of 2020," https://www.eurodad.org/2020_debt_crisis

short and middle term repayments for Low Income Economies with market access, like Ghana, Kenya, Senegal or Côte D´Ivoire.

It is critical to understand that if we look at the debt tensions from the perspective of developing countries, and specifically, African countries, they need solutions that bring both China and the private creditors and bond holders on board. In that sense, the focus only on bilateral debt of the DSSI needs to be considered an outdated approach. Without relief from private creditors, countries with such debt exposure are merely postponing a debt sustainability crisis. New financing in grant or concessional terms, alongside debt relief, including explicit haircuts and debt cancellation are needed to find a real solution.

Several drivers of this new cycle must be taken into account to understand both the constraints and responsibilities of all actors involved, from sovereign states, to creditors or international institutions. The new bond issuances opened up new financing opportunities, but had a very high financial cost, on average 7% and as high as 10.75% interest rates.[13] In an economic rationale, if the interest rates are higher than your rate of growth you are running towards unsustainable debt no matter what use you are making of those resources. If you factor in that these debts are incurred in hard currencies, namely U.S. dollars, then currency devaluation makes those financial costs even heavier.

A closer analysis shows the inverse relation between Domestic Revenue Mobilization and tax collection increases and the use of debt. Throughout the decade of 2010, tax collection has remained stable under the 18% of GDP threshold for Africa (35% is the average for OECD countries), and in the meantime, an annual 10% increase in debt intake has happened. What does this tell us? That when increasing tax collection is a very difficult task, and there is an international environment that enables tax dodging, governments will seek easier ways to fund their needs or what they consider to be relevant for the near future. So debt has been used in many cases as a substitute for taxes, that were falling short to cover the needs of economic progress in developing economies.

The focus on large infrastructure projects has been an important ingredient of the debt crisis that was already unfolding before COVID-19, with all actors involved contributing to feed that trend –China as well as different multilaterals and to a lesser extent, other government agencies and development finance institutions (DFIs).

It is worth mentioning the important role the IMF has played in response to the pandemic. The overall narrative has shifted from the direct call for austerity after the 2008-2009 crisis, to an explicit call for public spending and investment to protect billions of people in the planet from the spillover effects of voluntarily freezing the economy. This has been very important, as has been the tide of emergency funding, that came forward at a very fast

[13] ODI, "Private lending and debt risks of low-income developing countries," June 2020, https://cdn.odi.org/media/documents/200615_private_lending_debt_risks.pdf

speed and with no actual conditionalities. The IMF collected resources from its membership to enable the CCRT to cover the debt repayments of 2020 and 2021 of 29 Low Income Countries—something the World Bank hasn´t done. However, Oxfam has analyzed most of the post-COVID lending programs by the IMF, and found that 84 percent encourage or require austerity measures.[14]

Recommendations

The situation for developing countries, and specifically for low and low-middle income African economies and Small Island States, in particular those in the Caribbean, is very urgent.

Some avenues to tackle the economic and social impacts of debt troubles for low and middle income countries:

- Scale up collaborative efforts under the G20 "common framework" umbrella, including China and the US, private bond holders and banks, in support of developing countries suffering the impact of the COVID19 crisis. Ensure debtors have equal voice and strength in seeking solutions that protect human rights and the SDGs.
- Move from the modest debt relief brought in by the DSSI moves to a next level, allowing for debt cancellation options under the Common Framework for all DSSI countries and Middle-income countries facing severe vulnerabilities.
- Establish a clear path for private creditors´ participation in debt relief operations under or beyond the common framework.
- Seek ways of providing legal protection to debtor countries from the potential risks of debt holdouts under the current crisis.
- Advance towards stable debt restructuring mechanisms that involve all parties, including debtor countries and civil society, to allow for fast and fair sovereign debt resolution.
- Accelerating new grant and concessional financing to the most vulnerable countries, steadily increasing ODA.
- Contribute to enhanced transparency standards and trust inside the G20 among all public and private creditors and sovereign debtors, with clear reporting and disclosure rules that apply to all parts, in collaboration with international bodies such as the OECD and the oversight of civil society actors.
- Agree to sustainable borrowing and lending standards to be applied to new operations, and prioritize economic recovery and protection of people and companies over other macroeconomic considerations.

[14] Oxfam, "IMF paves way for new era of austerity post-COVID-19," October 2020, https://www.oxfam.org/en/press-releases/imf-paves-way-new-era-austerity-post-covid-19.

Testimony of

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before the

House Committee on Financial Services

Subcommittee on National Security, International Development and Monetary Policy

Hearing on

"Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture"

10:00 am Tuesday, May 18, 2021

Thank you, Chairman Himes and Ranking Member Hill, for the opportunity to testify today. It is a privilege to be before this committee and to be on this distinguished panel.

The COVID-19 shock to the international financial system is a preview, a warning, and an opportunity. The pandemic has defied public health and economic predictions at every turn. Infections and deaths are still surging in parts of the world, including countries with high vaccination rates and those with domestic vaccine manufacturing capacity. Debt distress indicators were already flashing red in 2019, and debt stocks shot up faster and more broadly in 2020 than in any other year in modern history—but so far, we have not seen a 1980s-style sovereign debt crisis almost everyone expected a year ago.

Even without a wave of defaults, the pandemic has revealed a patchwork of 20th century institutions ill-prepared to handle 21st century global public health, climate, and financial shocks. On the bright side, enough people seem to have gotten the message. There is an opening for meaningful institutional reform, a shift in international debt architecture – not just sprucing up the upholstery. I hope we can take advantage of it.

In retrospect, the debt architecture debates of twenty years ago look quaint. The big worry was that bondholders would be harder to coordinate in a sovereign debt crisis than regulated commercial bank creditors. A battle unfolded between contract and bankruptcy solutions to coordination problems; contracts won, and most new sovereign bonds how have so-called collective action clauses (a good thing). From today's vantage point, so much of the battle was over a tiny sliver of process ground: how to implement majority voting among foreign private creditors to developing countries. Substantive architectural elements—the central role of the IMF in setting financing and adjustment needs, the function of the Paris Club of official bilateral creditors, and the preferred status of multilateral lenders—were broadly settled in the aftermath of the 1980s debt crisis, although they would continue to adapt at the margins. The HIPC and MDRI initiatives for low-income countries, familiar to this committee, were conceived as one-off events within the prevailing institutional regime, not as regime change.

Today's sovereign debt challenge is rather more complex than "banks vs. bonds." Consider Chad, the first country to see a creditor committee assemble under the new G-20 Common Framework.[1] It owes slightly more than a third of its external debt to the mining firm Glencore, and slightly less than a third to established multilaterals (IMF, the World Bank Group, the African Development Bank, and the International Fund for Agricultural Development). Its biggest bilateral creditors are China and Libya, followed by France, Angola, and India. Chad's other big creditors include regional and Islamic development institutions. While Chad has no foreign bonds, Zambia (also an early Common Framework applicant) owes comparable amounts to private foreign bondholders and Chinese state-owned banks. When Zambia tried to negotiate a payment suspension with its bondholders as part of DSSI, they demanded more information on China's concessions. Zambia reportedly refused; negotiations broke down, and it went into bond payment default in November 2020.

Ecuador, a middle-income oil exporter, restructured US$17.4 billion in foreign bonds using state-of-the-art CACs in August of 2020. Bonds represent slightly less than half of the government's foreign debt stock; followed by debt to multilateral creditors and debt to Chinese lenders. At 16% of Ecuador's external debt, the latter is quite complex, involving state policy and commercial banks, and linked to oil sales, infrastructure and commercial projects. In addition to restructuring its bonds, Ecuador secured an IMF program and reached agreement to reschedule more than US$800 million in debt payments due in 2020 and 2021 to China Development Bank and China ExIm Bank; however, US$2.4 billion in new disbursements over the same period from Chinese lenders were delayed. Six months after the bond restructuring, Ecuador's debt was back to trading at distressed levels.

For all the countries mentioned so far and for many other distressed sovereign debtors, claims by Paris Club creditors represent less than 5% of the foreign debt stock. Creditors with no experience in and no particular commitment to coordinated debt crisis resolution hold a large and growing part of distressed sovereign debt. Bond restructuring alone is unlikely to resolve a debt crisis today, if it ever could—and in any event, it is unlikely to succeed (CACs or no CACs) if bondholders believe that they are subsidizing other creditors. Bondholders too are getting more diverse and harder to herd: asset managers with different mandates, central banks, sovereign wealth funds, commercial banks and domestic residents may all hold identical Eurobonds, but with different goals in mind and different sources of bargaining power.[2] Meanwhile, collateralized sovereign borrowing is on the rise, seemingly unbound by the web of negative pledge clauses in commercial and private debt contracts.

Public debt disclosure remains utterly inadequate, which means that too much lending, borrowing, and high-stakes policymaking is based on little more than conjecture. Despite a flurry of

[1] The formal name is Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI).

[2] Russia was the biggest holdout in Ukraine's debt restructuring, and is in its fifth year of suing Ukraine on the bonds in English courts.

transparency initiatives, governments in over-indebted countries keep "misplacing" debts on the order of 10% of GDP. The fact that it took 100+ researchers to find 100 contracts that should have been public to begin with, and the fact that Chinese lenders are in such good company—hardly any bilateral official lenders publish their contracts—is simply embarrassing. Where economic logic holds, countries are overpaying to borrow because creditors worry about being diluted or subordinated—and where it does not, creditors are losing out.

In sum, sovereign debt stocks have grown more complex, more dynamic, and more precarious. Established debt restructuring institutions are struggling to stay relevant. If the long-predicted systemic debt crisis were to hit tomorrow, resolving it would be a giant protracted mess. Damage would not stay put with the poorest people in the poorest countries. Disease, conflict, and financial shocks all mutate and metastasize across national borders.

Over the past year, I have had the privilege of working with the Group of 30 on two reports about sovereign debt and financing for post-pandemic recovery. The second and final report, released earlier this month and appended to my testimony, includes practical steps to start building a better debt architecture. While I testify solely in my personal capacity, I would like to highlight several takeaways for the committee in hope that these might help inform your debt policy thinking.

First, the Common Framework is an important development and a worthwhile policy investment. It also needs a lot of work to live up to its architectural potential. The fact that China and other non-Paris Club creditors have agreed, however informally, to a coordinated multilateral debt restructuring template, is the most hopeful debt news in a long time. However, limiting Common Framework eligibility to DSSI countries risks marginalizing the new initiative and amplifying the stigma around debt restructuring—even when it is patently necessary to deal with debt overhang. Any country experiencing debt distress should be able to apply for Common Framework treatment.

Second, the Common Framework will quickly fall apart if it fails to establish threshold legitimacy with sovereign debt stakeholders, broadly defined. For starters, this means that all participating creditors must disavow all-encompassing confidentiality clauses and any other terms, including those we analyze in *How China Lends*, that flatly contradict the letter and spirit of G-20 commitments in the Common Framework. Beyond this basic step, it would serve the interests of all Common Framework participants to establish a mechanism to ensure transparency and consistency across *ad hoc* debt treatments with different committees of extraordinarily diverse creditors. A standing consultative mechanism—a "Secretariat Plus"—with representation from key stakeholders, access to debt information, ability to entertain method and process questions in real time, and authority to make public statements on policy matters, would go a long way to establish the Common Framework as a viable 21st century debt restructuring platform.

Third, participants in the Common Framework, the Paris Club, and the IMF should use their existing policies on comparability of treatment, financing assurances, and lending into arrears, among others, to ensure that debt restructurings are comprehensive and equitable. This means that all material creditor groups should participate on comparable terms, and that borrowers should have access to liquidity support while negotiating relief. Arguments over creditors' official and commercial status in this context are a costly distraction.

Fourth, the international community should invest in building capacity and agency among sovereign borrowers, especially those that are new to the international capital markets. This includes sound domestic practices in debt authorization and disclosure, common disclosure platforms, more standardized debt contracts subject to regular reviews, and better coordination among multilaterals themselves on collateral and negative pledge policies, among others. In particular, linking domestic debt authorization and disclosure has two key advantages: it helps make governments accountable to the people whose work will repay the debt, and it adds to enforcement friction for hidden debt in major financial jurisdictions. There must be a clear presumption against secrecy. *Public debt must be public.*

Fifth, because sovereign debtors tend to have few commercial assets abroad, the sovereign debt ecosystem creates powerful incentives to target payment systems and commandeer payments *en route* to other creditors. This is bad for the country and its creditors as a group, and bad for the international financial system. Contractual and statutory mechanisms to shield payment systems and payment intermediaries would help mitigate the most harmful spillover effects from sovereign debt enforcement, including risks to financial stability.

* * *

Sovereign debt architecture is an ambitious idea – and we should approach architecture reform as an ambitious project, now more than ever. The new debt architecture must be much more transparent, more comprehensive, more equitable, and more resilient. We should try to move away from a world in which distressed debtor countries take the reputational risk of applying for relief with no assurance of success and hardly any tools (short of self-immolation) to coordinate increasingly diverse creditors. The worst possible consequence of our research could be a race to the bottom – more secrecy, more creditors demanding collateral and trying to exercise policy control over countries that would keep losing agency as they struggle to stay afloat. Official creditors can and should take the lead, not only when it comes to debt transparency and coordination, but also in areas such as state-contingent lending, which could help alter crisis dynamics.

In conclusion, I would like to emphasize a broader point that many of us have made over the past year. Dozens of countries are suffering from debt distress, more now than a year ago. Dozens of countries desperately need resources to manage the pandemic and the economic fallout from it, to avoid a lost decade of growth and a lost generation of opportunity. There may be some overlap between these two groups, but they are distinct. Debt relief is rarely the best way to deliver financing for humanitarian and development goals, and debt relief by itself does not achieve these goals. Knowing the gaps in the prevailing debt restructuring architecture, relying solely or primarily on debt relief would be especially problematic. We should work hard to fix the debt architecture, keeping in mind that it is part of a broader financial architecture where there is still more work to be done.

Attachment: *Group of Thirty Report on COVID-19 and Financing for Recovery after the COVID-19 Shock*

Testimony before the U.S. House Committee on Financial Services
Subcommittee on National Security, International Development and Monetary Policy

"Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture"

Dr. Sebastian Horn
Economist, Kiel Institute for the World Economy

May 18, 2021

Chairman Himes, Ranking Member Hill, thank you for the opportunity to testify today. I would like to use my time to highlight findings from a recent research project with Carmen Reinhart and Christoph Trebesch.[1] I would also like to share my personal views on why I believe that greater debt transparency needs to be a cornerstone in all efforts to reform the international debt architecture.

Our research analyzes the volumes, terms and implications of China's overseas lending boom. Over the course of just 15 years the Chinese government and its state-owned enterprises and banks have lent at least 500 billion USD to developing and emerging market countries across the globe. This lending boom has turned the Chinese government into the world's largest official creditor, with outstanding claims surpassing those of the IMF, those of the World Bank or those of all Paris Club members combined (see Figure 1). Chinese overseas lending has filled a void left by traditional development donors and has contributed to meeting the enormous funding gap for infrastructure and reliable energy sources in the developing world. This has potentially large positive effects on economic growth and development.

At the same time, outstanding debt to Chinese creditors has risen fast and has contributed to debt servicing difficulties in multiple developing and emerging countries. For the 50 most indebted developing countries to China, we estimate that outstanding debt stocks have risen

[1] Horn, Sebastian, Carmen M. Reinhart, and Christoph Trebesch. 2019. China's Overseas Lending. NBER Working Paper 26050.

from almost zero in 2005 to an average of more than 15 percent of GDP in 2017. In more than two dozen developing countries, outstanding debt stocks to China now exceed 10 percent of recipient country GDP. The large majority of loans has been extended at commercial terms, meaning with interest rates that are close to those in private capital markets and with comparatively short grace periods and maturities. As a result, Chinese creditors are going to play a dominant role in the debt service payments of many low and middle-income countries for years to come.

Furthermore, the opacity surrounding Chinese lending practices has made it difficult to assess the exact debt burdens of recipient countries. Our analysis reveals that around 50% of Chinese lending to developing country public sector recipients has gone unreported, meaning that these debt stocks do not appear in the "gold standard" data sources provided by the World Bank and other international organizations. The unreported lending from China has grown to more than $200 billion USD as of 2016. Most of these liabilities are held on the books of state-owned enterprises and special purpose vehicles and are therefore outside the often narrowly drawn perimeter of public debt statistics.

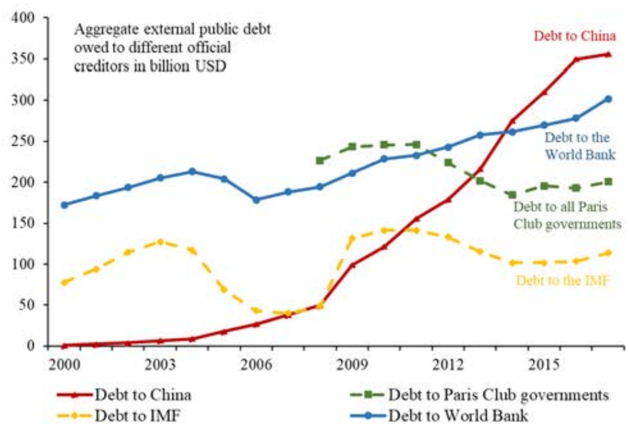
"Hidden" debt problems are wide-spread and not exclusively linked to Chinese lending. However, the opacity of the Chinese lending process has fueled the build-up of the problem and Chinese authorities so far have done little to address the issue: The Chinese government does not publish detailed statistics on its outstanding claims and lending activities and does not share information with the OECD Creditor Reporting System or the Paris Club. Furthermore, Chinese state-owned banks often include expansive confidentiality undertakings in their loan contracts that prevent the debtors from revealing the terms or even the existence of the loans.

Failing to account for unreported debts distorts the views of the official and private sectors in significant ways. First, macroeconomic surveillance work and debt sustainability analyses are undermined when parts of a country's debt are not known. Second, the private sector will misprice debt contracts, such as sovereign bonds, if it fails to grasp the true scope of debts that a government owes. Finally, in the case of debt restructurings, uncertainty about the amount and terms of outstanding claims erodes trust and coordination between creditors and leads to longer and ultimately more costly debt restructuring processes. All of these problems are aggravated by the fact that a substantial share of Chinese loans relies on formal and informal means of collateralization, so that Chinese creditors may be treated preferentially in case of repayment problems.

Maybe most importantly, the lack of transparency prevents citizens in both the borrower and creditor countries from holding their governments accountable for their borrowing and lending decisions. Exposing public debt to public scrutiny can help to reduce the risks of unsustainable debt build-ups and helps to mitigate the severity of recurring cycles of debt and financial crises.

The Covid-19 crisis has exposed debt vulnerabilities in developing countries along with the deficiencies of the international debt architecture. Broad action on debt is needed to ensure that developing countries can mobilize the resources they require to address the ongoing health crisis. While greater debt transparency alone cannot overcome all issues, it is a prerequisite to broader attempts to reform the international debt architecture. The best way for advanced countries to support such efforts is to lead by example.

Figure 1. China is the world's largest official creditor



Note: This figure shows aggregate public debt to different official creditors for all 122 developing and emerging market countries contained in the World Bank International Debt Statistics (excluding China). Debt to Chinese state-owned creditors is based on estimates introduced in Horn, Reinhart and Trebesch (2019). Debt to all 22 Paris Club governments is taken from the Paris Club website (available since 2008). Debt to the IMF and the World Bank Group (IBRD plus IDA) is from the World Bank's International Debt Statistics.

Testimony of

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Before

Committee on Financial Services
Subcommittee on National Security, International Development and Monetary Policy
U.S. House of Representatives

Virtual Hearing on

Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture

May 18, 2021

I. Chinese Lending in the Broader Context of Global Debt

Chairman Himes, Ranking Member Hill, and Members of the Subcommittee, thank you for the opportunity to testify on issues of Chinese lending practices and the international debt architecture.

To begin, I want to emphasize that the United States today *faces a turning point in the international framework* for dealing with sovereign debt problems. I say this for two reasons: First, government debt distress resulting from the pandemic is likely to be a multi-year issue. This means that the international community is currently paying closer attention to these problems than usual, and there may be greater appetite for putting in place necessary changes. Second, the global balance of economic power is likely to shift in the coming decades. The U.S. has been the central actor in international finance for over fifty years. This will not necessarily be the case forever. This means that the U.S. should act now to make sure that its values are reflected in lending and restructuring norms and practices going forward.

Much of my research focuses on problems associated with sovereign debt—the funds that countries borrow from other governments, from international organizations, and from private creditors—particularly when such debt becomes unsustainable or appears illegitimate. As such, the bulk of this written testimony details the financial challenges resulting from the pandemic, highlights emergency measures thus far, and argues for an explicitly multi-pronged approach to improving the global debt framework.

However, to introduce these broader issues, I want to emphasize three ways that Chinese lending practices fit into the story.

First, the problematic elements of Chinese lending practices—which are noted in the Hearing Memorandum and well-detailed in recent research by several of my fellow witnesses[1]—do not exist in a vacuum. These practices tend to reflect and amplify more general and endemic issues in the international debt arena, including: (i) a lack of transparency in loan amounts and terms; (ii) insufficient concern for whether debt actually benefits a country's underlying population, as opposed to its ruling elites and creditors; and (iii) a lack of comprehensive creditor participation. Chinese lending practices appear to take each of these defects to the extreme. Still, the best way to constrain problematic practices by *one* country or creditor is to establish norms and practices that are relevant to *all* countries or creditors. Otherwise, efforts to constrain particularly bad actors are unlikely to stick. This has been one of the key guiding principles of the post-World War II global order, and it remains essential. Therefore, any efforts to improve Chinese lending practices should be part of broader improvements to the international financial architecture.

Second, to the extent that the U.S. is concerned about China's increasing role in international capital flows, it needs to take steps now to cement American interests and values in international debt. These include transparency and accountability, public benefit, and collaborative and comprehensive participation in international efforts.

- This path, as with any long-term plan, begins with an initial step: The U.S. should start by committing to *support a swift, stable, and equitable recovery* from the pandemic, in both its public health and its financial dimensions. Such a commitment, made in conjunction with other countries and international organizations, will be essential to a full global economic recovery. It will also help to forestall follow-on consequences, such as political instability and disruptive migration patterns.
- In the medium-term, the U.S. should support the *implementation of widely-accepted sovereign lending and restructuring principles along multiple tracks*. This would include contract term improvements, domestic legislation within the U.S. and elsewhere, and international initiatives to support fair, comprehensive, and equitable restructurings. This matters regardless of whether creditors are private investors or government actors, especially when the line between these categories is starting to blur.
- To facilitate ongoing long-term progress, the U.S. should *consider the establishment of an independent authority* that could help coordinate improvements across these multiple tracks. Particularly given the potential of long-run changes in the global balance of power, an independent authority committed to broadly acknowledged principles of responsible lending, borrowing, and restructuring could be exceedingly helpful in the coming decades.

[1] Anna Gelpern et al., *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments*, CENTER FOR GLOBAL DEVELOPMENT (March 2021).

My third and final introductory point involves corruption and the mismatched financial incentives present in a number of borrowing countries. Greater tolerance of corruption appears to be a problem in some Chinese lending contracts, and the decisions made by borrowing country ruling elites may not always reflect the interests of their citizens. Again, this issue implicates broader and longstanding dynamics in international finance. Right now, I believe it means two key things:

- First, debtor country elites may have made poor borrowing choices, but *we should not punish the populations* of those countries when dealing with the pandemic and the related sovereign debt crisis. While it makes sense to promote transparency and responsible lending now, these countries' populations will suffer the most from international financial inaction.
- Second, *U.S. and other international actors must take the lead in implementing and modeling new norms and practices*. It is sometimes said that debtor countries are primarily responsible for transparency and other reforms. But corrupt elites in these countries may prefer to foot drag, while the countries' citizens often do not have the information or the power to take action. Given the practical dynamics, power imbalances, and information asymmetries on the ground, more needs to be done by creditors—whether bilateral, multilateral, or private. As such, U.S. support for strong creditor-focused rules on transparency and responsible lending could, over time, help undermine the internal dynamics of corruption and misaligned incentives in sovereign borrowers.

Before continuing, I should note that meaningful support for principles like transparency, sustainability, public benefit, and comprehensive restructuring may not be fully embraced by all U.S. stakeholders. In particular, a number of private creditors that *also* have benefited from gaps in the international framework are American entities or affiliates. If the U.S. is serious about curbing problematic debt practices—such as those exhibited in Chinese lending contracts—it will have to make that commitment clear to domestic constituencies as well.

II. An Overview of the Remaining Arguments

The remainder of this written testimony focuses on the broader global architecture and proceeds in several steps.[2] I first note the country financial difficulties generated by the COVID-19 pandemic and the ways that national responses will likely have long-term financial impacts that make states more vulnerable to debt distress, particularly in the developing world. I also delineate how any restructuring efforts that might result from such distress would have to contend with longstanding problems in the international framework relevant to sovereign debt. These difficulties have become more complex in

[2] The following sections of my written testimony are based on a forthcoming essay, *The Time Has Come for Disaggregated Sovereign Bankruptcy*, EMORY BANKRUPTCY DEVELOPMENTS JOURNAL (2021). I thank the student editors of that journal, along with the participants at a related March 2021 workshop, for their feedback on previous versions of these arguments. These sections also draw on research conducted as part of a 2020 consultancy for the United Nations Conference on Trade and Development (UNCTAD) on constructing a post-COVID-19 international debt architecture.

recent years, as demonstrated by the Chinese lending practices at the center of this hearing.

I then mention several initiatives that have been put forward to address the pandemic-related financial crisis, formulated by policymakers and scholars to deal with problems already present or likely to emerge. These mechanisms should, if fully implemented, help to address countries' financial distress in the short-to-medium term, and they deserve strong Congressional support. However, mixed reaction to such proposals has made the existing gaps in the international financial architecture even more apparent. If anything, the recent crisis suggests that—in addition to short-term, emergency-focused proposals—the need for a more rational global debt restructuring platform remains. As such, the fact of the ongoing and fast-moving public health and economic situation does not mean that we should exclusively focus on emergency-level solutions. Indeed, it remains imperative to harness the crisis energy to move in the opposite direction—toward putting in place longer-term institutions that will be ready for the next crisis and, perhaps, make that next crisis less likely or less intense.

I further argue that the U.S. should support a policy framework in which multiple processes at varying levels simultaneously operationalize a shared set of sovereign debt resolution principles and commitments. Although numerous actors have called for a full-blown multilateral treaty-based restructuring regime, most famously the International Monetary Fund (IMF) in the early 2000s,[3] such proposals have thus far met with resistance. Improvements in market-based, contractually grounded solutions have taken some of the pressure off, but still leave many problems un- or under-addressed. Although the narrative of voluntary, market-based advancements *versus* 'involuntary' (or perhaps less voluntary) international statutory options offers a neatly binary conceptual package, it is well past time to abandon such overly simplistic framing—especially given the rise of mixed and hybrid creditor models, as in the Chinese lending examples. Improvements in the contractual realm, in the multilateral arena, and at the level of domestic legislation should be conceived of as complementary rather than competitive. Or, if these arenas may sometimes compete, we should understand this as the type of healthy competition that ultimately results in better outcomes; there is no need to champion one approach over another.

To be clear, the explicit embrace of a multi-pronged framework for implementing debt resolution principles does not suggest that any such framework should be disorganized or free-floating. Instead, I suggest that ideally the U.S. would also support the establishment of an international consultative body, purpose-built to recommend, coordinate, and facilitate steady, incremental progress in the architecture for dealing with sovereign debt across multiple vectors.[4] Instead of a full-blown multilateral body with

[3] ANNE O. KRUEGER, IMF, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 31 (2002), https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf.

[4] In this, it echoes earlier and ongoing calls for a relatively modest but still internationally relevant forum. For example, the United Nations Conference on Trade and Development (UNCTAD) called for the development of an expert-based global debt authority in the first half of 2020; such a proposal, on which I have consulted, remains under development. In a somewhat similar vein, though more circumscribed, a

court-like adjudicative functions, a more pragmatically achievable and nimble organization could be proposed and implemented in order to serve as a focal point for ongoing activities designed to improve how the global community collectively deals with debt in the short, medium, and long term. Although any such organization may not be able to deal with the immediate financial fallout of the COVID-19 pandemic, advocates of more rational debt restructuring should not waste the sense of urgency present in the current crisis. We need to take steps now to adopt an infrastructure that would make future debt crises less severe and perhaps less likely—even when the spotlights are directed elsewhere.

(1) The COVID-19 pandemic and subsequent country responses have resulted in increased financial vulnerability and raised the risk of an international debt crisis.

Although the economic fallout of the COVID-19 pandemic has been well documented, several elements are especially important in thinking through its potential ramifications for international debtor-creditor relations. To begin with, factors that have led to decreased revenue and foreign exchange may have a lingering impact in the sovereign debt space. The drop in key export commodity prices for many countries has had a significant blow, along with the fall in global trade generally.[5] The near freeze in the international tourism industry dried up a key source of foreign exchange in certain regions.[6] And, for some countries, the significant decline in remittance flows from overseas workers, resulting from economic stagnation in remittance source countries, has constituted a significant hardship as well.[7] Given that many countries continue to denominate their external debt in foreign currency over which they have no control, these factors put together have meant that their capacity to service such debt has plummeted.

In addition, government expenditures have tended to rise steeply as a result of the pandemic, exacerbating the problems caused by the increased costs of international debt servicing, particularly in terms of certain local currencies.[8] The healthcare costs involved in addressing the crisis have been significant, especially where preventative measures

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recent G30 Report called for a consultative mechanism attached to the G20's Common Framework. G30, *Sovereign Debt and Financing for Recovery After the COVID-19 Shock: Next Steps to Build a Better Architecture* 3, 23 (May 2021).

[5] *See, e.g.*, Constantino Hevia & Andy Neumeyer, *A Perfect Storm: COVID-19 in Emerging Economies*, *in* COVID-19 IN DEVELOPING ECONOMIES 25, 25, 31 (Simeon Djankov & Ugo Panizza eds., 2020) (arguing that "developing countries will be harder hit by the pandemic than advanced economies").

[6] *See* Simeon Djankov & Ugo Panizza, *Developing Economies After COVID-19: An Introduction*, *in* COVID-19 IN DEVELOPING ECONOMIES, 8, 9 (2020) (stating that, throughout the COVID-19 pandemic, developing countries are facing "large negative economic shocks" linked, in part, to collapses in their respective tourist industries).

[7] *See* Hevia & Neumeyer, *supra*, at 25, 31 (discussing the negative economic impacts of COVID-19 in countries with emerging economies and arguing that a COVID-induced increase in unemployment in countries with advanced economies "will reduce immigrant remittances to their home countries").

[8] *See* Djankov & Panizza, *supra*, at 8, 20 (discussing how "local currency bonds issued by emerging market countries have been hit particularly hard by the Covid-19 pandemic" as government expenditures and debts continue to rise).

proved insufficient or failed to gain wide adherence.[9] Expenditures on unemployment have increased as many people struggled with pandemic-driven economic dislocation and turned to the state for assistance.[10] In countries with a significant reliance on global trade for key commodities, food security and related issues emerged as a real concern.[11] The World Bank estimated that 150 million people globally had been placed at risk of extreme poverty as a result of the pandemic, with global extreme poverty expected to rise for the first time in twenty years.[12]

Countries rightfully took measures to address this risk, and in some cases have turned to new debt as a cushion, leading to historically high public debt levels.[13] Particularly given low interest rates and increased liquidity, private entities have also partaken in the liquidity buffet, further fueling the massive rise in overall global debt levels.[14] Although such private entity debt does not directly impact sovereign state balance sheets, at least for now, in certain industries and for certain countries such debt may still end up as sovereign obligations if states are faced with the risk of struggling financial, infrastructure, or other systemic sectors down the line. In short, it is entirely understandable that countries and private actors alike have sought to mitigate the effects of the pandemic in any way possible. However, the aggregated impact of these national responses and private decisions may have long-term financial ramifications that make countries more vulnerable to debt distress.

It is important to point out that countries' (and individuals') exposure to pandemic-related challenges has been incredibly uneven, with World Bank President David Malpass warning of an "inequality pandemic" coming on the heels of the public health crisis.[15] States faced the crisis from different starting points, including in terms of basic economic

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[9] *See* Sarah M. Bartsch et al., *The Potential Health Care Costs and Resource Use Associated with COVID-19 in the United States*, 39 HEALTH AFFAIRS 927, 934 (2020) (discussing the causes and effects of health care spending in the United States during the COVID-19 pandemic).

[10] *See* David Laborde, Will Martin & Rob Vos, *Poverty and Food Insecurity Could Grow Dramatically as COVID-19 Spreads*, IFPRI BLOG: RESEARCH POST (Apr. 16, 2020), https://www.ifpri.org/blog/poverty-and-food-insecurity-could-grow-dramatically-covid-19-spreads (explaining how mandatory lockdowns and business closures caused unemployment to skyrocket around the world during the COVID-19 pandemic).

[11] *Id.*

[12] Press Release, World Bank, COVID-19 to Add as Many as 150 Million Extreme Poor by 2021 (Oct. 7, 2020), (available at https://www.worldbank.org/en/news/press-release/2020/10/07/covid-19-to-add-as-many-as-150-million-extreme-poor-by-2021#:~:text=The%20COVID%2D19%20pandemic%20is,severity%20of%20the%20economic%20contraction).

[13] *See* John Letzing, *Countries are Piling on Record Amounts of Debt Amid COVID-19. Here's What That Means*, WORLD ECON. FORUM (Nov. 5, 2020), https://www.weforum.org/agenda/2020/11/covid-19-has-countries-borrowing-money-just-about-as-quickly-as-they-can-print-it/.

[14] *See* Liz Capo McCormick et al., *The Covid-19 Pandemic Has Added $19.5 Trillion to Global Debt: Here Are Reasons to Be Grateful—and Worried*, BLOOMBERG, https://www.bloomberg.com/graphics/2021-coronavirus-global-debt/ (using data and charts to demonstrate how an increase in private debt that occurred in 2020 contributed to an overall rise in global debt amidst the COVID-19 pandemic).

[15] *See* David Malpass, President, World Bank Group, Speech at Frankfurt School of Finance and Management: Reversing the Inequality Pandemic (Oct. 5, 2020) (transcript available at https://www.worldbank.org/en/news/speech/2020/10/05/reversing-the-inequality-pandemic-speech-by-world-bank-group-president-david-malpass)

strength and healthcare capacity. Furthermore, countries had different external borrowing costs and levels of reliance on international transactions to begin with.[16] This meant, and continues to mean, that the long-term economic consequences of the COVID-19 pandemic, including the possibility of debt crises, will inevitably vary considerably across countries. Particularly for some, the risk of sovereign debt distress resulting from COVID-19 is real, and in certain situations already present, and it may prove long-lasting.[17]

(2) Long-term trends and the insufficiency of the existing sovereign debt architecture will compound the problems of any coming sovereign debt crisis.

What kind of financial architecture has been in place for dealing with debt crises when they appear and especially when they linger? While I discuss below the shorter-term international emergency measures taken and proposed in response to the pandemic, the background prognosis for longer-running crises is not especially encouraging. In particular, a brief review of the key challenges and recent trends underscores why debt crises and restructuring episodes may prove tenacious, especially once the headlines and emergency funds have moved on.

To begin with, the broad range of creditors, lending instruments, and local and international forums implicated in the sovereign arena has long fragmented this realm of debtor-creditor relations. Although official sector negotiations and private sector restructurings generally follow well-trodden pathways, with principles of comparability of treatment linking the two areas, issues of inequitable creditor outcomes and inconsistent legal interpretations remain. And recent trends have only exacerbated this fragmentation, particularly given the expanded range of creditors and financial instruments now implicated in sovereign debt. Whereas in the 1990s and through the early 2000s, sovereign bonds were by far the dominant private instrument, other forms of commercial lending have become more common, as have loans from hybrid public-private investors such as sovereign wealth funds and state-owned enterprises.[18] This fragmentation is further exacerbated by the steep increase since the Global Financial Crisis in developing countries' private indebtedness, which constitutes another important vulnerability and complication.[19] In addition, there has been a rise in collateralized lending,[20] central to Chinese loan contracts, in which creditors have recourse to specific assets in the event of nonpayment. Those assets thus may be removed from the general pool available to repay creditors in any broader restructuring. And, of course, among

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[16] *See, e.g.*, Hevia & Neumeyer, *supra*, at 25, 31 (discussing the varying financial circumstances facing different countries before and during the COVID-19 pandemic).

[17] *See generally* Ben Parker, *The Debt Crisis Looming for Poor Countries*, THE NEW HUMANITARIAN (Oct. 8, 2020), https://www.thenewhumanitarian.org/analysis/2020/10/08/pandemic-debt-crisis-looms ("The World Bank and the IMF list Mozambique as one of eight countries in 'debt distress', while 28 others were considered at 'high risk' as of June.")

[18] For an overview of recent trends, see, for example, IMF, *The Evolution of Public Debt Vulnerabilities in Lower Income Economies*, IMF Policy Paper, Feb. 2020.

[19] U.N. Conf. Trade and Dev., Rep. on Financing a Global Green New Deal, at 74–83 (2019).

[20] *See, e.g.*, IMF and World Bank, *Collateralized Transactions: Key Considerations for Public Lenders and Borrowers*, January 24, 2020.

bilateral and semi-official creditors, a number of non-Paris Club creditor countries, especially China, have become dominant, particularly in certain regions. This has made it even more challenging to achieve a comprehensive restructuring agreement that includes all creditors and is likely to provide sufficient and long-lasting relief consistent with sustainable and equitable development. Overall, these shifts have resulted in a complex context for any post-pandemic debt restructuring to come.

Indeed, and perhaps unsurprisingly, the past debt restructurings that have emerged from this framework tend to be "too little, too late"—providing countries with tardy and insufficient relief that undermines their return to economic health. Sovereign borrower states often delay the decision to restructure due to a range of factors that may include lack of information, electoral concerns, and worries about financial contagion. Creditors' reluctance to face the possibility of losses, and the difficulty of dealing with collective action problems, mean that incentive problems exist on both sides. Creditors and international actors may also express moral hazard concerns in explaining resistance, and certain creditors have asserted that voluntary restructuring conflicts with their obligations to shareholders, investors, or regulators.[21] And, once a decision to restructure is made, insufficiently deep restructurings can result from overly optimistic growth forecasts or concerns about reputation. Although debt restructurings are almost inevitably difficult and politically tense, any perceptions that they are also non-transparent, inequitable, and illegitimate can intensify civil strife and thus make them even more disruptive. Such second-order disruption can exacerbate the distress already generated by the restructuring itself.[22]

Although progress toward more comprehensive and equitable restructuring has been made through both contractual developments and, in some cases, domestic legislative action, such progress remains highly incomplete. The International Capital Markets Association (ICMA) developed a model clause in 2014 that offers a menu of alternative voting procedures, including a "single limb" option under which a single aggregated vote can be taken across all applicable bonds.[23] Although the use of such clauses has become dominant (though not universal) in U.K. and New York law bonds, there has been no uptake in other geographical regions.[24] These other regions are admittedly currently far

[21] *See, e.g.*, Inst. for Int'l Fin., *Terms of Reference for Potential Private Sector Participation in the G20/Paris Club Debt Suspension Initiative* (May 28, 2020), https://www.iif.com/Portals/0/Files/content/Regulatory/Voluntary%20Private%20Sector%20Terms%20of%20Reference%20for%20DSSI_vf.pdf.
[22] For more on the challenge and potential benefit of legitimate restructurings, and on how 'legitimacy' might be understood in the sovereign debt context, see Odette Lienau, *The Challenge of Legitimacy in Sovereign Debt Restructuring*, 57 HARV. INT'L L. J., 151, 154–55 (2016).
[23] In addition, the model clause offers a clarification that *pari passu* language does not provide holdout creditors with ratable payment, which was at issue in the long-running Argentina litigation under New York Law. Natalie A. Turchi, *Restructuring a Sovereign Bond Pari Passu Work-Around: Can Holdout Creditors Ever Have Equal Treatment?*, 83 FORDHAM L. REV. 2171, 2208 (2015).
[24] IMF, *Fourth Progress Report on Inclusion of Enhanced Contractual Provisions in International Sovereign Bond Contracts*, 4–5 (Mar. 6, 2019), https://www.imf.org/en/Publications/Policy-Papers/Issues/2019/03/21/Fourth-Progress-Report-on-Inclusion-of-Enhanced-Contractual-Provisions-in-International-46671.

less significant in terms of bond issuances, but they do include financial centers likely to become more prominent over time. And although the outstanding global debt stock without these enhanced Collective Action Clauses (CACs) should decline over time, it remains substantial.[25]

In addition, part of the risk with contract-based innovations is that they may be undone in subsequent rounds of negotiation. Although the enhanced CACs seem well established, the August 2020 restructuring process for Argentina's bonds included a creditor proposal to leave out the enhanced CACs in the future restructured bonds.[26] In short, although contractually based progress certainly helps, it is hardly foolproof—particularly when coverage is incomplete, and when it is not backed up by complementary initiatives supporting collective action. In terms of statutory efforts, several jurisdictions, most notably the UK and Belgium, have passed domestic legislation designed to address holdout creditors and protect market infrastructure (such as payment systems) from collection efforts. However, this approach is hardly widespread. Overall, the background architecture available to deal with any post-pandemic sovereign debt crisis that might linger does not look especially promising.

(3) The U.S. should actively support and strengthen measures currently under discussion to deal with the immediate risk of financial crisis, while also looking beyond the short term.

In light of this unpromising background, a number of proposals have been taken up at the international level thus far. Unsurprisingly and appropriately, the key measures have tended to focus heavily on dealing with the immediate emergency rather than on efforts to prevent and ease the cycle of sovereign debt crises more generally. These projects have relieved some of the immediate pressure, and the U.S. should take the lead in strengthening and extending these international initiatives. However, these initiatives should also be understood as stepping stones to longer term efforts to improve the sovereign debt architecture.

The core crisis response has centered around the G20 Debt Service Suspension Initiative (DSSI), first proposed and adopted in April 2020 and currently extended until December 2021 and expanded through the G20's November 2020 announcement of the Common Framework for Debt Treatments beyond DSSI (Common Framework) for situations

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[25] *Id.* at 7.

[26] *See, e.g.,* Joseph Stiglitz, Robert Howse & Anne-Marie Slaughter, *Sovereign Creditors Must Not Rewrite the Rules During the Pandemic*, PROJECT SYNDICATE (July 9, 2020), https://www.project-syndicate.org/commentary/argentina-sovereign-debt-rules-creditors-by-joseph-e-stiglitz-et-al-2020-07?barrier=accesspaylog#:~:text=Sovereign%20Creditors%20Must%20Not%20Rewrite%20the%20Rules%20During%20the%20Pandemic,-Jul%209%2C%202020&text=In%20the%20circumstances%20caused%20by,face%20risks%20of%20sovereign%20default; Lee Buchheit, Leland Goss & Brad Setser, Discussion at Virtual Panel: Collective Action Clauses: Argentina, Ecuador, and Their Future at the Official Monetary and Fin. Inst. Forum (Sept. 1, 2020), https://www.youtube.com/watch?v=w88s4aJmK_c (discussing CAC use in the recent restructurings of Ecuador and Argentina).

requiring more extensive workouts.[28] The basic DSSI approach allowed a range of Lower Income Countries (LICs) to request suspension of debt payments to bilateral official creditors (i.e. creditor countries). This did not restructure debt, but rather temporarily suspended payment, with interest accruing; it also did not include suspension of payments to private creditors or to official multilateral creditors like the IMF and World Bank. The Common Framework allows for restructuring in more extreme situations, but still applies only to the same limited set of countries—which is much narrower than the range of countries likely to face debt distress. It does mandate an IMF Program and, as an improvement, requires participating countries to request comparability of treatment from private creditors, although exceptions may still be possible.[29]

To further ease the stress on countries, the G20 economies have also recently agreed to a new allocation of IMF Special Drawing Rights (SDRs)—a key IMF mechanism for injecting liquidity into the global economy.[30] This could alleviate some of the pressure for struggling economies, and could also pave the way for the adoption of additional proposals to address countries' longer-run debt burdens, such as voluntary debt buybacks and debt swaps, perhaps through the establishment of new central credit facilities.[31] The current structure of SDR allocations means that they may not be sufficient or sufficiently targeted, given that they are currently distributed according to member country IMF voting shares. As such, further steps should be taken to recycle any allocations to where they will be most useful.[32] In short, although these initiatives deserve support, liquidity

[28] G20, *supra*; *see also* FITCH RATINGS, THE G20 COMMON FRAMEWORK AND PRIVATE-SECTOR RESTRUCTURING (Feb. 16, 2021), https://www.fitchratings.com/research/sovereigns/g20-common-framework-private-sector-debt-restructuring-16-02-2021.

[29] G20, *supra*; FITCH RATINGS, *supra*.

[30] *See* Reuters Staff, *Big Economies Agree to Boost IMF Funding, Georgieva Says*, REUTERS (Mar. 3, 2021), https://www.reuters.com/article/africa-imf/update-2-big-economies-agree-to-boost-imf-funding-georgieva-says-idUSL5N2L056W. The last allocation of SDRs happened in 2009 in response to the Global Financial Crisis. For those seeking more general background, the IMF semi-regularly updates an SDR Q&A. IMF, *Questions and Answers on Special Drawing Rights* (Feb. 26, 2021), https://www.imf.org/en/About/FAQ/special-drawing-right.

[31] *See, e.g.*, Patrick Bolton et al., *How to Prevent a Sovereign Debt Disaster: A Relief Plan for Emerging Markets*, FOR. AFF. (June 4, 2020), https://www.foreignaffairs.com/articles/world/2020-06-04/how-prevent-sovereign-debt-disaster (recommending that debtor interest payments be routed to a central credit facility in which creditors could receive a stake; also discussed and elaborated in related publications); Matthew Fisher & Adnan Mazarei, *A Possible IMF Pandemic Support Facility for Emerging-Market Countries*, PETERSON INST. FOR INT'L ECON. 1, 1 (July 2020), https://www.piie.com/sites/default/files/documents/pb20-11.pdf (advocating the establishment of a specialized IMF Pandemic Support Facility); Hamid Rashid & Joseph Stiglitz, *Averting Catastrophic Debt Crisis in Developing Countries*, CTR. ECON. POL'Y RSCH. 1, 3 (2020), https://cepr.org/active/publications/policy_insights/viewpi.php?pino=104 (recommending a multilateral buyback facility that could be managed through the IMF's New Arrangements to Borrow function).

[32] *See, e.g.,* Hannah Wanjie Ryder & Gyude Moore, Commentary, *When Special Drawing Rights Aren't So Special*, PROJECT SYNDICATE (March 1, 2021), https://www.project-syndicate.org/commentary/how-sdrs-can-help-developing-countries-by-hannah-ryder-1-and-gyude-moore-2021-03. In her March 3, 2021 address to the G20, IMF Managing Director Kristalina Georgieva suggested ways to redirect the liquidity more to countries in need, and the ultimate IMF proposal for the allocation will presumably include some of these elements. Reuters Staff, *supra* note 35. The final allocation would then have to be approved by major states, most notably the United States, though Treasury Secretary Janet Yellen and other key officials

injections, temporary debt suspensions, and only tentative efforts at restructuring may not be enough to handle the scale of debt distress that countries face.

The last year has also highlighted the degree to which even urgent circumstances and emergency measures are unable to overcome the longstanding problems of the sovereign debt arena. The mixed participation of Chinese state-affiliated creditors in debt relief efforts is disheartening.[33] And the highly reluctant (or non-existent) participation of private creditors further means that countries will likely receive less restructuring than they need. Toward the beginning of the pandemic, private sector creditors were "called upon" to participate in debt suspensions in line with the DSSI, but declined to respond to the call despite the exigent pandemic situation.[34] The Institute for International Finance (IIF), a key international private creditor industry group, issued an unencouraging statement in May 2020 indicating that any private sector participation should be entirely voluntary, net present value neutral, and arranged on a creditor-by-creditor (or at least debt contract-by-debt contract) basis.[35] A September 2020 letter further emphasized commitment to market solutions, sanctity of contracts, resistance to top-down approaches, and the risks of losing private market access.[36] This stance means that public sector forbearance could indirectly support the ongoing repayment of non-participating private sector loans. The Common Framework's comparability of treatment requirement will help, and the U.S. should commit to implementing this requirement. Ensuring that private creditors, including those based in the U.S., fully participate in any debt restructuring may encourage official sector or state-affiliated creditors to participate in relief efforts themselves. Otherwise, these and similar collective action problems could undermine the ultimate scale of the relief, rendering it less ameliorative than the current situation warrants.[37]

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have signaled their support. Andrea Shalal & David Lawder, *Yellen Backs New Allocation of IMF's SDR Currency to Help Poor Nations*, REUTERS (Feb. 25, 2021), https://www.reuters.com/article/us-g20-usa/yellen-backs-new-allocation-of-imfs-sdr-currency-to-help-poor-nations-idUSKBN2AP1U0.

[33] *See* G30, *supra.*

[34] Andrea Shalal, *Pandemic Debt Relief Needs Private-Sector Involvement: IIF*, REUTERS (Apr. 9, 2020), https://www.reuters.com/article/us-health-coronavirus-debt-iif/pandemic-debt-relief-needs-private-sector-involvement-iif-idUSKCN21R2L6.

[35] Inst. for Int'l Fin., *Terms of Reference for Potential Private Sector Participation in the G20/Paris Club Debt Suspension Initiative* (May 28, 2020), https://www.iif.com/Portals/0/Files/content/Regulatory/Voluntary%20Private%20Sector%20Terms%20of%20Reference%20for%20DSSI_vf.pdf.

[36] Letter from Timothy Adams, IIF President and CEO, to Mohammed Al-Jadaan, Minister of Fin., Kingdom of Saudi Arabia (Sept. 22, 2020) (on file with author).

[37] For civil society group Eurodad's assessment of the first iteration of the DSSI, *see* IOLANDA FRESNILLO, THE G20 DEBT SERVICE SUSPENSION INITIATIVE: DRAINING OUT THE TITANIC WITH A BUCKET? 1, 2–23 (Oct. 14, 2020), https://d3n8a8pro7vhmx.cloudfront.net/eurodad/pages/768/attachments/original/1610355046/DSSI-briefing-final.pdf?1610355046. Eurodad and other civil society groups have held a similarly dim view of the 'Common Framework' extension. *See* Julia Ravenscroft, *Reaction to G20 Common Framework for Debt Treatments: Designed By and For Creditors*, EURODAD (Nov. 13, 2020), https://www.eurodad.org/reaction_to_g20_common_framework_for_debt_treatments_designed_by_and_for_creditors.

Setting aside the lukewarm reaction by some key actors to these initiatives, they are a start, and these and other circulating ideas deserve further consideration and extension. Unfortunately, one drawback of the thinking and writing inspired by any emergency is that the intensive discussion sometimes lasts only as long as the crisis itself. If past emergency experiences are any indication, not all of the worthy measures proposed will be taken up. The international policy and scholarly community may put aside these ideas once the current moment has passed, shelving them indefinitely on working paper websites or online article repositories.

(4) The U.S. should commit to a multi-level process for improving the international debt architecture in the long term.

Although the attention paid to immediate crisis alleviation is entirely understandable, the U.S. would be short-sighted to focus exclusively on emergency solutions. The problems of creditor free-riding and insufficient relief remain, even in a situation widely acknowledged to be urgent. Recent circumstances have also highlighted the increasing complexity of the sovereign debt area, relative to previous decades—the multiplicity of debt instruments, the varied institutional forms of investors, the geographical spread of creditors, and the lack of transparency in all the above. The well-known statement that one should "never waste a crisis" applies with full force to the current moment. Before the energy and attention dissipate, it makes sense to set the foundations to deal more proactively with the next international debt crisis, if not avert it altogether. In particular, the U.S. *should commit to a framework by which multiple processes at varying levels simultaneously support or instantiate a shared set of sovereign debt resolution principles and commitments*.

One threshold question that might arise here is: why work across multiple tracks? Would it not be better to recommit to a more centralized and maximalist restructuring framework, perhaps revitalizing proposals from an earlier era, at least to the extent that the willpower exists for such an endeavor? Or maybe more can be done with market-based solutions, given sufficient global attention? Perhaps. But one of the complications in the sovereign debt arena—as in so many areas of policymaking—is that the key problems, actors, and plausible solutions change over time. The Chinese mixed-form creditor entities and lending practices at the center of discussion today offer a good example of this dynamic. Such complexity and fluidity can make proposals that once seemed appropriate appear outdated farther down the line. They also suggest that the occasionally binary nature of discussions in sovereign debt policy-making—market-based advancements *versus* statutory options—should be set aside. Under the circumstances of complexity, fluidity, and uncertainty, which do not appear likely to change in the foreseeable future, it is hard to know which debt instruments or actors will be implicated and thus which approach will be needed at any given moment. In this world, multiplicity should perhaps be understood not as a defect or a compromised second-best but rather as a *virtue*.

If this is the case, what are the 'multiple processes at varying levels' and 'principles and commitments' that underpin such a vision? To begin with, the basic principles and commitments in this arena should not be very controversial; there is no need to reinvent the wheel here. We need to improve the effectiveness, efficiency, and legitimacy of the sovereign debt market and of debt restructuring events. Supporting these overarching ideas, key sub-goals may include the promotion of preventive restructuring; encouraging comprehensive and equitable creditor participation; supporting realistic debt sustainability analysis; enabling standstills on litigation where appropriate; enhancing the transparency of sovereign debt obligations and restructurings; and improving markers and perceptions of sovereign debt legitimacy, among others.[38] To an important degree, the 'multiple processes at varying levels' also already exist, at least in part. The tools for instantiating core commitments might include contractual or market-based mechanisms, national or provincial legislation, international legal guidelines and principles, and measures that could be implemented by other international bodies, such as through UN Security Council Resolutions or IMF measures, or eventually perhaps a stand-alone statutory mechanism.

What could still exist more fully is a commitment to knitting these principles and processes together, particularly at a global scale, and to explicitly conceiving of them as complementary and deserving of simultaneous attention and support. Instead of deciding whether to press forward with market-based measures, alterations in domestic law, *or* international guidelines or semi-adjudicatory procedures, it may well be the case that greater progress will be made across all these tracks when they are pursued in parallel. To highlight one example worth remembering, it appears that, until the early 2000s, New York-based market actors were wary of incorporating even the most basic first-generation CACs into New York-law governed bonds, despite their longstanding and widespread use in UK-law bonds.[39] However, the possibility of a more muscular treaty-based mechanism for dealing with collective action problems, raised with the presentation of the IMF's Sovereign Debt Restructuring Mechanism (SDRM) proposal,[40] corresponded to renewed declarations of fealty to market-based solutions and a recommitment to updated contractual clauses. In this case, a perception of competition may have proved a virtuous instigation rather than a problem.

A more explicit and public shared commitment to fair principles and processes across multiple tracks could also have the benefit of making each of these steps appear less solitary, and thus might make them more likely. Statutorily-based domestic restructuring frameworks, such as for corporations, have become widespread internationally—and, indeed, at least some portion of the investors concerned about a more comprehensive (and less voluntary) restructuring system for sovereign debt nonetheless actively

[38] These cross-cutting goals, and this document more generally, are in line with the 2015 UNGA Resolution establishing basic principles for sovereign debt restructuring as well as the April 2015 UNCTAD 'Roadmap' for Sovereign Debt Workouts. G.A. Res. 69/319 (Sept. 10, 2015); U.N. Conference on Trade and Development, Sovereign Debt Workouts: Going Forward 1, 3–5 (April 2015), https://unctad.org/system/files/official-document/gdsddf2015misc1_en.pdf. For more on what the elusive concept of 'legitimacy' might mean in the sovereign debt context, *see* Lienau, *supra* note 24, at 151–214.

[39] Mark Gugiatti & Anthony Richards, The Use of Collective Action Clauses in New York Law Bonds of Sovereign Borrowers 1, 1 (July 11, 2003) (unpublished manuscript) (on file with author).

[40] ANNE O. KRUEGER, IMF, A NEW APPROACH TO SOVEREIGN DEBT RESTRUCTURING 31 (2002), https://www.imf.org/external/pubs/ft/exrp/sdrm/eng/sdrm.pdf.

participate in domestic bankruptcy claims trading. Still, it can be difficult to act alone or as a first mover in the international arena. National or sub-national legislatures may not want to go out on a limb in embracing legislative innovations, and practitioners could find comfort in making changes as part of a broader community of actors moving in the same direction. Naming and sharing a collective project—even a project spread across multiple levels and processes—could help to spur on and facilitate that progressive movement.

(5) The U.S. should consider supporting the establishment of an independent international debt authority, which could coordinate ongoing improvements in line with widely-accepted lending and restructuring norms.

The deliberately multi-tiered approach proposed here could conceivably emerge from the natural patterns of international relations, perhaps catalyzed by a change of outlook. However, any such emergence would likely be painfully slow, less organized than ideal, and far from guaranteed. Instead, the U.S. should consider establishing *an internationally oriented body to recommend, coordinate, and facilitate steady, incremental progress in the architecture for dealing with sovereign debt*. Although any such institution obviously could not contend with the immediate financial fallout of the pandemic, it would nonetheless be a valuable outcome of the current moment.

This approach is closest in spirit to past recommendations for a semi-structured international framework—one that aims to improve coordination and strengthen shared principles and practices but still draws from institutional mechanisms already in existence. It echoes the possibility of an international debt authority floated in the first half of 2020[42] as well as earlier calls for a relatively modest but still internationally relevant forum.[43] To clarify, this coordinating authority would not be a full-blown multilateral organization with adjudicative functions along the lines of the IMF's earlier SDRM proposal.[44] Instead, a more modest institution could be established, perhaps even by a smaller number of states and supporters, to serve as a focal point for ongoing activities designed to improve how the global community collectively deals with debt in the short/emergency term, medium term, and long term. This authority would work toward operationalizing the substantive goals noted above in particular situations,

[42] Alonso Soto, *New Global Body to Help with Debt Relief*, BLOOMBERG (April 22, 2020), https://www.bloomberg.com/news/articles/2020-04-22/un-to-call-for-new-global-body-to-help-with-debt-relief.
[43] One earlier proposal called for an even less formalized "Sovereign Debt Forum" more focused on research and prevention efforts and on bringing together creditors and debtors at an early stage, structured as a private, incorporated, non-profit organization. RICHARD GITLIN & BRETT HOUSE, CTR. INT'L GOV'T INNOVATION, A BLUEPRINT FOR A SOVEREIGN DEBT FORUM, (March 2014). An interdisciplinary, academically based research hub of the same name has been recently launched, which could serve as a partner in certain of the GDA's activities. An earlier UNCTAD Roadmap and Guide from 2015 also recommended, in broad strokes, an independent "Debt Workout Institution" along these lines that can be understood as a precursor to the proposal currently under development. The Roadmap suggested that a higher degree of legitimacy would result from a more coordinated multilateral establishment of any such body. U.N. Conference on Trade and Development, *supra* note 43, at 62–63.
[44] KRUEGER, *supra* note 45, at 31.

pushing forward and coordinating developments at the contractual level, domestic legislative level, and international level—either in establishing soft-law guidelines or in the development of more enforceable hard-law legislation.

As part of this larger mission, it could serve as an *idea generator and home for orphaned proposals*—worthy ideas formulated during a crisis (such as the present one) but then set aside as the international community shifts its focus to other problems in the news cycle. While higher-level attention is directed elsewhere, a dedicated debt institution could establish work streams to combine and then refine proposals in the same topic family—for example around domestic legislation to address collective action problems, support for debt transparency, protection of financial market infrastructure, or emergency standstills. If the authority were working on nationally-based but coordinated emergency standstill legislation, it might formulate and negotiate appropriate and shared triggers for emergency measures. It could formally endorse model laws, establish relationships with those actors that might be in a position to implement them, and have both the substance and the processes at the ready for when the moment is right. Furthermore, as part of its ongoing and incremental work, it could revisit and update past proposals and recommend their further consideration or adoption when appropriate.

As should be clear from the foregoing, part of this body's work would be to *identify, cultivate, and coordinate the cross-cutting tools, actors, and networks that might best achieve substantive goals*. Such actors and alliances could include national/provincial/supranational legislator groups; international and national associations centered around insolvency professionals and judges; creditor groups such as the IIF and ICMA; bond trustee institutions; market utilities such as payment clearing systems; UNCITRAL and other bodies active in legislative coordination; civil society organizations; and subject matter experts. Many others would, of course, be relevant depending on the goals, tools, and processes under consideration. To be sure, certain of these networks exist to some degree already, through fairly regular academic, policy, and interdisciplinary conferences. Still, they could be further formalized and extended, particularly to include actors and groupings important for progress in these arenas but not already deeply attentive to and involved in sovereign debt matters. Similarly, other international organizations undertake certain of these activities at various times, such as the IMF and UNCTAD, or even private creditor groups like the IIF. However, they can be limited by their broader missions, attentiveness to other issues, and concomitant political constraints. In some instances, existing organizations also may be considered insufficiently neutral due to their financial interests, affiliations, and positions in global economic and political relations—all of which may shift in the coming decades.

The proposed authority could also serve as a *natural institutional home for important debt-relevant proposals*. Indeed, one striking feature of the sovereign debt arena is the current absence of such a landing spot. An example of this is the occasional homelessness of initiatives that are widely acknowledged to be valuable, such as a truly global 'sovereign debt registry' to make core information more transparent and broadly accessible. The IMF would have been a natural location but declined, seemingly on the basis of political delicacies—and, indeed, its goals going forward could tie even more deeply into changing sensitivities engendered by the shifting balance of global economic power. A private creditor organization would be less than ideal for such a registry, and indeed the IIF's own debt transparency principles are a step in the right direction but leave many key indicators out.[46] An academic institution is unlikely to carry sufficient weight, and of course the commitment of any academic institution alters with the make-up and interests of particular faculty members.[47] The Organization for Economic Cooperation and Development (OECD) has stepped up for now, launching an initiative to develop a data platform later this year. This could be promising but may prove insufficient, particularly given that it builds upon and does not purport to extend the IIF approach.[48] As such, a purpose-built international debt authority could serve as an informational hub or repository for accessible, comprehensive, and comprehensible sovereign debt-related information. This could include developing and maintaining databases for, for example, debt restructuring agreements, debt sustainability analyses, and of course a central sovereign debt registry, perhaps in conjunction with the OECD. Other valuable initiatives and proposals that may emerge down the line deserve a swifter and more secure positive response.

III. Conclusion: The U.S. should take the lead in the current crisis, and also not waste this moment to embed its values in a longer-term international architecture for dealing with sovereign debt.

While the ongoing economic crisis caused by the COVID-19 pandemic has generated important initiatives for addressing countries' financial distress—initiatives that deserve American support—it has also made even more apparent the ongoing gaps in the international financial architecture. These defects in the global debt framework are of a piece with the problematic elements of Chinese lending practices, which tend to take these insufficiencies to the extreme. In addition, the current crisis has highlighted the extent to which the international community pays closest attention to the sovereign debt infrastructure in situations of crisis—well past the ideal time to develop and implement necessary improvements. As part of the discussion of how to deal with the pandemic's financial fallout, the U.S. should explicitly support multi-tiered efforts across different jurisdictional spaces. Such an approach would not favor one mechanism over another and indeed would explicitly embrace the potentially complementary rather than competitive nature of progress along different tracks. It makes particular sense given that a single adjudicative mechanism remains politically unattainable and may not even be appropriate given the complexity of the current international debt market.

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[46] *See* Inst. for Int'l Fin., Voluntary Principles for Debt Transparency 1, 2–5 (June 10, 2019), https://www.iif.com/Portals/0/Files/Principles%20for%20Debt%20Transparency.pdf.

[47] The Euro-Mediterranean Economists Association has also launched a debt transparency platform advocating for a global sovereign debt registry. It is at an early stage and would likely benefit from broader support and perhaps a more explicit connection to other initiatives. DEBT TRANSPARENCY PLATFORM, https://dtransparency.org/ (last visited Mar. 28, 2021).

[48] OECD Debt Transparency Initiative, https://www.oecd.org/daf/fin/financial-markets/oecd-debt-transparency-initiative.htm (last visited May 17, 2021).

As part of this long-term project, the U.S. should consider supporting the development of a corollary institution. An international authority could act as a base and catalyst for developing and implementing incremental improvements to the sovereign debt arena across a range of levels and mechanisms, guided by a shared set of principles and commitments. Ideally debtors, creditors, and the international community writ large would eventually have a regularly updated menu of prepared options ready to be put into action whenever needed—even as we hope that the time of need never comes.

Testimony of

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Before the

House Committee on Financial Services

Subcommittee on National Security, International Development and Monetary Policy

Hearing on

"Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture"

10:00 a.m., Tuesday, May 18, 2021

Thank you Chairman Himes and Ranking Member Hill for the opportunity to testify today.

Twenty-five years ago, this committee was instrumental in putting forward the Heavily Indebted Poor Country initiative (or "HIPC") to relieve the debt burdens of 37 poor countries when it became clear that they could no longer sustainably service this debt. At the time, the United States agreed to forgive nearly $2.5 billion in debt owed to US government agencies, making it one of the largest of the 55 creditor countries to participate. Little noticed at the time: Costa Rica was a bigger creditor to poor countries than was China.

Today, nearly all the low-income HIPC countries are again at risk of debt distress, with debt vulnerabilities that have been greatly exacerbated by the economic shock of the COVID pandemic. But on the creditor side, the picture has changed dramatically. The United States government today is one of the smallest creditors to low-income countries, with just $370 million in outstanding claims. China, on the other hand, with over $31 billion in outstanding claims to the HIPC countries, is a bigger creditor than all other government creditors combined. And that picture holds true well beyond the poorest countries. China today is by far the largest official creditor in the world, with estimates of outstanding claims on the order of $350 billion.

So, when we consider how best to address a potential widescale debt crisis in developing countries, we must grapple with China's dominant position. That starts with an understanding of not just *how much* China lends but *how* China lends—not just lending volumes and interest rates, but the full array of conditions that Chinese lenders might attach to their loans.

I would like to focus the balance of my remarks on the findings of a new report that I co-authored with Anna Gelpern and Sebastian Horn (both also on the panel today), as well as Brad Parks and Christoph Trebesch.[1] This report, submitted along with my testimony, was published jointly by AidData, the Center

[1] Gelpern, A., Horn, S., Morris, S., Parks, B., & Trebesch, C. (2021). *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments.* Peterson Institute for International Economics, Kiel Institute for the World Economy, Center for Global Development, and AidData at William & Mary.

for Global Development, the Kiel Institute for the World Economy, and the Peterson Institute for International Economics. We assessed the provisions of 100 Chinese debt contracts, the first assemblage or study of Chinese contracts on this scale. Our findings have implications for the debt relief agenda, which I will address at the end of my statement. And while there are other important factors when it comes to debt vulnerabilities in the developing world, including the increased role of commercial creditors, I will limit my remarks to the behavior of Chinese government lenders, as evidenced by their debt contracts.

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Four main insights emerge from our research:

First, Chinese contracts contain unusual confidentiality clauses that bar borrowers from revealing the terms or even the existence of the debt. In commercial loan contracts, confidentiality provisions are typically aimed at protecting sensitive information about the borrower, with non-disclosure restrictions imposed on the lender. But what we see in the Chinese contracts are clear non-disclosure requirements imposed on borrower governments. Importantly, these restrictions are waived when they conflict with domestic laws. But should no domestic reporting requirements exist in the borrowing country (and they typically don't), borrowing governments are bound by the terms of the contract, which could include restrictions on reporting to the IMF, the World Bank, the Paris Club, or any other creditor groups.

These non-disclosure restrictions are problematic: they hide government borrowing from the taxpayers who are bound to repay it; they impede budget transparency and sound fiscal management; they hide the borrower's true financial condition from its other creditors; and they can serve as an obstacle to timely and orderly debt restructurings, which depend on a full accounting of a debtor government's obligations to all its creditors.

Second, Chinese lenders seek advantage over other creditors through collateral arrangements such as lender-controlled revenue accounts. Chinese lenders appear to use escrow accounts and other formal and informal collateral arrangements far more frequently than other lenders, government or commercial. Chinese lenders use such arrangements to mitigate risk of non-payment in otherwise risky lending environments. But it's important to recognize the problems these arrangements can pose for the borrowers, particularly in distressed environments. Cash accounts of this sort encumber scarce foreign exchange and fiscal resources of developing country governments. And when the accounts are hidden through strict non-disclosure requirements, they can distort the overall economic picture for a country in the eyes of the IMF and other creditors. Revenues that are assumed to be flowing to the developing country government are in fact flowing to an offshore account controlled by the Chinese lender. Again, such arrangements may serve as a barrier to timely and efficient debt restructurings.

Third, Chinese lenders also seek advantage over other creditors through requirements to keep the debt out of collective restructuring efforts by the Paris Club of creditors or any other multilateral arrangements. We have dubbed this contract feature the "no Paris Club" clause, and no other lender we are aware of, private or government, employs it. The clause unambiguously seeks to set Chinese creditors apart from, and ahead of, other creditors in restructuring situations.

The provision prohibits the borrower from seeking any debt restructuring from the Chinese lender on terms that are comparable to those obtained through the Paris Club of creditors, a forum the United States and other governments established nearly 70 years ago to coordinate debt restructurings. A core principle of the Paris Club is that a debtor government, in exchange for obtaining relief from the United States and other club members, must commit to seeking comparable relief from its other creditors. By prohibiting such comparable relief in its contracts, China is putting debtor governments in an impossible position should they need debt relief—either violate the terms of the Chinese debt contract or violate their commitment to the Paris Club. Importantly, China itself is not a member of the Paris Club, but it has signed onto the G20's Common Framework for Debt Treatments[2], which adopts key Paris Club principles, including the requirement for comparable treatment.

Fourth, cancellation, acceleration, and stabilization clauses in Chinese contracts have broad scope and imply significant policy leverage over the borrowing country. These provisions, which enable the Chinese lender to accelerate payment or cancel a loan, are broadly written, giving the lender substantial leverage across a wide array of policy issues. Cross-default clauses also reinforce ties across Chinese government lenders. As we observe in the case of Ecuador, China Development Bank is empowered to accelerate or cancel its $1 billion loan facility due to any harm experienced by any Chinese government entity in Ecuador. Given the scale of financing, this amounts to considerable leverage with extraordinary reach across Chinese entities and policy issues.

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With these findings in mind, I would like to turn to the US government's policy agenda. As you consider appropriate responses to China's lending behavior, I would urge you to keep the interests of developing countries and their citizens in mind, particularly during the current crisis. The poorest populations in the poorest countries are also the most vulnerable to the COVID pandemic. And as we have heard repeatedly from public health experts, their vulnerability is ultimately our vulnerability. These countries need extraordinary support right now, and I would urge you to make that your leading objective in considering how best to respond to China's lending in the months ahead.

That means:

- The US government should work with partners to mobilize as much aid and concessional financing as possible. Some low-income countries are already in debt distress and will need some form of debt relief. But debt vulnerability is a symptom of a broader problem that nearly all developing countries are experiencing right now—a massive economic shock resulting from the COVID-19 pandemic. Debt relief alone is neither sufficient to respond to this shock, nor is it appropriate in every circumstance. What is needed is the sort of financial support that can help these countries mount an appropriate health and economic response to the crisis and get their economies growing again. To date, crisis response in developing countries measured in economic terms has been meager compared to the measures taken in the United States and other advanced economies. If these countries are going to do more, they will need support from wealthier countries.

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[2] "Common Framework for Debt Treatments beyond the DSSI," G20 Finance Ministers and Central Bank Governors, November 13, 2020.

The United States is already stepping up with direct support for COVID relief and access to vaccines for these countries, and the faster we can move on these measures the better. When it comes to economic support, we should continue to look to multilateral institutions like the World Bank and International Monetary Fund as leading partners. Our contributions to these institutions are effectively leveraged many times over by matching contributions from other donors and additional borrowing in financial markets. This year, the World Bank will be seeking new commitments from the United States and other donor governments to support its financing efforts in the poorest countries. Our current contributions to the bank amount to a fraction of one percent of our total aid budget. There is scope to do far more. And by the way, a strong US pledge will likely motivate the Chinese government to give more to the Bank. That would be another good outcome.

- The United States should have clear objectives and take a tough line with the Chinese when it comes to debt relief and sustainable lending, particularly under the auspices of the G20 Common Framework for Debt Treatments, an initiative launched last year to better organize efforts to provide debt relief to poor countries. As the largest of the government lenders to indebted countries, the Chinese government should bear the largest cost of any debt relief initiative. But that outcome will not be automatic, and the United States should take a number of steps to seek to ensure that China bears its share of the burden.

  Under the Common Framework, the United States should work with other countries to obtain a more comprehensive definition of government creditors such that Chinese government-owned creditors are not shielded from debt relief commitments. China Development Bank ought to meet that definition, despite the Chinese government's assertions to the contrary.

  The United States should also insist that the Chinese government disavow "no Paris Club" clauses in debt contracts and soften restrictions on borrower disclosure when those restrictions are at odds with reporting obligations to the IMF, World Bank, and the Paris Club. These commitments should apply retroactively to existing debt and should also take the form of a commitment to keep such restrictions out of future debt contracts.

- When it comes to responding to China, don't punish the victims. Where China has been an imprudent lender, we should be careful about punitive measures that are borne by the borrowing countries and that ultimately harm the citizens of those countries, particularly during a COVID-19 crisis that was not of their making. Measures that would withhold financing from developing countries due to their borrowing from China would greatly harm crisis response efforts and would ultimately set back US efforts to strengthen ties in these countries. Similarly, suggesting that these countries could selectively default on their legal obligations to Chinese lenders is misguided and would ultimately be damaging to these countries.

- The United States should lead by example when it comes to government contract transparency. The degree of secrecy we observe in Chinese contracts is unusual, particularly when it comes to restrictions imposed on the borrower, but the reality is that secrecy is the prevailing norm when it comes to government lending globally. The IMF and World Bank have sought to use various carrots and sticks over many years to promote greater disclosure among borrowing governments, with limited success.

But there are two parties in any government-to-government debt transaction and the case for transparency is equally strong on both sides of the loan. Just as citizens in borrowing countries ought to be able to know what commitments their governments are making to foreign lenders (particularly when that lender is another government), I ought to be able to know what commitments my government is making as a lender to foreign governments. In short, public debt ought to be public in creditor and debtor countries alike.

While the burden of transparency has fallen almost exclusively on borrowing countries to date, the United States could lead in expanding this agenda to creditor governments as well. That should start with a commitment to proactively publish government-to-government debt contracts where the US government is a creditor, whether through US Exim Bank, the US International Development Finance Corporation (DFC), the Department of Agriculture or any federal agency that is lending money to a foreign government. There is no downside in being a first mover on this agenda, and it will put the United States in a strong position to seek similar commitments from other G7 and G20 countries, with China being the primary target among the G20 governments.

- Finally, as the United States seeks to compete with China in offering development finance, our government should be vigilant about avoiding China's mistakes in lending imprudently into vulnerable environments. There's a particular risk that a legitimate desire to support US firms in foreign markets, along with a legitimate desire to provide financing to developing countries, can make us indifferent to the risks of too much lending or lending on terms that are too costly for debt-vulnerable borrowers.

  There's no doubt that the US government, through agencies like USAID, Exim Bank and the DFC, could be doing more to support high quality infrastructure projects in developing countries. But doing so in a manner that protects the US taxpayer and reliably generates benefits in these low-income countries will require focusing on independent measures of project quality and safeguards, financing terms that are appropriate to country circumstances, and strong alignment with IMF and World Bank financing frameworks.

Thank you.