

**Testimony of**  
**Anna Gelpern**  
Professor of Law and Anne Fleming Research Professor, Georgetown University Law Center  
Non-Resident Senior Fellow, Peterson Institute for International Economics

**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 20<sup>th</sup> century institutions ill-prepared to handle 21<sup>st</sup> 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 now 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.<sup>1</sup> 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.<sup>2</sup> 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

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<sup>1</sup> The formal name is Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative (DSSI).

<sup>2</sup> 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 21<sup>st</sup> 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.

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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*