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May 13, 2021

Memorandum

To: Members, Committee on Financial Services
From: FSC Majority Staff
Subject: May 18, 2021 Subcommittee Hearing entitled, "Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture."

The Subcommittee on National Security, International Development and Monetary Policy will hold a virtual hearing entitled, "Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture" on Tuesday, May 18, 2021, at 10:00AM via Cisco Webex. There will be one panel with the following witnesses:

- **Professor Anna Gelpern**, Anne Fleming Research Professor at Georgetown Law and nonresident senior fellow at the Peter G. Peterson Institute for International Economics
- **Mr. Scott Morris**, Senior Fellow, Center for Global Development
- **Professor Odette Lienau**, Professor of Law, Associate Dean for Faculty Research and Intellectual Life, Cornell University Law School
- **Mr. Jaime Atienza**, Debt Policy Lead, Oxfam
- **Mr. Sebastian Horn**, Economist, Kiel Institute for the World Economy

Background

As the COVID-19 pandemic has affected the global economy, many vulnerable countries have moved closer to default on their sovereign debt obligations. Even before the pandemic began, a joint IMF-World Bank staff paper published in February 2020 assessing public debt vulnerabilities in lower-income economies[1] found half of such economies to be at high risk of or already in debt distress. The sustainability of debt levels in many of these countries, according to IMF economists, hinged on a continued benign global environment and relatively stable commodity prices.[2] The IMF Board of Directors noted that the increased reliance on debt provided on commercial or near-commercial terms is raising debt service burdens and making low-income countries more vulnerable to domestic and external shocks. The IMF Directors called for greater debt transparency and more effective coordination among official creditors, critical elements for timely and effective debt resolutions.[3]

[1] The term "lower-income economies" includes all countries that are eligible for concessional financing from the World Bank (IDA-eligible countries), which includes all countries eligible for IMF concessional financing (PRGT-eligible countries) as well as recent PRGT graduates, for a total of 76 countries.
[2] *The Evolution of Public Debt Vulnerabilities in Lower Income Economies*, prepared by IMF and World Bank staff, December 26, 2019
[3] *Press Release summarizing the views of the Executive Board as expressed during its consideration of the staff report*, January 22, 2020

Within a month of Board consideration of the staff report, over 100 countries worldwide had instituted either a full or partial lockdown to prevent the spread of the Coronavirus disease 2019 (COVID-19), and many other countries had recommended restricted movement for some or all of their citizens.[4] The subsequent contraction in global trade, the service sector, tourism, a drop in commodity prices, and a reduction in remittances was a huge economic shock to developing and emerging market countries. To date, continued low interest rates, liquidity support from the international financial institutions, including grants from the Asian Development Fund and an expected a temporary suspension of debt service from the poorest countries to official bilateral creditors have been able to stave off a pandemic-induced sovereign debt crisis in the rest of the world.[5] [6]

<u>China's Belt and Road initiative</u>

China's Belt and Road initiative, or BRI, is a multi-trillion dollar infrastructure financing initiative announced in 2013, and is President Xi Jinping's signature foreign policy vision for putting China at the center of the global economy.[7] Some people see the Belt and Road, in particular the ports that China is building, as having military implications. Almost all infrastructure is dual-use–the same port built to accommodate a large commercial vessel could also accommodate a military vessel. Telecommunications have not only a business purpose but also a security and potentially an espionage application as well.[8]

The String of Pearls theory, which predicts that China is trying to expand its military presence by building civilian maritime infrastructure along the Indian Ocean periphery, may be shaping into reality.[9] In Sri Lanka, China loaned about $1.5 billion for a new deep-water port. But by 2017, it was clear Sri Lanka couldn't repay the loan, so instead, they gave China control of the port as part of a 99-year lease. China also controls a strategic port in Pakistan, where it has a 40-year lease.[10] It's pushing for a similar agreement in Myanmar, and it just opened a Chinese-run and owned naval base in Djibouti.[11]

China-backed infrastructure projects have a reputation for size and speed in implementation, but they have also provoked a backlash for their rejection of international development standards, lack of transparency, failure to use aid to promote good governance, and unsustainable debt practices that can undermine country and global stability.[12] Through BRI, low-income and emerging market countries now owe more to China than to all other major creditor governments combined. According to one study, developing and emerging market governments owe $370 billion to China compared to $246 billion in debt owed to the group of 22 Paris Club member governments

[4] *Coronavirus: The world in lockdown in maps and charts*, BBC News, 7 April 2020

[5] Asian Development Bank, *ASIAN DEVELOPMENT FUND 13 DONORS' REPORT: TACKLING THE COVID-19 PANDEMIC AND BUILDING A SUSTAINABLE AND INCLUSIVE RECOVERY IN LINE WITH STRATEGY 2030* (October 2020).

[6] International Monetary Fund, *IMF Executive Directors Discuss a New SDR Allocation of US$650 billion to Boost Reserves, Help Global Recovery from COVID-19* (March 23, 2021).

[7] *China's trillion-dollar plan to dominate global trade*, Vox, April 5, 2018

[8] *China's Belt and Road at Five*, John Hamre, Oct 1, 2018, Center for Strategic & International Studies

[9] *With Sri Lankan port acquisition, China adds another 'pearl' to its 'string',* by Jamie Tarabay, CNN, February 4, 2018

[10] *China's 'Belt and Road' Plan in Pakistan Takes a Military Turn*, New York Times, by Maria Abi-Habib, December 19, 2018

[11] *Satellite Images Show That Chinese Navy Is Expanding Overseas Base*, H I Sutton, Forbes, May 10, 2020

[12] *China's Belt and Road: Implications for the United States,* Jacob J. Lew and Gary Roughead, Chairs; Jennifer Hillman and David Sacks, Project Directors

combined.[13] The U.S. Department of Treasury under the previous administration estimated China lending to be somewhere in the range of $350 billion and $1 trillion.[14]

Debt Service Suspension Initiative

On April 15th, 2020, in the wake of the economic devastation caused by the COVID-19 outbreak, the countries that make up the G20 announced the Debt Service Suspension Initiative (DSSI). The DSSI allows for 73 low- and lower middle-income countries to temporarily suspend principal and interest payments on bilateral sovereign debt to G20 countries.[15] Eligible countries must be either International Development Association countries or "least developed countries," as defined by the United Nations, and must be current on their debt service to the World Bank and IMF. In addition, a country that delays debt payments must commit to using those funds instead to "increase social, health or economic spending in response to the crisis."[16]

Countries that opt into the initiative are given a five-year repayment period for missed payments with a one-year grace period.[17] In April 2021, the G20 extended the DSSI through the end of 2021, though no further extensions of the initiative are expected.[18] According to the IMF, as of mid-April, 46 countries have requested to participate in the DSSI, resulting in the deferral of almost $6 billion in debt service payments.[19] G20 countries called on private creditors to voluntarily participate in the DSSI and provide similar relief, but eligible countries that joined the initiative continued to pay their private creditors even after obtaining official relief due to fears of reputational damage, credit rating downgrades, and loss of market access.[20] Also, China asserted that the China Development Bank (CDB), the largest official bilateral creditor to low-income countries, should be treated as a private creditor, and as a result debt-service payments to the CDB were not suspended under the DSSI.

Common Framework

In November 2020, the G20 launched the "Common Framework for Debt Treatments beyond the DSSI" ("Common Framework"). The Common Framework is intended to go beyond the more modest DSSI to provide real debt relief to the same set of eligible countries through restructuring of debts from both G20 nations and private lenders. As it becomes clearer that debt restructuring, and in some cases, debt forgiveness, will be necessary to create sustainable debt loads for low- and lower-middle income countries, the Common Framework is seen as a way to ensure that all creditors are able coordinate equitable burden sharing.[21] The most significant feature of the Common Framework is that it brings non-Paris Club creditors—most importantly, China—into a new multilateral process for official debt relief with clear norms and expectations. Also, as opposed to the voluntary nature of private lender participation in the DSSI, debtor countries are

[13] *China's Overseas Lending*, Sebastian Horn, Carmen M. Reinhart, and Christoph Trebesch NBER Working Paper No. 26050, July 2019
[14] Center for Strategic and International Studies, Interview of Brent McIntosh (November 20, 2020)
[15] World Bank. COVID 19: Debt Service Suspension Initiative (April 23, 2021)
[16] Commiqué, Virtual meeting of the G20 finance ministers and central bank governors Riyadh, Saudi Arabia, April 15, 2020
[17] Reuters. How the G20's Debt Service Suspension Initiative works (October 15, 2020)
[18] Financial Times. G20 extends debt relief for low-income countries until end of this year (April 7, 2021)
[19] IMFBlog. Funding the Recovery of Low-income Countries After COVID (April 5, 2021)
[20] Yale Program on Financial Stability. The Limits of the G20's Debt Service Suspension Initiative (May 18, 2020)
[21] Devex. G-20 releases debt framework details (November 16, 2020)

required to seek treatment "at least as favorable" from private creditors as they receive from official bilateral creditors. [22]

The Common Framework relies on transparency and cooperation from all of the lender nations involved, but questions remain about how private-sector participants will participate. Also, although China has said that its support of the Common Framework signals a commitment to multilateralism[23], many China contracts give China senior creditor status over other sovereign creditors, which is at odds with the Common Framework principle of fair burden sharing amongst sovereign creditors and could complicate debt renegotiations.[24] On January 27, 2021, Chad became the first country to request debt restructuring under the Common Framework[25] and was followed shortly thereafter by Zambia and Ethiopia.[26]

How China Lends

The scope of lending from China is largely unknown. The Chinese government or government-controlled entities do not disclose their lending, and since China is not part of the Paris Club, they have not been required to make standardized disclosures. What information had been made public is largely based on excerpts of documents or media reports.[27]

A recent paper entitled, "How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments" provides the broadest view yet into the specific terms written into contracts between Chinese official entities and sovereign borrowers. Though these contracts originate through different entities within the Chinese state, with deals with the China Development Bank and the Export-Import Bank of China making up a large majority of the documents studied, the features of the contract are similar to each other, enough so that the authors concluded that this sample is "sufficiently large to make clear that Chinese entities use standardized contracts."[28]

The paper outlines three aspects of Chinese lending contracts that differ from almost all other similar bilateral agreements. First, all Chinese lending contracts signed since 2014 contain broad confidentiality clauses that bar the borrower from disclosing broad swaths of information about the debt, up to and including the debt's very existence.[29] These confidentiality clauses put both sovereign borrowers and other foreign creditors in difficult situations. Sovereign debtors are unable to seek assistance when necessary without violating the terms of their agreement, while international creditors are not able to get a full picture of a sovereign borrower's liabilities.[30]

Second, many of the contracts include a requirement for Chinese-controlled collateral accounts[31] and requirements that the debt not be included in any comprehensive debt restructuring, such as the Common Framework.[32] Nearly a third of the contracts studied in the report, totaling 55% of

[22] HIS Markit. The G20's Common Framework (March 16, 2021)
[23] Center for Strategic and International Studies, Interview of Brent McIntosh (November 20, 2020)
[24] Devex. How does China lend? Insight from a study of 100 loans (March 31, 2021
[25] Reuters. Chad becomes first country to ask for debt overhaul under G20 common framework (January 28, 2021)
[26] Bloomberg. Rescheduling Payments to Ease Ethiopia Debt Risks, IMF Says (April 15, 2021)
[27] The Wall Street Journal. Hidden Chinese Lending Puts Emerging-Market Economies at Risk (March 30, 2020)
[28] Gelpern, Anna, et al., *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments* (March 2021)
[29] Financial Times. China's secret loan contracts reveal its hold over low-income nations (March 31, 2021)
[30] CNBC. About half of China's loans to developing countries are 'hidden,' study finds (July 12, 2019)
[31] The Economist. What 100 contracts reveal about China's development lending (March 31, 2021)
[32] Reuters. Database reveals secrets of China's loans to developing nations, says study (March 31, 2021)

the amount loaned,[33] required borrowers to keep collateral at a bank to serve as securitization of the loan. These special accounts necessarily mean that the international creditors and observers are not given a full picture of the borrower's fiscal health and can lead to overestimation of a borrower's debt servicing capacity.[34] In addition, these loans often include so-called "no Paris Club" clauses, which require borrowers to agree not to seek to restructure the covered debt in the Paris Club of major creditors and can keep borrower countries at risk of default. [35] With the inability to disclose the debts due to the very broad confidentiality agreements and the inability to restructure those debts through the Paris Club process, borrower countries are given very few options for amelioration of severe debt stresses.

Third, the specific terms of the acceleration and termination clauses aim to give China maximum leverage over the internal politics and policymaking of the borrower[36]. The contracts contain debt acceleration, termination, and cancellation clauses that go beyond those seen in other contracts and seem to aim at giving the Chinese state increases leverage over the borrower's domestic and foreign policy. Contracts from the China Development Bank and the Export-Import Bank of China contain not only cross-default clauses, which allows the lender to demand immediate and full repayment and termination of the loan if a borrower defaults on any of its China-entity loans, but also allows for such acceleration and termination if the borrower undertakes any actions that are deemed to be adverse to Chinese interests.[37]

<u>Legislation</u>

- **H.R. XXXX, Authorization for theU.S. to participate in the 12th Replenishment of the Asian Development Fund.** This bill would authorize $177.44 million to fund the U.S. contribution to the twelfth replenishment of the Asian Development Fund, delivering COVID relief grants to the poorest countries in Asia.
- **H.R. XXXX, To Authorize Debt Treatment for Countries Eligible for Assistance from the International Development Association and/or Countries that are United Nations Least-Developed Countries, including through the "Common Framework for Debt Treatments beyond the Debt Service Suspension Initiative" (Common Framework) and through the Debt Service Suspension Initiative (DSSI).** This bill would provide for a $52 million U.S. contribution for debt restructuring and relief efforts under the G20's Debt Service Suspension Initiative and the G-20 Common Framework for Debt Treatments.
- **H.R. XXXX, To authorize the Secretary of the Treasury to loan Special Drawing Rights to the Poverty Reduction and Growth Trust at the International Monetary Fund to help eligible low-income countries respond to the health and economic effects of the global COVID–19 pandemic.** This bill would authorize the Secretary of Treasury to lend 1.1 billion Special Drawing Rights to the IMF's Poverty Reduction and Growth Trust to provide zero-interest loans to help poor countries respond to the pandemic and restore economic growth.

[33] Gelpern, Anna, et al., *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments* (March 2021)
[34] Quartz. Secret contracts show how China structures loans to become Africa's "preferred" lender (April 9, 2021)
[35] Axios. How China uses secret loans for geopolitical power (March 31 ,2021)
[36] Devex. How does China lend? Insight from a study of 100 loans (March 31, 2021)
[37] Voice of America. Report Raises New Concerns over China's Overseas Lending (April 9, 2021)