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Gregory Makoff
Harvard Kennedy School

Théo Maret
Mesarete Capital

Logan Wright
Rhodium Group

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Sovereign Debt Restructuring with China at the Table: Forward Progress but Lost Decade Risk Remains

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Gregory Makoff, Senior Fellow, Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School.

Théo Maret, Investment Analyst, Mesarete Capital

Logan Wright, Partner, Rhodium Group

I. Introduction

Sovereign debt restructuring deals have not been smooth sailing over the last few years. They have moved slowly, been marked by bickering between China and G7 stalwarts, and the outcomes have been inconsistent. Recent policy innovations, however, have successfully accelerated the pace at which deals are being completed — that's the good news. The bad news is that China remains highly reluctant to grant permanent debt relief. Deals are coming faster, but debt relief may be insufficient to avoid repeat restructurings. This is deeply unfortunate in the post-Covid-19 context, with many lower income countries at or near debt distress (World Bank 2024 at 18).

The first part of this paper explains this recent history. We explain how the architecture of sovereign debt restructuring has evolved over the last four years in response to China's objections to the traditional rules and procedures of the Paris Club and the IMF. After a short introductory section on China's overseas lending boom, we

review disputes over the procedures applied in the restructuring of the debt of Congo Brazzaville (2018–2019), Suriname (2021–2023), and Zambia (2020–2024). Then we review the policy innovations announced between 2022–2024 to resolve these disputes. We suggest that faster motion in recent debt restructurings is a direct result of this successful policy process, China's pressure leading to positive procedural changes.

The latter part of this paper addresses a remaining challenge: China's general unwillingness to grant permanent debt relief. This creates the possibility that the international restructuring architecture will be run to prefer debt maturity extension and avoid granting debt relief. This risks a repeat of the "lost decade" of the 1980s, when write-downs were systematically avoided, and many countries were trapped in serial restructurings until debt relief was finally granted in the Brady plans of the 1990s. We discuss this topic in two parts, first addressing China's complex institutional setting, then explaining China's policy, legal, and economic constraints to granting debt relief.

We conclude by recommending that China establishes a sovereign debt asset management company to centralize management of its problematic sovereign loans, an idea borrowed from the playbook China used in the 1990s to clean up its commercial banks. The idea would be for the new agency to take over all the problematic loans from China Development Bank (CDB) and China Eximbank. This would provide significant institutional efficiency, allow better high-level oversight, facilitate superior data management, and allow China to more flexibly respond to the exigencies of future international sovereign debt negotiations.

II. Background

1. China's Lending Boom

By 2020 it was essential to include China as a full member of international sovereign debt restructuring negotiations because of its significant new lending to developing economies. This section summarizes the main features of China's post-2000 overseas lending boom, highlighting several characteristics of China's lending program that have added complexity to the debt negotiations that followed.

According to AidData, China has lent $1.3 trillion since 2000, peaking in the decade between 2009 and 2019, followed by a more recent pullback (Parks et al 2023 at 10). China's lending to developing countries has rivaled that provided by the G7 since 2000, and it has had a significant concentration in many of the poorest—former HIPC—countries. As a result, when the boom turned to bust, China found itself—more often than not—to be the biggest single bilateral lender at the debt renegotiation table.

China's lending boom was driven by several factors. Historically, China lent in the developing world—particularly in Africa—for political reasons, for example building the TAZARA Railway (operated by the Tanzania-Zambia Railway Authority), to allow land-locked Zambia to export its minerals without going through white nationalist South Africa and Rhodesia (Liu Haifang 2024). From 2001 China has increasingly encouraged foreign business lending and business acquisition as a part of its plan to boost China's own economy. In the country's 10th Five Year Plan (2001–2005) China called it a "Go Out" strategy (Kroeber 2020 at 301). In the wake of the Global Financial Crisis of 2007-2008 China had excess capacity in steel and cement, and so sought more foreign

projects to build railways, roads, and dams as a way to deal with industrial overcapacity—and protect jobs—at home (Alex He 2019). China's foreign lending programs have also been used to boost sales in high-tech industries, including telecommunications; internet; satellites; social control software; and undersea cables (Hillman 2021).[1] Another rationale for China to boost foreign lending has been to earn a higher yield on excess reserves, historically parked in U.S. Treasury bonds (Zongyuan Liu 2023).

There is some debate on the degree of central planning that went into China's international loans in this period. Some foreign experts suggest there was a high degree of centralized planning. Look, for example at China Development Banks $50 billion of loans to Venezuela between 2001 and 2015.[2] Others suggest, however, that China's lending has been chaotic and poorly planned.[3] In a recent paper, Tianyi Wu and Yunnan Chen provide a comprehensive overview of the diverse array of Chinese international lenders to Africa, including a detail mapping of the loan products and the approval process for each lender; this work suggests to us that China's international lending had systematic government oversight throughout (Tianyi Wu and Yunnan Chen 2024).

China's foreign lending is generally described as "complicated," one aspect of which is its growing multiplicity of lenders over time. China's foreign lending was

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[1] In another example, China Development Bank extended a $30 billion credit line to Huawei and a $15 billion line to ZTE Corp. to support their international expansion, giving them a significant financial advantage when bidding against international rivals (Sanderson and Forsythe 2013 at 158).

[2] In September 2011, China Development Bank President Chen Yuan, met with Venezuelan President Hugo Chávez in Caracas, where he presented the country's leader with a 600-page book filled with advice on long-term strategic planning (Sanderson and Forsythe 2013 at 131).

[3] The Belt and Road Initiative (BRI) is a "loose portfolio of disparate projects," and there "are no official figures on the total amount of money…no clear definition of what distinguishes a BRI project from any other form of Chinese outbound investment or aid. Nor is there a central coordinating bureaucracy for the BRI." (Shirk 2023 at 228).

historically provided by CDB and China Eximbank, since 2015 more than 40 commercial creditors have become involved, including state-owned commercial banks, state-owned enterprises and private companies, and including insurance provided by Sinosure (Tianyi Wu and Yunnan Chen 2024 at 1).

China's lending portfolio also developed a characteristic legal complexity over the last fifteen years. First, many of its loans are secured on commodity exports (i.e. oil in Venezuela and copper in Zambia). Second, China has insisted on including unconventional conditions in its sovereign loans, including confidentiality clauses, expansive cross-default clauses, preference clauses vis-à-vis other bilateral lenders, and reserve accounts (Kanyi Lui and Yunnan Chen 2021, Gelpern et al 2021).

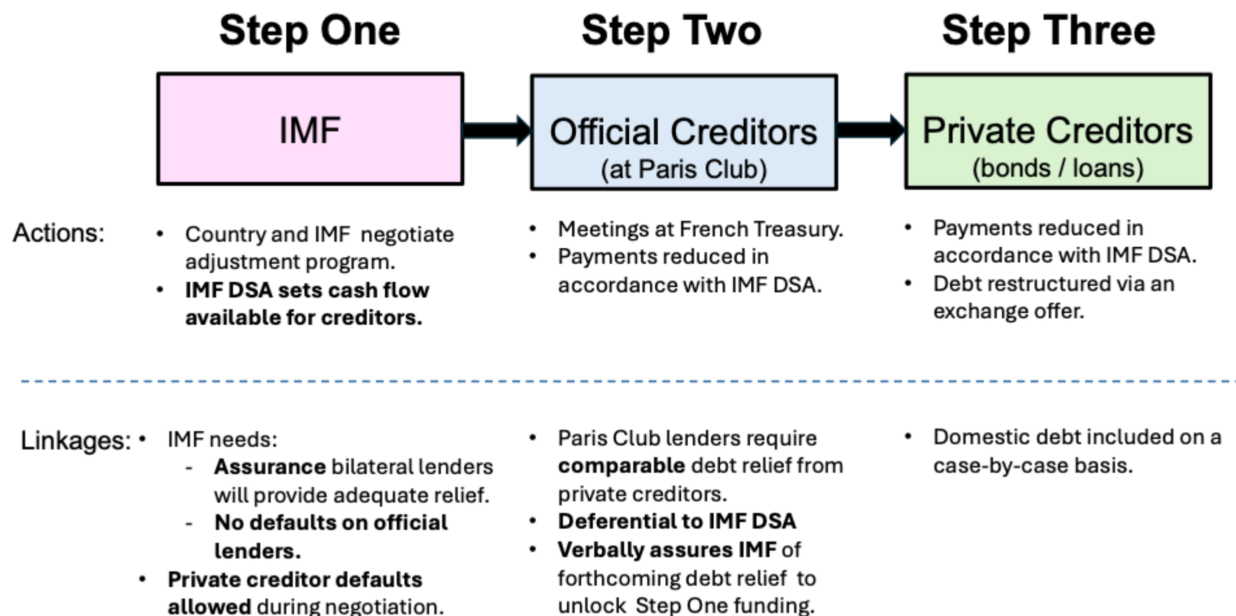
In sum, after 2000 China rapidly became a leading international lender to many of the world's poorest countries, its lenders included a growing multiplicity of entities, and many of its loans involved unusual legal conditions. This left China particularly exposed to losses in its lending portfolio and getting dragged into messy sovereign debt restructurings once the boom turned into a bust around 2020.

2. Sovereign Debt Restructuring Before 2020

The pre-2020 system for restructuring sovereign debt dates to around 1989, when the various pieces jelled into place. Figure 1 sets out the basic steps in the restructuring process, involving three distinct counterparts to the country: The IMF, official bilateral creditors, and private commercial creditors.[4]

[4] Most sovereign debt was in loan form in the 1980s but is in bond form today. As a result, some IMF policies during the intervening years refer first to sovereign loans and then later to sovereign bonds, historical details we ignore in this overview discussion.

Figure 1: Pre-2020 Sovereign Debt Restructuring Process



The action in a debt restructuring flows from left to right. Step One is for the country to work with the IMF staff to develop a robust economic plan for the country, called a "Program." Under this program the country commits to carry out the fiscal, monetary, and structural reforms, required to correct the imbalances that caused the country to fall into financial distress in the first place. The IMF runs what it calls a "Debt Sustainability Analysis" or "DSA," which is used to calculate how much cashflow the country can devote to debt service going forward. This defines the depth of the debt restructuring to follow because bilateral and commercial debts need to be reduced to fit within the payment "envelope" calculated by the IMF. In Step Two the country approaches official bilateral lenders for debt relief consistent with the IMF DSA. In Step Three the country approaches private commercial creditors for debt relief consistent with the IMF DSA.

While a simple-looking three-step linear process, there are complex interlinkages between the steps. The most important interlinkage comes in Step One. The problem is that at this step the country generally needs to unlock immediate funding from the IMF to continue to provide basic goods and services. The IMF, however, cannot unlock funding unless it is confident that the debt relief required in steps two and three will materialize in due course. The accepted practice has been for the IMF request assurances from the country's official bilateral lenders that they intend to provide debt relief consistent with the IMF's DSA. These so-called "financing assurances" have traditionally been provided by the Paris Club to the IMF in verbal form.[5] Such assurances, traditionally, have been sufficient to unlock interim funding from the IMF—a linkage from Step Two back to Step One.

An astute reader will now ask why the IMF would be willing unlock funding with such an assurances only from official bilateral creditors while not demanding similar assurances from the country's private commercial creditors before lending? After all, debt relief must be obtained in both Step Two and Step Three if the country's future cash flows are to fit within the envelope set out in the country's DSA. The problem is that public bondholders cannot agree in advance to provide debt relief that will satisfy the IMF; they only commit to a transaction after the Step Three negotiation, after full disclosure, and after presentation of a binding offer. As a result, the IMF and Paris Club have developed a two-part solution. First, official bilateral creditors in the Paris Club condition the effectiveness of their debt relief agreements on the country seeking

[5] "That assurance is derived verbally from the chair summing up at the end of the Paris Club meeting where the working paper for the treatment is discussed" (IMF 2024-Financing Assurances at 11).

"comparable treatment" from its private commercial creditors.[6] Second, the IMF's act of lending to the country while it is in default to commercial creditors—a mechanism that helps the country get a better deal, as we now explain.

When the IMF lends to a country in default the country gains bargaining power vis-à-vis private creditors by its ability to keep functioning. A country can typically survive months or years funded by the non-payment of commercial debts plus cash from the IMF (and other development partners). Thus, the country's back is not to the wall and can wait out commercial creditors, who generally do not like owning non-performing assets. Holding tough, insisting month-after-month on restructuring terms consistent with the IMF's DSA and comparable to the terms agreed with Paris Club lenders gives the debtor country bargaining power against creditors who otherwise, as in the 1980s, would seek full repayment. This is exactly why the IMF introduced its "Lending Into Arrears" (LIA) policy under which it simply requires a country to be in "good faith negotiations" with its private creditors to receive funds.[7]

More recently, in 2015, the IMF introduced a parallel "Lending Into Official Arrears" (LIOA) policy to address the scenario under which one or more bilateral creditors refuse to cooperate in Step Two, which traditionally was not a problem. Driving the shift was the Russian invasion of Ukraine, after which the IMF faced the prospect that a dispute between Russia and Ukraine over an unpaid $3 billion financing would allow Russia to block the approval of a new IMF loan to Ukraine.[8] The new policy "would allow the IMF, in certain carefully defined circumstances, to provide financing to a

[6] In IMF jargon this interlinkage is generally referred to as "comparability of treatment" or abbreviated as CoT.
[7] "Before the Lending Into Arrears policy was introduced in 1989…commercial creditors could have veto power over Fund financing." (IMF 2024-Financing Assurances at 15).
[8] See "The IMF Outfoxes Putin: Policy Change Means Ukraine Can Receive More Loans" (Åslund 2015).

country even when it has outstanding arrears to official bilateral creditors" (IMF 2015), while before this policy was introduced all bilateral loan arrears had to be resolved or consented to before the IMF would lend. This policy was further expanded in a 2022 policy review (IMF 2022) in response to frictions with China—as discussed below.

The steps set out above describe the main features of how most sovereign debt restructurings have worked for over 30 years. To be sure, there have been many exceptions and variations. For example, sometimes countries restructure their debt prior to missing a payment, compressing the three-step process. These are "pre-emptive restructurings" and include restructurings done by Uruguay in 2003 and Greece in 2012. The order of the steps has been shifted too: Jamaica's 2010 deal was launched and settled prior to IMF board approval of its program. Other classes of debt may also be included, for example, domestic debt.

Another common exception to this three-step process was the treatment of non-Paris Club and other historically non-traditional lenders. Significant debt restructurings, such as Iraq's, often involved a large number of non-traditional creditors, which were dealt with pragmatically. For example, Iraq's commercial creditors, which were treated together in 2006, were primarily contract counterparts, builders of roads and power stations and trade counterparts, not bond lenders, while the country's bilateral lenders included members of the Gulf Cooperation Council, Serbia, and China (Hinrichsen 2019 at 32). Closing the country's Paris Club agreement in 2004 did not depend on concurrent settlement of these other bilateral claims. Instead, the country committed to a comparable restructuring of these other bilateral debts over time.

It was in this ancillary fashion that China has long been a part of the sovereign debt restructuring process. The country has restructured its obligations with many borrowers over the years (Kratz et al 2020), sometimes on a purely bilateral basis, and sometimes, as in the case of Iraq, as a follow on to Paris Club negotiations. With the growth of Chinese lending, however, by 2020 this ancillary inclusion of China was no longer tenable. For example, how could the Paris Club agree on the terms of a restructuring with a country and expect China to accept its terms when China is a much bigger lender? The challenge, however, would be how to make China comfortable when the rules of the game included a certain informality based upon the common majority control of the Paris Club[9] and the IMF board.[10] Not surprisingly, disputes followed.

III. Disputed Deals

1. Republic of Congo Restructuring 2018–2019: China Does Not Provide Financing Assurances

The Republic of Congo (Congo-Brazzaville) approached the IMF for a program in 2018, but a program couldn't be agreed until 2019, in part, because of friction over the restructuring of debt owed to China. Congo-Brazzaville's external debt stood at 61.75%

[9] For reference, the permanent members of the Paris Club are Australia, Austria, Belgium, Brazil, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, Korea, Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States of America. The following countries have enjoyed *ad hoc* status allowing them to participate on a voluntary basis: China (since 2013), India (since 2019), and Hungary (since 2024). The additional countries have also been involved on an *ad hoc* basis: Argentina, Czech Republic, Kuwait, Mexico, Morocco, New Zealand, Portugal, Saudi Arabia, South Africa, Trinidad and Tobago, Turkey and the UAE (Paris Club 2025).

[10] Under current allocation the permanent Paris Club members control 61% voting stake at the IMF board, while China is underrepresented with only a 6.08% stake (IMF-Voting Power 2025).

of GDP of which roughly a third (21.4% of GDP) was owed to China. In that context, the IMF was not comfortable disbursing funding until it had obtained assurances that China would agree to restructure this debt, as per the policies described above in Part II.

As per tradition, the IMF requested a commitment from the Chinese authorities committing to provide a debt treatment in line with program parameters. This became a sticking point because, while China had often provided debt relief to countries over the years, it was not in the habit of signing such commitments in advance, particularly without knowing exactly the financial parameters of the deal. Moreover, the IMF approached the People's Bank of China (PBoC) to provide the financing assurances even though the bulk of the lending had been provided by China Eximbank and CDB – two institutions over which the PBOC has little *de facto* control (even though all three entities are 100% owned by the government of China).

China refused—or was unable—to sign the financing assurances requested by the IMF. As a result, the program was stalled until China and Congo-Brazzaville bilaterally agreed to a debt restructuring the following year.[11] These events are not well known—the only hint coming in a cryptic footnote in a June 2019 IMF staff report: "This report provides a full update to the July 2018 Staff Report that could not be considered by the IMF Board due to the lack of sufficient financing assurances" (IMF-Congo 2019 at 5).

[11] Another reported challenge was a parallel dispute with commodity trader counterparts over similar matters.

2. Debt Service Suspension Initiative (DSSI) 2020 – 2021: Lack of Private Creditor Participation Breeds Distrust

In the wake of the COVID-19 outbreak, China joined the G20 in supporting an initiative to grant the 76 poorest countries[12] a one-year suspension of debt service to help them deal with the pandemic. This was an important milestone: Never before had China been a full member of such an international debt restructuring initiative. Moreover, China would be the largest single grantor of debt relief because it had lent 66% of the debt cash flows in the scope of debt to potentially be rescheduled in the program.[13] The program was called the G20 Debt Service Suspension Initiative (DSSI) and, economically, it provided for a delay of payment, not a write-off, as suspended amounts would be repaid in future years—the lightest form of debt restructuring.

While celebrated as a great achievement of international cooperation, the DSSI ended up breeding distrust.

China became upset that neither commercial creditors nor multilateral lenders provided any comparable debt relief in the end. China's consternation is understandable because an April 15, 2020, G20 Communiqué said: "All bilateral official creditors will participate in this initiative, consistent with their national laws and internal procedures."; "We call on private creditors, working through the Institute of International Finance, to participate in the initiative on comparable terms."; and, "We ask multilateral development banks to further explore the options for the suspension of debt service"

[12] DSSI eligible countries included IDA countries (those eligible to borrow from the World Banks International Development Assistance Association) and the "least developed countries" as defined by the United Nations.
[13] Calculation using data available in Brautigam and Huang (2023 at 8); counting $27 billion "all China" applicable cash flow and $14 billion non-China bilateral cash flow and excluding multilateral and non-China private categories because they did not participate in DSSI.

(G20-April 2020). Yet neither commercial creditors nor multilateral lenders were forthcoming with debt relief. So, when China gave the largest amount of debt relief it felt that it had been misled and taken advantage of. For their part, Paris Club lenders, who gave comparable relief, but on a smaller nominal amount of debt, were frustrated that China worked separately and was sparse in sharing data.[14]

Notwithstanding these growing tensions, in October 2020, China joined the G20 in calling for the creation of a new Common Framework for restructuring the sovereign debt of the poorest countries, a process to supersede the Paris Club, one which would include China, India, and other traditional non-traditional players (Paris Club-Common Framework 2020). While such an inclusive system was long overdue, it would get off to a rocky start.

3. Suriname's Debt Restructuring Negotiation 2021–2023: China Challenges IMF Debt Sustainability Analysis and IMF Struggles with Lending into Official Arrears Policy

Suriname's debt restructuring process began in April 2021 when the country reached a staff-level agreement with the IMF on a new program, which anchored expectations for the debt restructuring to follow. The press release announcing the $690 million, three-year program, said "Debt relief from Suriname's official bilateral partners and additional financing from multilateral partners will be required to help ensure debt sustainability and close financing gaps. This will need to be complemented by progress toward a

[14] As the largest lender to the affected countries, China gave the largest absolute amount of debt relief; on a relative basis China and Paris Club offered similar relief, China 30% of their exposure, Paris Club lenders 34%, using data from Brautigam and Yufan Huang (2023 at 16).

restructuring of commercial debt that will result in sufficient creditor participation to restore debt sustainability and close financing gaps.” (IMF 2021-Suriname).

Suriname too wealthy to apply for the Common Framework,[15] the traditional, pre-2020 restructuring process would apply. As a result, the country would negotiate separately with Paris Club members, non-Paris Club members, with bondholders (organized into a “steering committee” of top holders), and with non-bond commercial creditors. Yet Suriname’s three biggest international creditor segments were multilaterals (30% of GDP), Bondholders (31% of GDP), and China (17% of GDP), while traditional Paris Club Creditors were owed only 2% of GDP. This meant that the core negotiation would be with China and commercial creditors, not the Paris Club.

Just as in Congo-Brazzaville, financing assurances were a sticking point: China did not want to assure the IMF that it would provide the debt relief required by the IMF’s DSA in advance of its bilateral negotiations with the country — there are also reports that the Chinese negotiators were wary of providing debt relief that would not be matched later on by commercial creditors.[16] This, in turn, made it impossible for the IMF to approve Suriname’s program and to disburse funding. The program was stuck. And it took 8 months—until December 22, 2021—for the board to approve the program, which had been agreed with the staff that April. The wording of the December announcement was telling: “Suriname owes arrears to China and India, which have provided assurances, although less specific than those provided by the Paris Club creditors, that they intend to work with Suriname toward a debt restructuring that will restore sustainability” (IMF 2021-Suriname Staff Report at 14). The announcement clarified that

[15] The same eligibility criterion applies as in the DSSI (see footnote 10).
[16] According to sources familiar with the negotiations.

the program could only go forward because China had given its consent for the IMF to lending while Suriname was in default to it (Maret-Suriname 2022).

Beneath the delay—and the headlines—was the fact that Suriname being a non-Common Framework country meant that China was not bound to accept the IMF's debt sustainability analysis as the starting point of debt relief discussions. The subtlety in the dispute was that in Common Framework restructuring cases China (like all participants) had agreed to accept the IMF's DSA as the starting point. But in this case China had the latitude to dispute the IMF's DSA—and it did. In June 2023, an anonymous Chinese diplomat in Suriname told *The New York Times*, "The I.M.F. gives some parameters relating to the debt relief, but for us I think it is not binding" and "China will negotiate only with the Surinamese government" (Goodman 2023).

Notwithstanding tensions over financing assurances, consent of arrears, and DSAs, Suriname's bilateral and bond restructurings were completed in late 2023 (Suriname 2023).

4. Zambia's Debt Restructuring Negotiation 2021–2024: China Challenges Lack of Domestic Debt Restructuring and Lack of Comparable Contribution by Bondholders

In November 2020, Zambia was the first African country to default post-COVID-19 (Cotterill 2020), and, in early 2021, Zambia—alongside Chad and Ethiopia—was one of the first three countries to apply for the restructuring of its debt under the Common Framework (Reuters 2021, Paris Club—Common Framework 2021). Yet it took four

years for Zambia to reach the finish line (Mitimingi and Hill 2024), China and its international counterparts wrangling repeatedly over the restructuring process.

The first battle was over an IMF 2021 decision to allow Zambia to exclude the country's domestic debt from the perimeter of the restructuring. This exclusion was not atypical, but foreign investors subsequently piled into Zambia's domestic bonds and enjoyed an exceptionally high return on the back of the country's no-restructuring promise. There were almost $3 billion of inflows from foreign investors, an amount equal to the size of Zambia's Eurobonds. Now Zambia—and the Fund—had an awkward situation: the country's foreign bondholders and bilateral lenders would be taking a large loss while these new foreign bond buyers would be making a big profit. China was right to question the situation even though there was an initial logic in protecting the local market so that it would provide interim funding to the government. The IMF's response to the awkward situation was to rework the DSA's assumptions to increase the cash flow available to pay external creditors, which mollified China (Maret-Zambia 2023).

The second battle broke out in October 2023 when China balked at Zambia's agreement with bondholders on the terms of their restructuring. China and other official bilateral creditors had agreed on the terms of a restructuring deal with Zambia in June 2023, IMF managing director Kristalina Georgieva announcing, “This is a significant milestone for the G20 Common Framework under which China, India, Saudi Arabia and Paris Club creditors joined forces to agree deep debt relief for Zambia” (IMF-Zambia 2023). However, she spoke too soon because soon after Zambia announced the terms of its bond restructuring, China decided that the bond debt relief was not comparable to that agreed with official bilateral creditors, and on November 17, 2023, the official

creditors committee (co-chaired by China) concluded the same (Hill and Goko-Petzer 2023), forcing a renegotiation of the bond restructuring.[17] Bondholders complained vigorously, but revised terms were agreed in April 2024 and the restructuring transaction was completed in June 2024 (Maret-Zambia 2024).

As painful as was the processes of restructuring the debt of Zambia, Congo, and Suriname, the contention led to positive change, as we now review.

IV. Policy Evolution in Response to China-Related Disputes

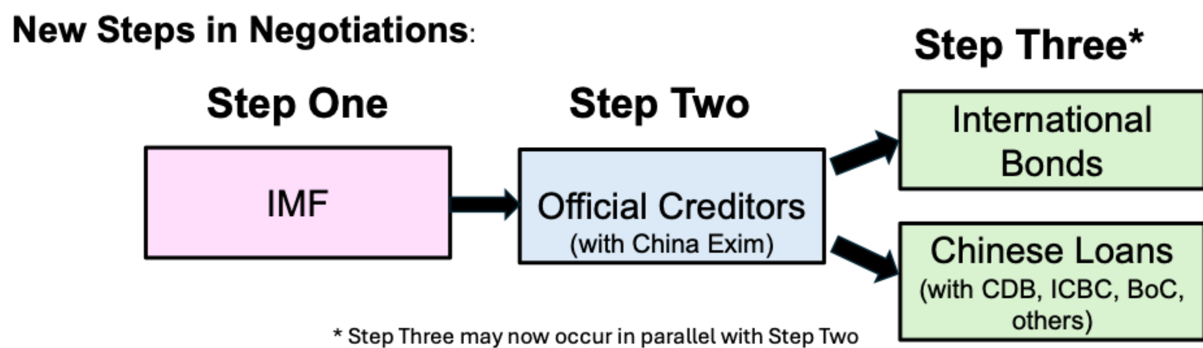
The first headline policy innovation to address these delays and conflicts in sovereign debt restructurings was the establishing of the Global Sovereign Debt Roundtable (GSDR) in December 2022. First convened in April 2023 (IMF-GSDR 2023), the GSDR was established to be a forum to discuss processes and standards in sovereign debt restructuring. It has been a successful endeavor, the GSDR emerging as a unique vehicle to build trust and improve transparency in the area of sovereign debt restructuring policy.

In parallel, IMF staff worked intensively on several policy adjustments to address the various IMF-related issues being raised by China. The fruits of their work are reflected in the following publications: May 18, 2022, Review of the Fund's Arrears Policies and Perimeter and, October 31, 2024, Guidance Note on the Financing Assurances and

[17] We understand that China had been shown in June indicative terms of what private creditors would be offered, and the October terms exceeded China's expectations. Given that Chinese negotiators stop at every juncture to review development with authorities in Beijing, it was a serious breach of protocol for expectations to not have been met (Hancock, Hill, and Al-Rikabi 2023). See also Maret (2024) about the position of CDB and ICBC.

Sovereign Arrears Policies and the Fund's Role in Debt Restructurings. Together with various GSDR pronouncements, the revised rules set out in these new IMF policy papers have established a new set of practices have come into being as described in Figure Two.

Figure Two: The New Post-2020 Debt Negotiation Process



New Rules and Processes:

- IMF **expands accepted form of debt relief assurances** to accommodate China.
- IMF willing **to lend to countries in default on some official loans,** diminishing official creditor holdout risk
- G20 has stated that official creditors' **"collective assessment" will complement the IMF's DSA analysis.**
- **Enhanced** right of bilateral creditors to **revoke agreements** if private creditors do not give **comparable debt relief** (in deal MOUs).
- **Higher scrutiny** of cases where **domestic debt** is excluded from transactions.

The first important difference from the pre-2020 system is that China appears explicitly in the diagram and in two places: China Eximbank appears as an official creditor in Step Two while CDB and state-owned commercial banks and suppliers as commercial lenders in Step Three. This differentiation has been accepted by the international community in recognition of China's wish to treat these lenders differently.

To put this in perspective, this treatment is not so different from the United States and the U.K. and Germany where the government would sit as official creditors on the Official Creditors Committee while commercial banks and bondholders based in their countries would sit on the Commercial Creditors Committee. It's a manageable complexity, provided China's various lenders are reasonably coordinated.

The second important difference is that the IMF built operational flexibility into its "financing assurances" policy to accommodate China's institutional challenges in providing binding debt relief commitments in advance of Official Creditor Committee negotiations. Under the new policy IMF staff can evaluate the credibility of such assurances provided by a bilateral lender on a case-by-case basis.[18] This new modality seems to satisfy both China and IMF staff and management.

The third difference comes in the treatment of local debt. A local debt working group of the Global Sovereign Debt Roundtable announced on October 12, 2023, that domestic debt would be treated on a "case-by-case basis" (GSDR 2023 at 6). At a headline level, this policy is no different than that which applied prior to 2020—it was "case-by-case" before as it is now. But we believe that expectations are now changed: Prior to 2020, including domestic debt was done quite selectively, while after China's complaint about Zambia's exclusion of domestic debt it seems to be almost required. For example, on the tails of China's dispute over the exclusion of domestic debt in Zambia, private creditors pressured Sri Lanka to include domestic debt in its

[18] IMF staff may now evaluate whether a "credible official sector process" is in place and that a "key stage" in their processes has been reached, rather than receiving hard and fast verbal and written commitments (IMF 2024 at 10).

restructuring even though government documents during 2022 indicate that only an external debt restructuring would be required.[19]

The fourth difference is an important evolution of the IMF's 2015 policy that allows Fund to lend to countries in default to official bilateral lenders, it's Lending Into Official Arrears Policy (LIOA). The recent China-related delays in lining up program approvals (for example Congo and Suriname) led the IMF in the context of a 2022 policy review to broaden the scenarios under which it is permitted lend to countries in default on official bilateral loans.[20]

The fifth difference relates to the enforcement of the comparable treatment of official bilateral lenders and commercial creditors. The October 2024 Ha co-chairs progress report refers to the inclusion of "revision or clawback clauses in official creditor agreements" as a way to enforce comparability of treatment of private creditors (GSDR-Compendium 2024 at 6). This language is stronger than the language demanded in the past by the Paris Club requiring countries to seek comparable treatment from commercial creditors. Individual bilateral creditors, including China, would now have the contractual right to back out of deals if a country gives better terms to commercial creditors. To underscore its importance, China pushed this issue in the Zambia deal, insisting that the country renegotiate its deal with private creditors because its calculations showed that commercial creditors were getting too good a deal. Thanks to China, the longstanding comparability of treatment rule now has some teeth.

[19] Only sovereign external debt is referred to in moratorium announcement of April 12, 2022 (Sri Lanka-Moratorium 2022) and debt restructuring presentation of September 23, 2022 (Sri Lanka-Investor Presentation 2022 at 18).

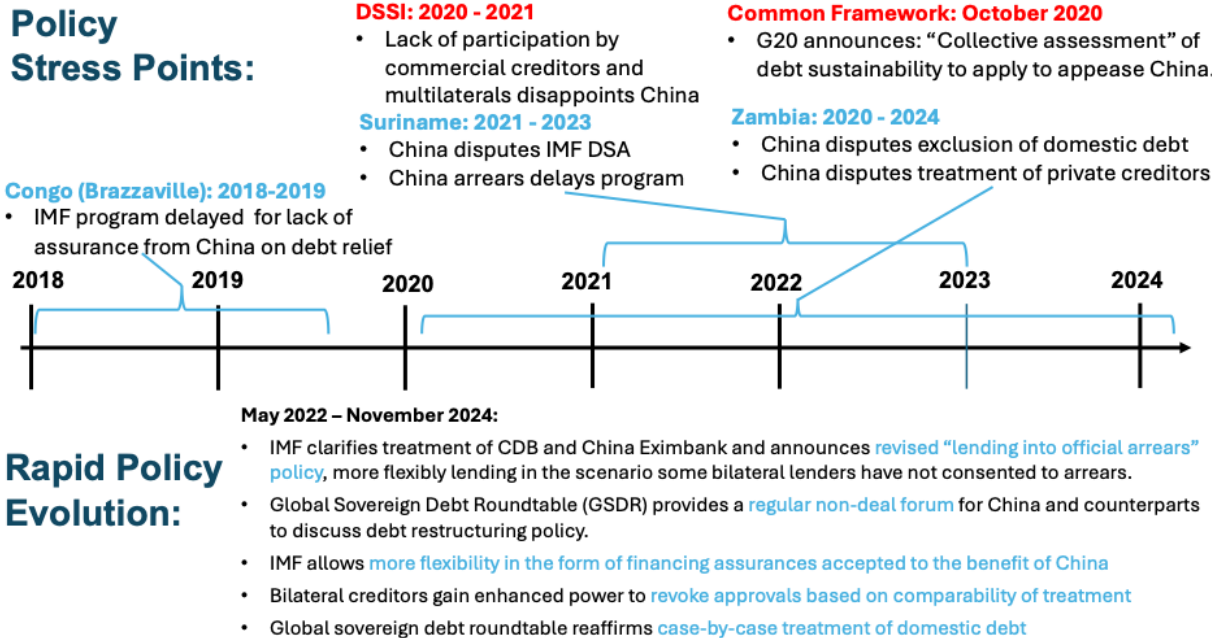
[20] The four scenarios under which the IMF is permitted to lend are detailed nicely in a recent IMF staff paper (IMF-Financing Assurances 2024 at 28-38).

Sixth, there has been a significant tussle over the role of the IMF's DSA in the process even though there has been no change in policy: IMF lending, as before, is explicitly conditional on the country carrying out a debt restructuring to reduce future debt cash flows to within the payment envelope determined by the IMF staff. What's notable is that the founding document for the Common Framework published by the G20 and the Paris Club stated: "The need for debt treatment, and the restructuring envelope that is required, will be based on an IMF-WBG Debt Sustainability Analysis (DSA) and the participating creditors' collective assessment" (G20-Common Framework 2020). In the context of the recent disputes over the deals for Suriname and Zambia we read into this language a warning that China wants to be heard on DSA calculations and does not want to be subject to big haircuts just because the IMF staff running the DSA for a country feels the country should get incrementally more debt relief rather than incrementally less. However, to the disappointment of China, there was no subsequent change in official IMF policy: Fund staff retains control over the DSA. Yet some recent deals have come under scathing attack for being too friendly to China and other creditors. For example, Council on Foreign Relations expert Brad Setser wrote recently about Sri Lanka's 2024 deal: "The structure of the IMF's debt targets set completely aside what I consider to be the core issue, namely whether $45 billion of debt is too much for an economy that struggles to generate foreign exchange and has no history of collecting tax revenues....Sri Lanka's difficulties are being treated by both the IMF and creditors as problems of extended illiquidity, not a problem of fundamental solvency—a judgment I question given the rise of Sri Lanka's gross (and net) external debt…between 2012 and 2022" (Setser 2024).

All this work to build consensus on the rules of the game in sovereign debt restructuring is now bearing fruit: deals are moving faster. As of writing this paper, Zambia and Ghana's pending deals are completed, Sri Lanka's deal is nearing completion and Ethiopia's deal is progressing expeditiously. The logjam is broken.

To wrap up, Figure Three summarizes the disputes of the last few years and the recent policy innovations that followed. The next section moves on to discuss debt restructuring's remaining challenge: China's general unwillingness to grant permanent debt relief.

Figure 3: Summary of Policy Evolution 2022 – 2024



V. China’s Loss Avoidance and Institutional Complexity

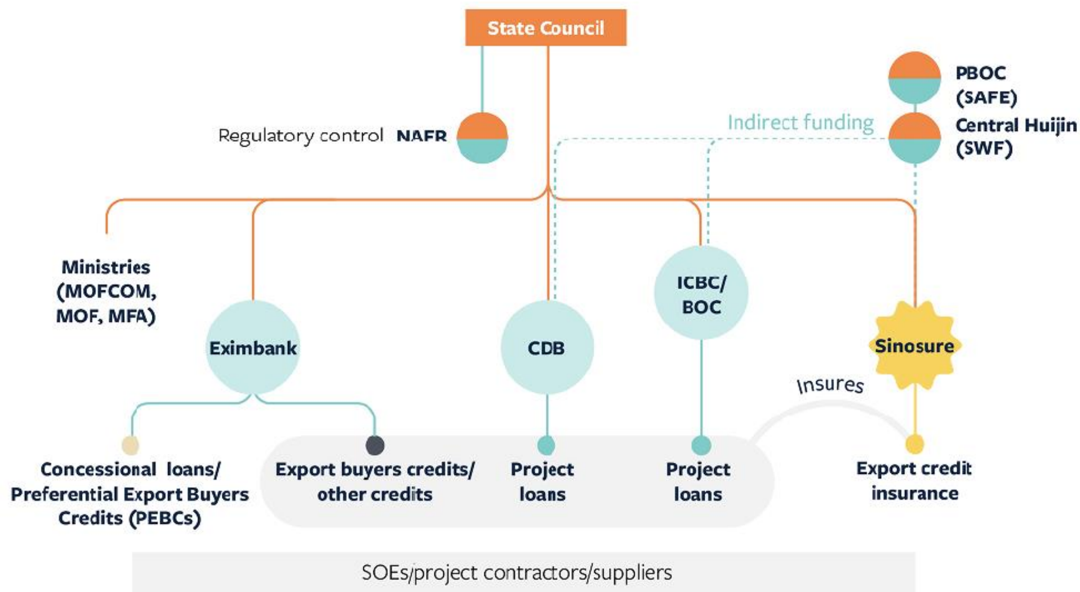
While much has been written about China’s “complicated” participation in sovereign debt restructuring over the last few years, most foreign scholarship fails to detangle relevant institutional and substantive factors. We take these in turn, first addressing China institutional complexity and then addressing China’s clear and open reluctance to grant permanent debt relief.

1. Institutional Complexity

China has a particularly Byzantine way of managing its participation in international sovereign debt restructuring negotiations. Rather than deciding on its objectives and sending officials to international negotiations with the power to deal, Chinese negotiators are reported to have little latitude to agree on changes to state positions. International counterparts are often left waiting as their Chinese counterparts jump through numerous hoops at home to respond.

Figure Four sets out China’s institutional architecture: The main lenders are the CDB and China Eximbank, followed by state-owned commercial banks, including ICBC, Bank of China. State-owned insurer Sinosure guarantees a large portion of loans provided by the commercial banks. Funding comes from government entities, shareholdings split between the Ministry of Finance and the Peoples Bank of China and other entities.

Figure Four: Architecture of China's Overseas Lending



Source: Yunnan Chen and Zongyuan Liu (2023) at 6.

The first thing to appreciate is that China's system reportedly runs exceptionally quickly and efficiently when granting new loans. China's lenders are famous for approving loans in a year, for example, when the World Bank might take three years. The challenge is that China's lenders move exceptionally slowly when a borrower wants debt relief. The typical explanation is that Chinese loan officers are generally unwilling to sign off on debt restructuring agreements for fear of criticism and black marks in their career files as well as legal and regulatory concerns. The same applies to their managers and the top executives of the lenders. As a result, officials at each node in the system require the approval of officials from the node above. Nothing moves until the State Council signs off—which often takes months. Hence, the long delays when granting debt relief.

It doesn't help that China has put its two main policy banks in different negotiating categories: China classifies China Eximbank as an official bilateral lender and CDB as a commercial lender. Not only does China represented separately at Step Two and Step Three of the debt negotiation process, but China Eximbank and CDB send different teams. This practice contrasts with G7 countries who generally send a single counterpart who represents both their direct, bilateral sovereign loans as well as their export guarantee agencies that lend on a more commercial basis. As mentioned above, China has also fielded a multiplicity of other lenders in recent years.

2. A Policy of Loss Avoidance

China has an explicit policy of avoiding taking losses of sovereign loans, which is backed up by regulations and procedures that make it very difficult for officials to operationalize exceptional losses.

To start with, loss avoidance has generally applied to domestic loans. China has worked hard to prevent its banks from recognizing non-performing loans and has recently provided exceptional support to prevent its municipalities from defaulting on over $1.4 Trillion dollars off debt (Bloomberg 2024). In 1999, China set up four "asset management companies" to take on the losses of the country's four major banks. While this looked, at first, like an international standard "good bank/bad bank" restructuring in which the good bank is recapitalized, and the bad bank is wound down over time, the Chinese bad banks took another path (Zongyuan Liu 2023 at 80). As expected, the asset management companies took on the banks' bad assets, although at par value. However, instead of writing down the value of their bad assets, the asset management

companies obtained licenses to develop new business lines, including speculation in shadow lending to real estate developers and setting up securities brokerages to try recoup the losses. China's 1990s bank losses have never been transparently accounted for.[21]

China has also avoided recognizing losses in its international lending portfolio. To be sure, China's lenders have agreed to a large number of debt reschedulings with their international borrowers over the years, extending payment terms, sometimes raising, sometimes lowering the interest rate. But there is only a limited record of Chinese lenders agreeing to debt write-downs that would trigger recognition of permanent losses. Chinese sovereign debt write-downs that have been recorded are exceptional and involve a small percentage of its lending portfolio. For example, China did agree to a debt write-down for Iraq in 2010, but this was justified by linking it to opportunities to invest in the country's oil sector.[22] ODI scholars Marina Rudyak and Yunnan Chen explain that only RMB-denominated Zero Interest foreign aid loans are generally available for loan forgiveness/write-off, but that these only account for around 5% of Chinese loans (Marina Rudyak and Yunnan Chen 2021 at 14); they have also noted that Cuba and Venezuela have received exceptional debt relief because the countries are considered "special friends" of China.

Chinese scholar Muyang Chen explains (Muyang Chen 2023 at 1760) that Chinese lenders have taken a "new money approach", generally offering distressed

[21] This treatment of losses contrasts with the U.S. model where, for example, during the Global Financial Crisis, losses by banks and auto companies were recognized openly and early so the businesses could move on.
[22] "Chinese Deputy Foreign Minister Shen Guofang reportedly explicitly stated that the Chinese Government forgave the debts incurred during Saddam Hussein's regime for the purpose of gaining access to the bidding processes on oil and infrastructure projects" (AidData—Iraq).

countries new loans to pay old debts rather than to write off debts—the same tactic international lenders used in the early years of the 1980s LDC debt crisis. She writes:

> "Emergent empirical research indicates that China has demonstrated a preference for a commercially oriented new-money approach over an interventionist haircut approach, despite the fact that the major Chinese banks are state-owned. China has written off zero-interest foreign aid loans capitalized by government revenue, which account for a rather small portion of its overseas development finance, but insists on not writing off bank loans, which represent the vast majority; while it has frequently restructured loans, it has rarely made changes in interest rates or reduced their principal."

In her recent book *The Latecomers Rise* (Muyang Chen 2024 at 19, 67-68) Chen also explains China's general reason for avoiding granting debt relief, in this case with respect to domestic government debt: "The government has no intention to wipe out the debts with taxpayers' money; it sees the debt as a market issue that should be resolved through a market-based means."[23]

Notwithstanding this stated policy, China does have a record of recapitalizing its policy banks as recorded by AidData in Figure Five.

This data suggests that China's policy banks are stressed by losses and payment delays in their portfolios—given the lack of transparency, it's hard to know for sure.

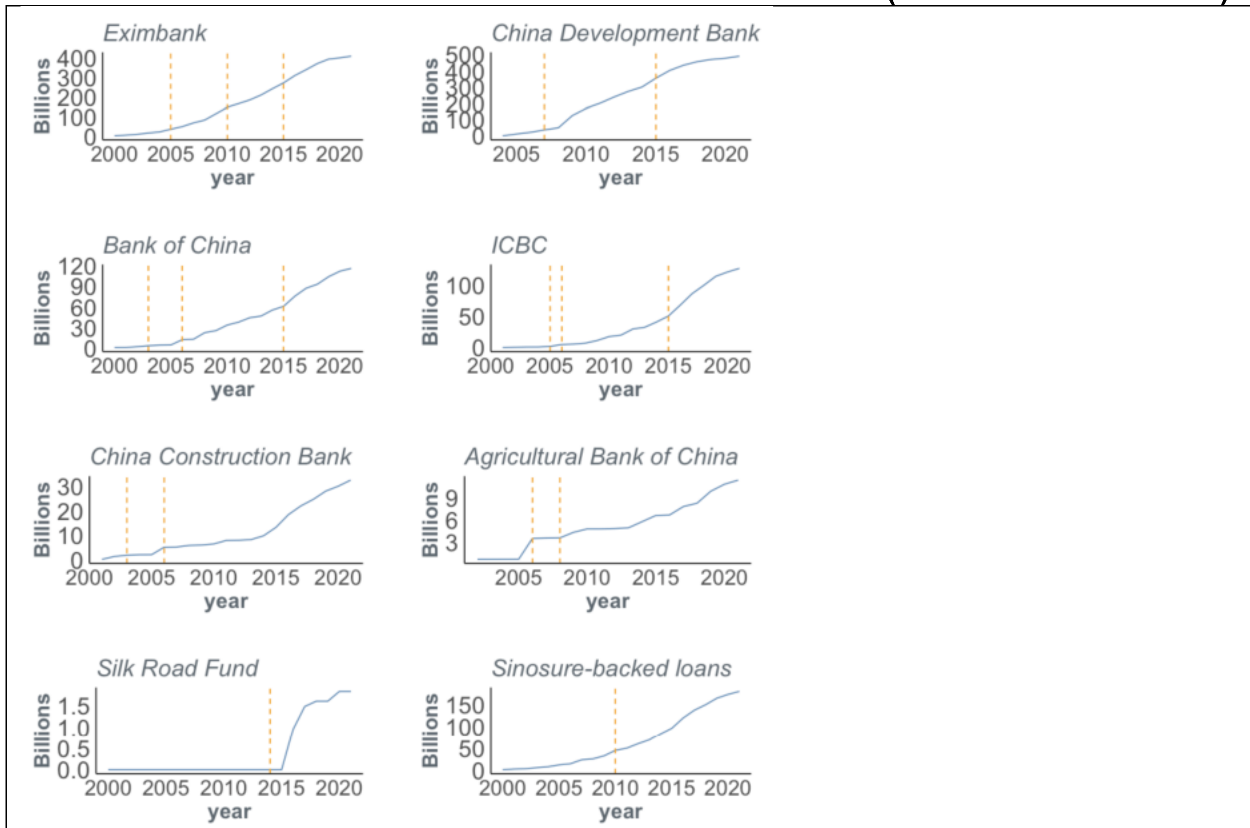
[23] While Chinese stated policy is tough, out of the spotlight China has selectively granted payment deferrals that imply net present value reduction; but without transparency, an orderly internal process, and smooth working relationships with international counterparts, it will be hard to a) give China due credit for any such generosity, and b) move along debt relief in an orderly and predictable way in the future.

For our purposes, however, it's important to distinguish that CDB, primarily lends to local governments in China for infrastructure and has a gigantic balance sheet. CDB's total assets at end-2022 $2.6 trillion (China Development Bank 2022 at 9).

In contrast, China Eximbank focused entirely on external lending, granting trade credit/export credits with state guarantees. China Eximbank had total assets at end-2022 of $861 billion. However, its net profit of only $1.1 billion—a 0.14% return on asset, suggests little financial capacity to agree to losses on foreign loans without further recapitalization (China Eximbank 2022 at 7).

Figure Five. China's Overseas Lending Entities and Recent Recapitalizations

Cumulative Loan Commitments to Low Income Countries (Parks et al 2023 at 61)



These recapitalizations include (Parks et al 2023 at 62-63):

- July 2005: SAFE injected $5 billion into China Eximbank
- December 2007: Central Huijin injected $20 billion into CDB
- June 2008: SAFE injected $166.5 billion into CDB
- April 2010: Central Huijin injected $11.7 billion into China Eximbank and Sinosure.
- June 2011: China Investment Corporation injects $3.15 billion into Sinosure.
- July 2015: SAFE injected $48 Billion into CDB and $45 Billion into China Eximbank.
- October 2023: Xi announces $50 billion injection into each of CDB and China Eximbank

In sum, we believe that China has little willingness and little financial capacity at its policy banks to agree to large-scale debt write-downs on their developing markets loan portfolio at international sovereign debt negotiations. This is consistent with the outcome of recent debt negotiations with Suriname, Zambia, Ghana, and Sri Lanka—all of which involved debt maturity extensions and interim coupon reduction/forgiveness, not principal write-downs, by official bilateral lenders.[24]

China's position on sovereign debt restructuring, and its significant sway as a large lender, risks a repeat of the lost decade of the 1980s, when international banks insisted on "extend and pretend" restructurings to avoid taking losses (Sachs 1986, Fischer 1987). In that period, U.S. banks were so exposed to what was then called Less Developed Country (LDC) debt that they couldn't afford to take losses. To protect them the U.S. Treasury, the Federal Reserve, and the IMF developed economic plans that

[24] See: Suriname (Paris Club 2024); Zambia (Zambia 2023); Ghana (World Bank-Ghana 2024); Sri Lanka (Sri Lanka 2024).

assumed sufficient growth to pay off the existing debt. The growth never materializing, this led to serial debt restructuring, which didn't end until the 1990s, when the countries carried out Brady restructurings with significant debt relief (Rieffel 2003).

The Brady plans were a success. After these restructuring nearly all the Brady countries thrived, using the opportunity to reform and improve financial governance to avoid ever going into debt default again.[25] This 1980s episode proves the damage that will be caused if international lenders do not give sufficient debt relief when it is warranted. We fear the same scenario is playing out again today, the international community not giving sufficient debt relief, substantially raising the odds that serial restructurings and a lost decade, particularly in Africa, will follow. Therefore, we urge China do build in more flexibility to its processes and policies to grant permanent debt relief when needed. But our message is by no means targeted exclusively at China: All the parties at the table need to work together to deliver prompt debt relief where it is warranted.

VI. Recommendation

We have reviewed developments in the area of sovereign debt restructuring since 2020. Impressive progress has been made with significant help from China and through good faith dialogue and negotiation. Policy announcements by the Global Sovereign Debt

[25] Some countries, notably, Argentina, Venezuela, and Ecuador did not follow through with reforms and ended back in extended or repeated debt crisis.

Roundtable and new policy papers published by the IMF make the rules of the game much clearer and more complete.

Yet sovereign debt restructuring will ever be quick or easy: It entails a complicated, interlinked process that involve many parties and many difficult policy and financial decisions. Therefore, it should be no surprise if sovereign debt restructurings continue to take more than a year to go through all the steps, including the development of a sound economic plan with the IMF staff. The hope is that, with recent reforms, they don't take much longer than a year or eighteen months going forward.

But efficiency and timeliness in processing sovereign debt restructurings is not enough. Deals need to restore countries to financial health and economic stability. In this respect, some recent deals are falling short. It's good the system is running faster and clearer, but its concerning to perceive a strong reluctance to grant permanent debt relief—even when it is truly needed. More needs to be done by all parties: The IMF, official bilateral lenders, and private creditors.

Since this paper has focused on China's role, we close by offering a suggestion to China to help it continue to play an active and constructive leadership role in international sovereign debt restructurings, including granting permanent debt relief.

We suggest that the Chinese government applies its 1990s bank clean up model to its current sovereign debt exposures. We propose that China evaluates the benefits of setting up a new asset management company whose purpose will be to administrate China's problem sovereign loans and whose focused, dedicated team would represent China at all international sovereign debt negotiations.

We see three potential benefits to China in undertaking such a strategy.

#1. Financial. This strategy would protect the balance sheets of China's policy banks. Under our proposal all China Eximbank's and CDB's problems loans would be transferred to this asset management company at par value. As a result, they could then focus their internal resources on their new loan businesses without distraction from complicated international sovereign debt restructurings.

#2. Governance. The Chinese government would have superior control of its financial and reputational risks if relying on a single, consolidated team to manage all of its sovereign debt exposures. It takes a high level of skill and experience to handle these restructurings, and China could deliver superior training to a smaller, centralized team. Furthermore, by fielding a single team at international negotiations, China would have tighter control over messaging and negotiating positions. Data management would also be facilitated by having a single entity that can invest in sophisticated data analytics.

#3. Flexibility. This institutional set up will give China's top leadership more flexibility to respond to diplomatic exigencies. If debt relief is warranted and agreed in the future by the top Chinese officials, this organizational structure would allow maximum control of the process.

We believe that setting up such an asset management company would be in China's national interest and make life much easier for those involved with this painful and difficult issue. And we believe that lending officers at China's policy banks should welcome such policy innovation. Moving bad sovereign debts to a new agency at par

value should be welcomed with relief at CDB and China Eximbank, whose officers would otherwise need to be associated with the absorption of losses.

To close, we recall Stanley Fischer's words from 1987 (Fischer 1987 at 169):

> "Without debt relief, the debt crisis promises to drag on for decades, slowing growth in the developing countries, sapping the energies of policymakers, and tieing up the multilateral lending agencies in endless crisis negotiation. With sensible debt relief, countries and the multilateral institutions can begin to worry about growth-oriented development policies."

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About the Authors

Gregory Makoff: is a senior fellow at the Mossavar-Rahmani Center for Business and Government at the Harvard Kennedy School and a senior fellow (non-resident) at the Centre for International Governance Innovation (CIGI), a think tank based in Waterloo Canada. Gregory is the author of *Default: The Landmark Court Battle over Argentina's $100 Billion Debt Restructuring.*

Théo Maret: is an Investment Analyst at Mesarete Capital. He is also the author of the *SovDebt Oddities* blog.

Logan Wright: is a Partner at Rhodium Group and leads the firm's China markets research group. He has a Ph.D. from George Washington University and has master's and bachelor's degrees in security studies and foreign service from Georgetown University. Fluent in Mandarin, Logan is based in Washington D.C. after over two decades living in Beijing and Hong Kong.

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