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POLICY POINTS

Chinese creditors provided 63 percent of all the suspensions between 2020 and 2021, while holding 30 percent of claims. This reinforced deep concerns in Beijing about “**joint action and fair burden sharing**”.

Paris Club norms on debt treatments were not shared by Beijing. On many issues, such as the definition of “official bilateral creditor” and whether solvent state-owned companies should be given debt relief there is no universal rule.

Accusations from G7 leadership that China was creating “debt traps” reinforced hardliners in China who were **suspicious of multilateral cooperation on debt** and weakened the position of those who saw cooperation as benefiting China and borrowers.

Integrating China into Multilateral Debt Relief: Progress and Problems in the G20 DSSI*

Deborah Brautigam and Yufan Huang

ON MARCH 25, 2020, AS THE COVID-19 PANDEMIC swept across the world, the heads of the International Monetary Fund (IMF) and the World Bank proposed that the leaders of the world’s 20 largest economies, the Group of 20 (G20), provide breathing space by suspending the collection of debt service on official loans to 73 of the world’s poorest countries. The G20 quickly launched the Debt Service Suspension Initiative (DSSI) on April 15, 2020.

The DSSI was the first big test of the G20’s global economic coordination leadership regarding low and middle-income country sovereign debt. The changing pattern of global credit demanded a new architecture for solving debt crises. Since 2008, the G20 has been the premier forum for international economic coordination, but the G20 had not previously worked with the Paris Club. The DSSI was intended by some of its designers to bring China into a well-oiled system for global sovereign debt governance, with the Common Framework as the scaffold upon which a new architecture would be built. Through analysis of available data, process-tracing through over 100 interviews with G20 participants and borrowers, and case studies, we argue, with some caveats, that China fulfilled its role fairly well as a responsible G20 stakeholder implementing the DSSI.

WHY DID CHINA JOIN THE DSSI AND THE COMMON FRAMEWORK?

FIRST, CHINA WAS CONCERNED ABOUT its reputation given its previous commitment to the G20 and its reliance on the G20 to support China’s quest for reforms like IMF quotas. In 2013, the People’s Bank of China, Ministry of Foreign Affairs, and the Ministry of Finance co-wrote a 130-page research report laying out China’s strategy to gain more say in international finance

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through the G20. Chinese President Xi Jinping had critiqued the US before, saying that countries must not “use [multilateral institutions] when they fit into one’s self interest and abandon them when they don’t.” When the DSSI was proposed as a G20 initiative, Chinese decision makers felt somewhat locked in.

Second, China had concern for its reputation due to COVID-19. Even though the Chinese government had been pushing strongly against the idea that COVID-19 originated in China, Beijing was under pressure to shore up its image as “a responsible major power” and to help out countries hurt by the pandemic. “This would be a positive gesture for China to the outside world, that we are trying to help others to weather the problems caused by COVID-19,” one Chinese official said.

Third, the Chinese Ministry of Finance and central bank officials attending the G20 did not have enough time to process all the information, consult with different ministries and banks at home, and fully understand what the initiative entailed legally, financially, and politically when they signed on to the DSSI. For example, which Chinese creditor should be classified as “bilateral official creditor”, and whether Chinese banks should be compensated by the government, was not fully discussed.

Fourth, some of the Chinese officials in charge believed that the time was ripe for China to engage in multilateral debt coordination. These officials, with more experience in international finance, were able to convince leaders at home that participation in the Common Framework appeared to be in China’s interest for the long term despite the near term financial loss, as long as restructuring involved “joint actions and fair burden sharing.” Compared to their colleagues, these officials are also much more sensitive to the reputational risks discussed above. These less-sensitive colleagues, together with the banks and several other ministries that were not involved in the G20 policy process, would play a much bigger role in the implementation stage.

Finally and probably most importantly, with China’s past success in pushing through the IMF quota reform using the G20, these globalist officials have developed enough trust and a sense of ownership toward the G20 platform, which they believed was not dominated by the US or the West (unlike the Paris Club). They felt comfortable enough that they could co-write the rules

according to China’s interests, and eventually, to some extent, they did. Yet the vagueness of the initial terms led to considerable “storming” within the G20 as the DSSI and Common Framework were implemented.

HOW DID CHINA PERFORM DURING THE DSSI?

BORROWERS WORRIED ABOUT THE implications of the DSSI for their sovereign credit ratings, and about cross-default clauses in their contracts. One interviewee involved in the process said eligible countries “were terrified” to join the DSSI. Furthermore, administrative costs were high in implementing the DSSI, which required lawyers to negotiate new contracts for every deferred loan, negotiations that had to be repeated in each of the three phases. Countries were required to pay interest on the deferred amounts, which imposed new costs totalling US\$ 575 million. Twenty-seven eligible countries and regions did not participate in the DSSI at all, and another three participated in 2020 but backed out in 2021.

Using data published by the World Bank and available in the International Debt Statistics, supplemented by IMF data for Angola, where the China Development Bank (CDB) and Industrial and Commercial Bank of China (ICBC) provided voluntary loan reprofiling, we found that Chinese creditors provided 63 percent of all the suspensions between 2020 and 2021, while holding 30 percent of the claims.

We also looked more narrowly at China’s participation in the DSSI as an official bilateral creditor compared with other G20 countries. Using data for 2021 (the only full year), we find that Chinese official creditors (this could include CDB) only suspended 43 percent of the debt service they were due that year. This is about the same percentage as Germany (45 percent), lower than other Paris Club members of the G20 like France (65 percent), Japan (89 percent), and the US (73 percent), but higher than other middle-income creditors like Brazil and Turkiye. This suggests that guidelines for suspensions were not always clear or mutually agreed, which resulted in less relief than originally anticipated.

We also found that many borrowers experienced drops in disbursement from Chinese creditors. In the 46 participating countries, disbursements from all Chinese creditors dropped 51 percent in 2020-2021 from the

level two years before, while disbursements from other bilateral creditors increased 17 percent and multilateral creditors 15 percent. A Chinese businessman facing payment delays in an African country explained: “Chinese banks overall do not allow loan disbursements during debt service moratoriums,” yet Chinese disbursements also dropped in DSSI eligible countries that did not participate in the suspensions, suggesting that a more general fear of sustainability may have been at work.

WHAT WERE THE MAIN CHALLENGES OF THE DSSI?

OUR RESEARCH ILLUSTRATES FOUR challenges that would spill over from the temporary DSSI to the Common Framework.

1. Fair Burden-Sharing.

As the DSSI was taking shape, calls for fair burden sharing among all three creditor groups (bilateral, multilateral, and commercial) were strong in Europe, Africa, and even in the US private sector. For example, as the DSSI was being launched, the president of the Institute of International Finance, an influential Washington DC-based trade group of commercial banks, advised that debt restructuring, if required, should include “multilateral, bilateral and commercial creditors.” China’s Minister of Finance, Liu Kun, issued a blunt statement as the DSSI was being launched: “If the World Bank Group fails to join, its role as a global leader in multilateral development will be seriously weakened, and the effectiveness of the initiative will be undermined.” Ultimately, World Bank and IMF data show that Chinese creditors contributed more than their share of suspensions. Perceptions of unfairness reinforced Chinese demands for full creditor participation.

2. Common Understandings.

Through decades of experience with debt relief, the G20’s eleven Paris Club members enjoy a common vocabulary. For many in the G20, “private” and “commercial” were synonyms, yet China regarded its state-owned policy bank, China Development Bank (CDB) as a commercial lender (as did Germany its state-owned commercial lender KfW-IPEX). The World Bank’s Debtor Reporting System guidelines specified that official lending

comprised “lending by sovereign governments and all public institutions in which the government share is 50 percent or above.” Yet a few paragraphs later, the guidelines stated that debtors were to classify external creditor institutions “engaged in commercial banking activities” as private, not official, “whether the ownership of the bank is public or private”.

Disputes arose over the perimeter of debt to be treated. The Paris Club normally included all debts owed by central governments, their state-owned enterprises (SOEs), or private firms with a government guarantee (when these were included in the IMF’s analysis), while some non-Paris Club creditors believed the moratorium should only extend to central government debts. Companies – whether state-owned or not – who take out debt with sovereign guarantees create a contingent liability for the government, which will only “owe” that debt if the company itself cannot pay. Our interviews confirm that indeed, during G20 negotiations Chinese officials strongly resisted including loans to SOEs in the DSSI.

3. Geopolitics and the “Discourse Trap”.

The DSSI was launched in a period of high geopolitical tensions, where the Trump administration and other G7 members regularly made unfounded accusations that China was using debt to entrap countries for strategic leverage. Interviewees repeatedly pointed to these geopolitical tensions as a factor in internal discussions. The geopolitics strengthened the feeling many held in Beijing that the IMF was biased against China, and that the multilateral development banks were reluctant to participate only because the G7 wanted to shift additional costs to China. For Chinese officials that understand the benefits of multilateral coordination, such paranoia is both hard and politically risky to argue against.

4. Fragmented Decision-making in China.

While the G20 financial track is shared by China’s Ministry of Finance and People’s Bank of China, the implementation process in China involves many other players such as the banks, Ministry of Commerce, Ministry of Foreign Affairs, and the National Development and Reform Commission. Even for the Ministry of Finance (MOF), the Department of Fiscal and Financial

Affair, which was not in charge of the G20 negotiations, became the main body at the MOF that coordinated the DSSI and Common Framework implementation. These departments do not share the same level of concerns for China's reputation and understanding of sovereign debt as those who brought China into the DSSI and Common Framework. During implementation, these multiple veto points created opportunities for those opposed to multilateral debt initiatives to drag their feet. This was especially true after a senior MOF official who supported the G20 initiatives left the Ministry (in August 2021), leaving a position unfilled for over a year.

CONCLUSION

THE DSSI PROCESS PROVIDED MODEST debt relief for the countries that joined, although, ironically, their total costs are likely to have increased given that global interest rates rose sharply after the initiative ended, affecting costs on the deferred debt service. However, its more important success lies in putting in place a ramp for China to enter a multilateral system of mitigating debt distress. Although the Common Framework has rightly been criticized for its contentious implementation, Chad, Zambia, and Ghana have all had their IMF programs approved, with financing assurances from China and other G20 creditors as part of a new multilateral process.

For policymakers trying to elicit China's cooperation with multilateral debt restructuring, the way geopolitics

spilled over into the fragmented policy process in China suggests the importance of continued dialogues to build trust and encourage learning of Chinese actors about the benefits of creditor coordination. ★

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