上海國際問題研究院
SHANGHAI INSTITUTES FOR INTERNATIONAL STUDIES

SIIS Report

The G20's Sovereign Debt Agenda
What Roles for China and the US?

Contributing Authors
YE Yu
ZHOU Yuyuan

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Task Force on Sovereign Debt Governance
Shanghai Institutes for International Studies
October 2021

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Foreword

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Following the second phone call between the two leaders of China and the United States, the bilateral high-level exchanges have picked up momentum in the fields of diplomacy, trade and security. Notably, the Zurich meeting between Yang Jiechi, Director of the Office of the Foreign Affairs Commission of the CPC Central Committee and Jake Sullivan, US National Security Advisor on Oct. 6 was widely considered a "practical", "in-depth" and "constructive" dialogue by both Chinese and American media, and has paved the way for the first Xi-Biden virtual summit by year-end. Some observers went further to comment it as a turning point of China-US thaw and even upturn in bilateral interactions.

Nonetheless, this optimistic mood or just cautious optimism is far from prevalent in Beijing and Washington today, as both sides have yet to bridge the enormous perception gap on how to carry and manage China-US relations. During recent talks in Zurich, Yang Jiechi explicitly rejected the US defining bilateral relations as "competitive". From Beijing's perspective, it is not the Washington-stated "China-US strategic competition" that exacerbated bilateral tensions, but rather the rampageous suppression and containment of China since the Trump administration that led to where the two countries are. To defend her core interests in development, sovereignty and security, China had no choice but to push back against the United States. The root cause of the tension, as a matter of fact, is Washington's intolerance of another great power with non-Western political institutions and ideologies embarking on accelerated rejuvenation, which is projected to be on par with the United States at some point in the future. In Beijing's observation, President Biden by and large inherited his predecessor's China policy, whose nature of suppression and containment remains the same, particularly in the fields of science & technology, security and ideology. In this light, Beijing feels the duplicity and even hypocrisy of Washington when the Biden administration repeatedly peddles the "competitive" definition of the China-US relations, while calling on joint efforts from both sides to "set guardrails" on this "competitive" relationship. Beijing further points out that a truly stable relationship calls for Washington to take the first step to revamp the past perception and to view China's development as well as strategic intention with a more rational and balanced mindset.

Another reason for Beijing's opposition of defining China-US relations as "competition", as Washington phrases, is that China fully realizes that this bilateral relationship has reached a "new crossroads" where various stakeholders are stepping up their attempts to reshape the China-US relations based upon their own interests and preferences. Needless to say, both Chinese and US governments play

pivotal roles in steering the direction of this process. If Beijing agrees on Washington's definition of "strategic competition", the China-US relations may very likely fall into the mire of "self-fulfilling prophecy", which could further develop into an all-out strategic confrontation that endlessly traps both. As Beijing sees it, when the world suffers from the still raging Covid-19 pandemic, polarized economic growth, exacerbated environmental degradation, and mounting risks of extremism and terrorism, both countries should handle the relations from the strategic height of jointly delivering global public goods to solve the conundrums of common development and common security. Along this line, such narrow-minded mentalities as zero-sum game and extreme egocentrism must be abandoned. As President Xi pointed out when speaking with President Biden on the phone, "Whether China and the United States can handle their relationship well bears on the future of the world. It is a question of the century to which the two countries must provide a good answer…Getting the relationship right is not optional, but something we must do and must do well."

It is with the same spirit that experts from the Shanghai Institutes for International Studies (SIIS), either independently or in collaboration with American colleagues, published a series of reports in recent years highlighting potential areas of China-US cooperation, namely cyberspace, climate change and institutional reform on global economic governance etc. Such unremitting efforts to explore innovative ways of China-US cooperation in today's turbulent and transforming global landscape, to our delight and relief, have received much attention from governments and academia of both countries as well as the Asia-Pacific community. Encouraged and inspired by readers and colleagues from both sides, SIIS is committed to continuing such efforts of promoting bilateral cooperation on global governance and, right before the G20 2021, we are happy to release this new report on The G20's Sovereign Debt Agenda: What Roles for China and the US. Co-authored by senior fellows Ye Yu and Zhou Yuyuan, this issue is the latest among the *SIIS Report* series that aims to explore how China and the United States can work together to develop a new agenda for bilateral collaboration.

As an advance notice, I am happy to inform our readers from the think tanks, academia and respective government agencies across the Pacific that the future *SIIS Report* series will be joined by some other thoughtful authors beyond the SIIS expertise. Let us expect what such open-minded academic discussions could bring to the China-US relations, global governance and beyond.

Summary

The issue of sovereign debt governance, especially for lower-income countries, entered into the G20 agenda well before the outbreak of the Covid-19 pandemic. But the pandemic brought this issue to the center of the G20's collective efforts in assisting the developing world to tackle the crisis. The US and China, one as the dominant financial power and the other as the largest official bilateral creditor, share common interests and responsibilities in enhancing sovereign debt governance and fostering global sustainable development under the G20. The two countries have played constructive roles for the G20 to successfully launch the Debt Service Suspension Initiative (DSSI) and the Common Framework for Debt Treatments beyond the DSSI, and for the multilateral financial institutions to mobilize emergent resources for indebted countries, exhibiting the catalytic role of the G20 for global governance.

However, this is far from enough. When sovereign debt vulnerabilities are expected to rise due to the inflation pressure in the next several years, the two countries need to exhibit more spirit of multilateral cooperation on this issue. First and foremost, both sides should put politics right and prioritize cooperation on sovereign debt treatment and sustainable development. The US should stop scapegoating China for the sovereign debt of developing countries, by hyping the theory of "debt trap", while China should also address the concerns of the US, such as on the issue of debt transparency. Second, the two countries should lead in coordinating macroeconomic policies, controlling global debt risks and mobilizing new resources for alleviating the debt burdens of the debtor countries. Third, China and the US should work together in exploring truly multilateral and public-private partnership approaches to deal with the unsustainable debts, based on case-by-case terms, ensuring equitable and fair burden-sharing among all categories of creditors. In particular, the International Monetary Fund and the World Bank need to play constructive roles in leveraging all parties' participation and promoting equitable solutions. Fourth, the two countries should also take the opportunity of debt treatments in fostering green and sustainable development of the debtor countries, while respecting their ownership and development level. Lastly, China and the US should deepen trilateral development cooperation in the developing world through broader policy dialogue in the future.

The G20's Sovereign Debt Agenda:

What Roles for China and the US?

Since the outbreak of the Covid-19 pandemic in early 2020, the economies of developing countries have suffered heavy losses, resulting in dwindling government revenues and acute growth challenges. So far, the liquidity shortage has been relieved due to the extraordinary stimulus policies of major economies led by the US. But overall, due to the uncertainties about the pandemic, economic recovery, and financing environment, global debt vulnerabilities have increased significantly. The rising expectation of inflation and monetary policy adjustment in advanced economies are making the situation worse.

For many developing countries, China is becoming the largest bilateral creditor. Meanwhile, as the majority of debt is in the US dollars, the US still effectively regulates international capital market and controls the "general switch" for the debt levels of the developing world. In this sense, Beijing and Washington share common responsibilities for the prevention, control, and resolution of debt problems in developing countries. However, the "debt trap theory" regarding China's Belt and Road Initiative (BRI), promoted by the US since the Trump administration, cast a deep shadow over development cooperation between the two countries. No significant shift has been observed after the inauguration of the Biden-Harris Administration. In response to the pandemic, the Group of Twenty (G20) launched the Debt Service Suspension Initiative (DSSI) and the further Common Framework for Debt Treatments beyond the DSSI, which provided the first historic opportunity for G20 emerging creditor nations, including China, to coordinate with the Paris Club on sovereign debt treatment. Although the implementation of the initiative has so far exposed profound differences between China and the US, the rising uncertainties call for the two countries to exhibit more collaborative spirit, leveraging all public and private actors to work together for a more effective solution.

Rising Debt Risks in the Developing World

Since the 1970s, financial liberalization and globalization accelerated after the collapse of fixed exchange rate system under the Bretton Woods. This enabled the developing countries to tap international financial market for economic development, while also introducing more vulnerabilities to their economies due to the rising dependence on external debt. According to the World Bank, developing countries have experienced three waves of large-scale credit expansion and debt crises. The first wave occurred in the 1970s and 1980s when petrodollars flowed into

the banks of developed countries and returned to developing countries. This led to a surge in overseas borrowings in developing countries in Latin America and Africa when the oil price was high. The global oil crisis thereafter had worldwide repercussions. Acute debt distress followed economic and financial crises, causing what was later called the "lost twenty years" in the developing world. The second wave lingered from the 1990s to the beginning of the 21st century, resulting mainly from the rapid growth of private debts in emerging countries and transition economies, which eventually evolved into the Southeast Asian financial crisis and financial crises in Russia, Argentina, Turkey, and other countries. As the impact of the Asian financial crisis began to recede, global lending once again grew exponentially. In the wake of the 2008 global financial crisis, countries that rely heavily on the financial institutions of the US and the European Union were severely affected. In particular, countries in Europe and Central Asia experienced serious credit crunch, triggering the third wave of debt crises.

A new round or the fourth wave started with the expansion of international capital flows to developing countries following the 2008 international financial crisis. The tentacles of European and American "mega-banks" have extended from emerging markets to all developing countries worldwide. From 2010 to 2018, the debt-to-GDP ratio of emerging and developing countries rose from 116% to 170%, at an average annual growth rate of 7%, reaching a new historical high.[1] Compared with the regional features of the previous three waves of debt crises, the current wave of debt growth is more global, covering 80% of developing countries.[2]

The debt risk issue concerns both developed and developing countries, while the latter are more vulnerable due to much less policy space. The Covid-19 crisis is an "inequality accelerator" and has more severely harmed the government revenues and economic development of developing countries, limiting their expenditures in anti-epidemic measures, infrastructure, poverty reduction, education, social assistance, and other medium- and long-term development areas. In addition, the flight of capital has exacerbated the debt burden and liquidity shortage, exerting further pressures on anti-epidemic efforts as well as economic and social development in developing nations. Total external debt-to-GNI ratio of low and middle-income countries rose to 29% in 2020 from 27% in 2019.[3]

Since poorer countries have a relatively high proportion of foreign debt and relatively limited financing channels, they face relatively greater debt risks. Before the pandemic, more than half of low-income countries were already in debt distress. Thirty-five countries, or half of Internatinoal Development Association (IDA) eligible countries subject to the World Bank's Low-Income Debt Sustainability Analysis (LIC-DSA) were assessed as being at high risk of debt distress or in debt

[1] M. Ayhan Kose, Peter Nagle, Franziska Ohnsorge, Naotaka Sugawara, Global Waves of Debt: Causes and Consequences, Washington DC: World Bank, 2020.
[2] M. Ayhan Kose, Peter Nagle, Franziska Ohnsorge, Naotaka Sugawara, Global Waves of Debt: Causes and Consequences, Washington DC: World Bank, 2020, p. 3.
[3] World Bank. International Debt Statistics 2022. Washington, DC: World Bank, 2022.

distress in 2020, compared to 23% in 2013.[4] The external debt stock of IDA countries rose at an average rate of 12% in 2020 to US$860 billion, equivalent on average to 38.8% of their combined GNI, higher than other developing countries.[5] In 2021, more than 30% of tax revenues in about 35% of low-income countries and 75% of emerging market countries will be used to repay sovereign debt.[6] These countries maintain a fragile balance of payments under a "high debt, high expenditure, and low growth" model. When the coronavirus pandemic deals a severe blow to the national economy, reduces foreign exchange reserves, and depletes external capital inflows, this balance is easily broken. Given their limited financial resources, these countries have to choose between debt repayment and development expenditure, or to make a trade-off between a debt crisis or a development crisis.[7]

In November 2020, Zambia defaulted on its debt due to failure to repay the interest on Eurobond holders, which aroused widespread public concern. With the sweeping fiscal and monetary policies in advanced economies, the flight of capital in the developing world has slowed down since April 2020 and developing nations have been exempted from a systemic debt crisis. The International Monetary Fund (IMF) and multilateral development banks have also provided large emergency liquidity support. However, it is worth noting that developing countries have benefited unevenly, and the debts of countries with poor fundamentals have further deteriorated, and once the blanket stimulus policies of advanced economies are phased out, the risk of unsustainable debt will only increase.

Shared Interests and Common Responsibilities of China and the US

China is often allegedly held responsible for the rising debt in developing countries, thus conveniently becoming the scapegoat for the looming debt risks. However, the problem has deep-seated structural and systemic causes. Specifically, the extraordinary macroeconomic policies are the structural drivers, while the insufficient debt utilization capacity in developing countries and the fluctuant global economic environment are the deep causes. In fact, the debt problem of developing countries reflects the expansion of the global financial system and the trend of a indebted world economy led by advanced economies, bringing systemic challenges for global sustainable development. As key actors and stakeholders in the world financial system, China and the US share common responsibilities in tackling the challenges for stability of the system, which is also in the interests of both countries.

The US as the "super regulator" for global debt market

As the issuer of the US dollar, the US is the real driver behind the expansion of the

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[4] World Bank. International Debt Statistics 2022. Washington, DC: World Bank, 2022.
[5] World Bank. International Debt Statistics 2022. Washington, DC: World Bank, 2022.
[6] IMF, World Economic Outlook, Update of Oct., 2020.
[7] Ben Parker, "The Debt Crisis Looming for Poor Countries", The New Humanitarian, Oct.8, 2020.

global debt chain. The indispensable role of the US is mainly reflected in the following aspects.

First, any adjustment in US macroeconomic policy, in fact, has a fundamental impact on global liquidity and the debt burden of developing countries. The emergence and evolution of major sovereign debt crises in history are closely linked to the trends of the US monetary policy, and this time is no exception. After the Covid-19 pandemic that spread globally in early March 2020 triggered a plunge in stock markets in developed countries, the Federal Reserve lowered interest rates from 1.25% to 0% in less than fortnight, and restarted a US$700 billion quantitative easing program in the form of Treasury securities and agency-backed mortgage securities, followed by allowing the target inflation rate to go beyond 2%, in order to better cope with the dramatic increase in the fiscal deficit. It is worth noting that the US is, in fact, the most indebted country in the world and has driven the latest shift in macroeconomic policy thinking. In January 2019, Olivier Blanchard, former IMF chief economist, delivered the 2019 Presidential Address at the American Economic Association (AEA) annual meeting, arguing that the levels of debt in the US were not catastrophic because the interest rate on government borrowing was below the growth rate of the economy, and the debt financing should be sustainable.[8] The left took it further, arguing that the US fiscal policy should embrace the "new thinking" – the so-called "modern monetary policy", since the monetary authority can print money without limit to finance its fiscal deficit. The debate undoubtedly provided a convenient theoretical base for the US to continue to rely on the model of debt financing development, and brought about the enthusiasm for modern monetary policy in the global macroeconomics community. Since the pandemic, this "new thinking" has been gaining popularity, spreading from the US to other major economies. The US response to cope with the pandemic helps relieve the debt pressure of developing countries, but to some extent it also leads to further accumulation of the debt burdens in these countries, making them more vulnerable to debt crisis.

Second, the US has the world's most influential financial center and financial institutions, which in fact exerts significant influence on the direction of sovereign debt trading rules. The US dominance of the global financial market is reflected in not only the dominant trading currency, i.e. the US dollar, but also the fact that it is home to the most important financial institutions in the global debt chain. On the one hand, investment banks are the most influential financial institutions in the global financial system, and the US still has a commanding advantage in this regard. The largest sovereign debt restructuring deal in 2020, Argentina's US$65 billion debt restructuring agreement, was reached by the world's largest investment management company BlackRock Inc., who negotiated the deal with the Argentine government together with two other creditor groups.[9] In 1999, the repeal of the

[8] David Harrison and Kate Davidson, "Worry About Debt? Not So Fast, Some Economists Say," The Wall Street Journal, February 17, 2019, https://www.wsj.com/articles/worry-about-debt-not-so-fast-some-economists-say-11550414860.

[9] Scott Squires and Jorgelina do Rosario, "Argentina Reaches $65 billion Restructuring Deal after Default," Bloomberg, August 4, 2020, https://www.bloomberg.com/news/articles/2020-08-04/argentina-

Glass-Steagall Act, which removed barriers between commercial and investment banking and encouraged innovation in investment and financing instruments and the expansion of capital markets, gave birth to financial giants and provided easier access for emerging and developing countries to international capital market. On the other hand, in order to issue bonds in international capital market, developing countries need to be rated by rating agencies. The three most influential rating agencies in the world, namely Standard & Poor's, Moody's, and Fitch, are all American companies, and they make the rules on market access and trading in the global sovereign bond market. The influence of these agencies and investment banks has been growing as the form of sovereign debt has shifted from bank loans to securities since the 1990s. In addition, to date there is no international legal mechanism for sovereign debt dispute settlement. Disputes are mainly settled according to the domestic law chosen by the relevant parties; courts in the major international financial centers such as New York, London, and Frankfurt are the most common choices. Sovereign debt cases of Mexico, Argentina and other Latin American countries were taken to the federal courts in New York. It is worth noting that London, as the world's largest offshore financial center, also plays a pivotal role in the supervision and jurisdiction of sovereign debt in developing countries.

Third, as the largest shareholder of IMF and the home of many international financial institutions, the US has unparalleled influence on sovereign debt governance. Theoretically, the debt restructuring agreements are mainly reached between the creditors and debtors, while the IMF does not have the legal power. However, the IMF can play an important leveraging role in the process through its "lender of last resort" function. Either official creditors represented by the Paris Club, or commercial creditors, generally require debtor countries to obtain IMF bailout programs to ensure that they implement the necessary reforms before creditors providing sovereign debt restructuring. The central role of the IMF is to assess the debt sustainability, i.e., whether debtors are liquidity-starved or in debt unsustainability, and to decide accordingly whether to provide a bailout and the size of the bailout in the absence of a sovereign debt restructuring. This decision is the most critical step that exerts a major impact on the debt restructuring agreement between debtors and creditors. However, in view of the unpredictable economic growth of the debtors, the debt sustainability is difficult to be assessed through scientific method and relies heavily on the subjective judgment of the IMF and creditors, making the conclusions of this analysis politically charged. The US, as the largest shareholder of the IMF, has a history of mixing its political considerations with other issues and provided special favors to countries that fit its Cold War needs (e.g., Indonesia, India, Iraq, etc.), which has been criticized by many developing countries. In this regard, how the US plays its guiding role in the future is also worth observing.

Leveraging China's role as the largest bilateral creditor

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reaches-65-billion-restructuring-deal-after-default.

In the global debt market, of which the US dollar is the main carrier, China's position is similar to where it stands in the global supply chain and the global economy – in the middle of the chain. Nonetheless, while China does not hold as much authority as the US, its influence is on the rise. On the one hand, China's financial institutions are growing rapidly and playing an essential role in providing traditional development financing to developing countries just as what the West and Japan have done in the past. The high portion of China's official lending and the shrinking of official lending of advanced economies has made China the largest official bilateral creditor in most of the countries who get Chinese loans. This new reality brings China's lending into the limelight. The size, scope, and impacts of China's lending becomes a hot topic and arouses debates as well.[10] Leaving these debates alone, it is obvious that China's official lending as well as the rising of its overseas commercial lending have made China an important stakeholder of developing countries and international debt relief. On the other hand, with the rise of emerging creditors who are not members of the Paris Club, global mechanisms such as the G20 and IMF are anticipated to undertake more active roles as official creditor coordination platforms. As the world's second largest economy and the third largest shareholder in the IMF and the World Bank, China is one of the key players in global economic governance with the G20 as the main platform, and can play a more constructive role in promoting future cooperation on sovereign debt governance through aid and policy shaping.

The fact that none of the major debt crises since the 1970s have had a substantial impact on China also indicates that China lacks experience related to sovereign debt governance. Now that China is ascending to become the world's largest official bilateral creditor, it is indeed necessary to gradually increase its concessional aid and continue to strengthen government regulation, international cooperation and corporate autonomy in order to achieve debt sustainability, including greater information sharing. This new reality is making it necessary and feasible for China's interaction with the US and other stakeholders like the Paris Club.

The G20 DSSI and the Common Framework: Significance and Disputes

On April 15, 2020, the G20 announced the Debt Service Suspension Initiative (DSSI), calling on official bilateral creditors to allow the 73 poorest countries to suspend payments on their debts from May 1 through the end of 2020 to concentrate resources on fighting the pandemic.[11] The initiative, firstly brought up by the World Bank

[10] The CARI from Johan Hopkins University, Global Development Policy Center from Boston University, AidData among others have made great efforts defining China's global development financing in whole picture, or in Africa and Latin America respectively. Kevin Acker, Deborah Brautigam, "Twenty Years of Data on China's Africa Lending", CARI Briefing Paper, No.4, 2021; Ammar A. Malik, et al.Banking on the Belt and Road: Insights from a New Global Dataset of 13,427 Chinese Development Projects, AidData, William and Mary 2021.

[11] Communiqué, Virtual meeting of the G20 finance ministers and central bank governors, Saudi Arabia, April 15, 2020.

Group President David Malpass on March 23 and jointly supported by the IMF Managing Director Kristalina Georgieva, took only 22 days to be adopted. As the Covid-19 crisis unfolds, the suspension period has been extended twice through the end of 2021. On November 13 of 2020, the "Common Framework for Debt Treatments beyond the DSSI" received endorsement at the G20 meeting,[12] which goes beyond providing short-term liquidity, and deals with unsustainable debt for DSSI-eligible countries.

The first-ever coordination between China and the Paris Club on sovereign debt

The qualified applicant countries under the DSSI framework are IDA countries and the Least Developed Countries (LDCs) defined by the United Nations, most of which are African countries[13], while other emerging economies in Latin America and the Middle East are excluded. In this sense, DSSI works similarly as Heavily Indebted Poor Countries Initiative (HIPC) in a way that eligibility is based on the level of development. But there are essential differences between the Common Framework and DSSI. Though both are applicable to poorest countries, the Common Framework mainly targets countries with inevitable default and applies on a case-by-case basis, which is fundamentally different from the HIPC. This is an experimental coordination effort by the Paris Club and the emerging G20 creditors for DSSI countries and probably more countries in the future.

According to the G20, 42 countries applied for the debt service deferral of the DSSI for an estimated USD 5.3 billion in 2020 by July 18, 2020.[14] As of July 2, 2021, 45 countries have requested for the first extension of the DSSI (to June 2021) for an estimated USD 4.6 billion in the first half of 2021.[15] Participation in DSSI has improved after the suspension period was extended in October 2020, though the total amount of debt relief that DSSI can provide is still limited relative to the overall debt level of developing countries. Nonetheless, DSSI and the Common Framework are of historical significance as they officially kick-start the institutional coordination between emerging G20 creditors led by China and the Paris Club on sovereign debt treatment.

[12] Statement of the Extraordinary G20 Finance Ministers and Central Bank Governors' Meeting, Nov. 13, 2020 [Virtual], https://www.mof.go.jp/english/international_policy/convention/g20/g20_201113_1.pdf.
[13] In a total of 77 countries, 40 are in sub-Saharan Africa, 15 in East Asia and the Pacific, and 22 scattering in Latin America, South Asia, Central Asia and the Middle East. Zimbabwe, Sudan, Somalia and Eritrea are disqualified due to debt defaults on their IMF and World Bank obligations. To 10 with biggest debt service to official bilateral creditor countries are Angola, Pakistan, Kenya, Laos, Cameroon, Ethiopia, Uzbekistan, Zambia, Bangladesh and Mozambique, see https://datatopics.worldbank.org/debt/ids/TDSSI.
[14] Communiqué, G20 Finance Ministers & Central Bank Governors Meeting, Saudi Arabia, July 18, 2020.
[15] Communiqué, G20 Finance Ministers & Central Bank Governors Meeting, Italy, July 9-10, 2020.

Disputes over the DSSI and the Common Framework

The implementation of the DSSI has unveiled some long-existing challenges in the sovereign debt restructuring. These structural problems and controversies are even thornier to tackle in the evolving international development financing system. Meanwhile, the DSSI implementation not only exposes the different roles that China and the US play in the global debt chain but also raises disputes over who, when and how to get involved, which comes down to the essentials of cost and benefit sharing between leading Western and emerging creditor countries.

First of all, creditors of different types have uneven levels of involvement in the DSSI. The diversification of global debt structure is featured in the DSSI. Data from the World Bank shows that by the end of 2019, the long-term external public debt stock of DSSI countries totaled US$490.1 billion, of which official multilateral debt, official bilateral debt and private debt accounts for 43%, 36% and 21% respectively. And of the US$42.7 billion debt service payment due in 2020, 32% and 41% was due to official multilateral/bilateral creditors individually and the rest of 27% to private creditors. Notably, more than 40% of the interest due was paid to private creditors. In particular, the privately held sovereign bond was the most expensive category whose interest accounts for 32% while the principal only accounts for 6%. According to the Institute of International Finance (IIF), over the last ten years, there have been over 85 international bond issuances from 22 lower income countries, for a total of over US$65 billion.[16] Some US$5 billion in debt service on these sovereign bonds between May 1 and the end of 2020 was equivalent to the amount that official bilateral creditors pledged to implement the DSSI in the same period of time.[17] The diversity of creditors is exhibited in selected debtor countries in the following Figure 1.

In this light, the implementation of the DSSI does have its limitations. Official multilateral creditors as well as private creditors have not yet taken their actions so far although they were "strongly encouraged" and called on by the G20 to join the DSSI. For one thing, the World Bank and other multilateral development banks (MDBs) as the largest creditors, refused to participate in the DSSI since they would like to safeguard their access to low-cost financing based upon their preferred creditor status (PCS) and triple A ratings.[18] Compared with private creditors, MDBs do provide lower-cost financing service. However, multilateral creditors including the IDA usually make loans to low-income countries in US dollars rather than local currencies. As a result, the intensified risks of currency depreciation in borrowing

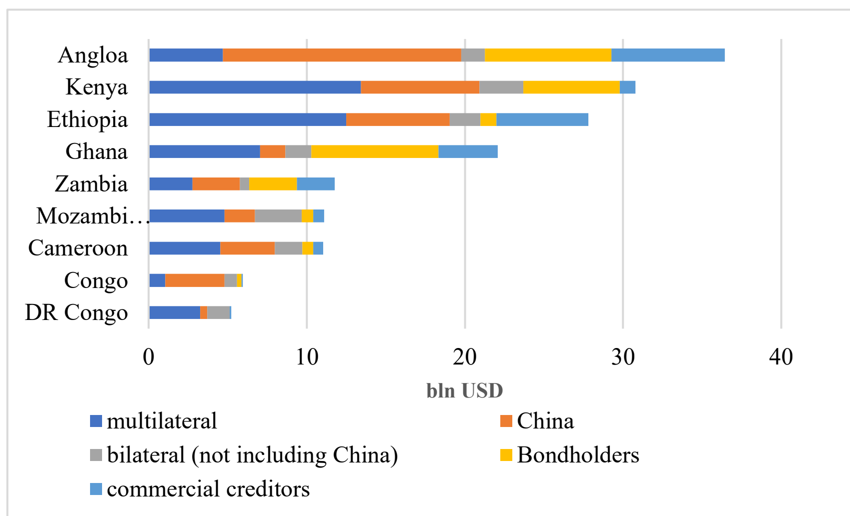
[16] "IIF Letter To G20 Regarding The Debt Service Suspension Initiative (DSSI)", Sept 22, 2020, https://www.iif.com/Publications/ID/4097/IIF-Letter-To-G20-Regarding-The-Debt-Service-Suspension-Initiative-DSSI.

[17] "IIF Letter To G20, IMF, World Bank and Paris Club On the Private Sector Terms of Reference for the G20/Paris Club DSSI", May 28, 2020, https://www.iif.com/Portals/0/Files/content/Regulatory/Cover%20letter%20for%20Voluntary%20Private%20Sector%20Terms%20of%20Reference%20for%20DSSI_vf.pdf.

[18] "Protecting the Poorest Countries: Role of the Multilateral Development Banks in Times of Crisis"("Joint MDB Note"), Explanatory Note, July 7, 2020, http://pubdocs.worldbank.org/en/976541595021399817/DSSI-Explanatory-Note.pdf.

countries have taken the heaviest toll on their long-term debt sustainability.[19]

Figure 1. The composition of external debt of selected countries by creditors by the end of 2019.



Source: World Bank, DSSI. Note that Ghana does not participate in the DSSI.

For another thing, private creditors facing more stringent market constraints were only willing to follow suit on a voluntary basis after official bilateral creditors joined the DSSI. To date, private creditors especially those sovereign bond holders have not played any role in the DSSI implementation. In the meantime, private creditors have not received any formal requests for forbearance from DSSI countries which could trigger an event of default and lead to rating downgrades and difficulties of financing in the capital markets.[20] After further clarification was given by international agencies, the DSSI finally observed significant increase of requests. Once skeptical about the DSSI, Kenya decided to join the initiative at the beginning of 2021. And in November 2020, Zambia announced its debt default after opting out of the Eurobond repayment, for private creditors, particularly Eurobond holders, now own more than half of Zambia's external debt. The case exemplifies that debt pressure and stakes of debt default are much higher for those with extraordinary levels of private debt, which serves as a wake-up call for other African nations in a similar situation including Côte d'Ivoire, Ghana and Chad.

The Common Framework to address unsustainable sovereign debt requires participation of private creditors in the DSSI together with official bilateral creditors under the comparability of treatment clause. However, this requirement is not easy to be well enforced. Private creditors have not shared equally in the burden of the substantial debt relief under the HIPC in 1996. In fact, many private creditors whose claims were repudiated or restructured during these initiatives have successfully sued for full repayment.[21] About 90% of newly-issued international sovereign bonds

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[19] Ruurd Brouwer,"Multilateral development banks are part of the problem", Financial Times, Oct. 9, 2019.

[20] Progress Update on Private Sector Engagement in the G20 Debt Service Suspension Initiative (DSSI), Institute of International Finance, July 14, 2020, https://www.iif.com/Publications/ID/4003/Progress-Update-on-Private-Sector-Engagement-in-the-G20-Debt-Service-Suspension-Initiative-DSSI.

[21] Skylar Brooks, Martin Guzman, Domenico Lombardi and Joseph E. Stiglitz, "Identifying and Resolving Inter-creditor and Debtor-Creditor Equity Issues in Sovereign Debt Restructuring", Center for

by low-income economies since October 2014 included enhanced Collective Action Clauses (CACs), broadly in line with the rate observed in more advanced economies. Nevertheless, as the total size of DSSI countries' bond debt is relatively limited, it will be much easier for bondholders to obstruct the debt restructuring process, which poses considerable challenges for low-income economies to manage their sovereign bond debts.[22]

To sum up, official bilateral creditors, widely regarded or designated as "front-runners", actually take more responsibilities than other creditors either under the DSSI or the Common Framework. According to the World Bank's data,[23] by 2019, China holds about 60% of the official bilateral debt for DSSI countries, and has become the largest contributor to the implementation of DSSI. By contrast, the Paris Club creditors hold a little more than 20% of the total, in which France and Japan are two largest creditors, and the US accounts for just about 1% of the total.[24] For all the first three applicants for the Common Framework treatments, i.e., Chad, Ethiopia and Zambia, the US is not in the group of their official bilateral creditors.[25] Nonetheless, the US is often a key source of private creditors. For example, in the case of Ethiopia, about 25% of non-official, external public debt is held by creditors of the US by 2020, similar to that of China. (Figure 2) This Ethiopia's debt composition also exhibits the very wide diversity of external creditors, including 18 official bilateral creditors and 15 source countries for non-official creditors in total,[26] and the important leveraging role China and the US should play. Perhaps contrary to the discourse, China was often found to be in a disadvantaged position to make more flexible concessions for debt restructuring,[27] while the US often delayed the debt restructuring process in the Paris Club in history, even though it was not the largest creditor in the group.[28]

International Governance Innovation (CIGI) Policy Brief No. 53, January 12, 2015.

[22] "The Evolution of Public Debt Vulnerabilities in Lower Income Economies", IMF Policy Paper, Feb., 2020; "The International Architecture for Resolving Sovereign Debt Involving Private Sector Creditors-Recent Developments, Challenges and Reform Options", International Monetary Fund, Sept. 23, 2020.

[23] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.

[24] The authors' calculation based on the World Bank's data.

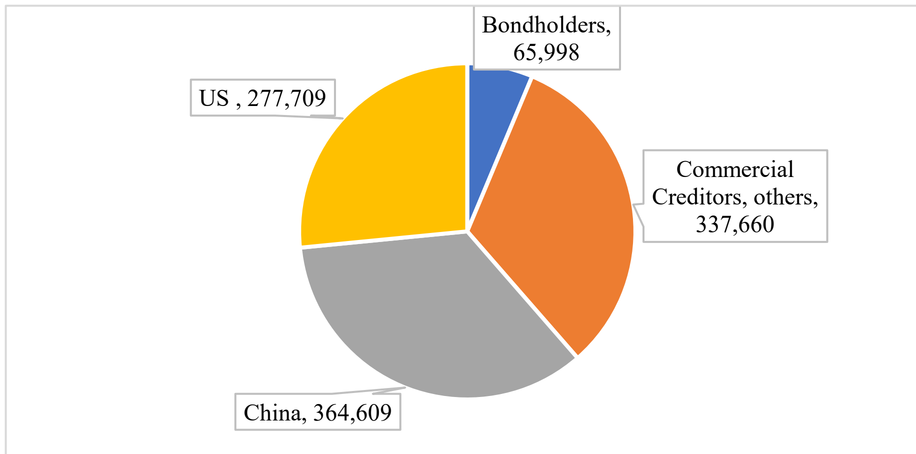
[25] https://www.worldbank.org/en/topic/debt/brief/covid-19-debt-service-suspension-initiative.

[26] https://datatopics.worldbank.org/dssitables/annual/ETH, updated Oct 10, 2021.

[27] Kevin Acker, Deborah Brautigam, and Yufan Huang, "Debt Relief with Chinese Characteristics", Working Paper No. 2020/39，China Africa Research Initiative, School of Advanced International Studies, Johns Hopkins University, Washington, DC, 2020, http://www.sais-cari.org/publications.

[28] John Hurley, "The Paris Club: Will the US Be Asked to Leave?", Center for Global Development, April 3, 2018, https://www.cgdev.org/blog/paris-club-will-united-states-be-asked-leave.

Figure 2. the Structure of Ethiopia's debt service to private creditors in 2021



Source: World Bank, In thousand USD.

Secondly, a relevant challenge is how to define official and non-official (private) creditors and particularly the role of national development banks. David Malpass, President of the World Bank Group, made his remarks in the virtual G20 Finance Ministers and Central Bank Governors Meeting on July 18, 2020 that the China Development Bank as an official bilateral creditor should have its full participation in the DSSI. From the US and Group of Seven (G7) perspective, all China's state-owned enterprises benefit from explicit and implicit government guarantees and should take part in the debt relief effort.[29] Nevertheless, the dividing line on whether Chinese loans are considered "official bilateral credits" in Beijing is whether there is a government-to-government agreement. And in most cases, lines of credit from China Exim Bank are preceded by an inter-governmental framework agreement signed by the Chinese Ministry of Commerce and its counterpart of host countries. While China Development Bank only provides commercial loans without any signature of a Chinese government ministry.[30]

The vague status of development banks in the DSSI implementation also reflects the regulatory conundrum behind the revival of development banks worldwide. Treated as commercial banks by rating agencies while as official creditors by the DSSI, development banks are struggling with double pressures in a challenging regulatory landscape. This reality appears to contradict the mission of development banks to integrate government and market functions. However so far, on the proposal of President Xi Jinping, the China Development Bank participated in the DSSI implementation on a case-by-case basis, which can be a good example for future cooperation on debt treatments within the G20 framework, although a consensus is urgently needed to settle relevant disputes. Further, as the Common Framework requires mandatory participation of both official and private creditors, the identity distinction is much less relevant.

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[29] Andrea Shalal, "G7 ministers urge full implementation of G20 debt freeze: U.S. Treasury", Reuters, July 13, 2020; Jeremy Mark, "Where does China really stand on debt relief?", June 8, 2020, The Atlantic Council, https://www.atlanticcouncil.org/blogs/new-atlanticist/where-does-china-really-stand-on-debt-relief/.

[30] Yufan Huang and Deborah Brautigam, "Putting a Dollar Amount on China's Loans to the Developing World", The Diplomat, June 24, 2020, https://thediplomat.com/2020/06/putting-a-dollar-amount-on-chinas-loans-to-the-developing-world/.

Thirdly, China and the US prioritize different conditionalities for debt treatment under the DSSI and the Common Framework. DSSI borrowers are required to make commitments as such: 1) use freed-up resources to increase social, health and economic spending in response to the crisis; 2) disclose all public sector financial commitments (debt); 3) limit non-concessional borrowing during the debt suspension period to levels agreed under the DSSI, or the IMF's Debt Limits Policy (DLP) and the World Bank's non-concessional borrowing policies. Evidently, the DSSI is designed for dual purposes. Apart from releasing fiscal resources in the poorest countries to combat the Covid-19 pandemic, western creditors take the DSSI as a good opportunity of pushing poor countries to strengthen fiscal discipline, manage debt sustainability and particularly improve their debt information sharing.

Debt transparency is an obvious point of contention. Asymmetric information between debtors and creditors is regarded as one of the basic and universal problems in the sovereign debt restructuring process,[31] which has also become a focus of sovereign debt governance in International Financial Institutions (IFIs). Although the DSSI asks debtor countries to share information while "respecting commercially sensitive information", the US along with other members in the G7 asks for "full transparency". In June 2020, G7 Finance Ministers issued a statement on debt transparency and sustainability before the G20 annual meeting, calling all IFIs, borrowers and creditors to work together on strengthening public reporting of debt data used in debt sustainability analyses, including a breakout by external creditor and more thorough coverage of contingent liabilities, state-owned enterprise debt, and collateralized financing.[32] In this light, the true aim behind the G7's efforts on promoting the DSSI is really beyond the DSSI per se, which is to advance their agenda of debt transparency and shift major obligations to official bilateral creditors.

Obviously, necessary debt transparency and information sharing are crucial for evaluating debt risks and conducting collective debt treatments effectively. Indeed, the more sophisticated financial instruments used in infrastructure finance, such as the public-private partnership (PPP) and Special Purpose Vehicles (SPV), are bringing new challenges for debt transparency both domestically and internationally. But these techniques were not invented by Chinese companies and should not be regarded as a unique "China problem", as a US government-sponsored study argues.[33] However, there is too much politicization of the "debt transparency", which is not useful for the issue to be solved.

China-US Cooperation within the G20 Framework

The rise of debt risks in developing countries is a key issue of global development

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[31] Lee Buchheit, Guillaume Chabert, Chanda DeLong, and Jeromin Zettelmeyer, "How to Restructure Sovereign Debt: Lessons from Four Decades", Peterson Institute for International Economics, May 2019, https://www.piie.com/system/files/documents/wp19-8.pdf.
[32] "Statement of the G7 Finance Ministers on Debt Transparency and Sustainability", June 3, 2020, https://home.treasury.gov/news/press-releases/sm1023.
[33] Ammar A. Malik, et al.Banking on the Belt and Road: Insights from a New Global Dataset of 13, 427 Chinese Development Projects, AidData, William and Mary, 2021.

governance, which calls for shared responsibilities of major countries. China and the US, both as important partners for developing countries and key players in global financial market, hold common interests and extensive space for debt cooperation. It should be acknowledged that both have made due contributions to help developing countries fighting the pandemic and preventing debt crises. On the part of China, it is by far the leading contributor to the DSSI implementation and has approved the Common Framework for further unsustainable debt treatments, which demonstrates China's open-mindedness and dedication in sovereign debt governance as a first-time participator in such multilateral coordination process. In addition, China has provided debt bailout to low-income countries through the IMF's disaster-relief instruments, while offering direct debt relief to some African nations.[34] Other than financial assistance and policy tools, China has consistently carried forward down-to-earth development cooperation to help with economic recovery in Africa and tackle debt conundrums in the developing world. On the part of the US, since inauguration, the Biden-Harris administration has departed from Trump's unilateralism, making promises of strengthening support for international development. For instance, among other practical means like facilitating an agreement between G7 and G20, backing the IMF for a new US$650 billion Special Drawing Rights (SDR) allocation is indeed a constructive measure to better support low-income countries.

It is also encouraging that China and the US are co-chairing G20 Sustainable Finance Working Group, which is re-established and elevated from the former Sustainable Finance Study Group, under the Italian G20 Presidency. The Working Group commits to allow for flexibility, avoid the one-size-fits-all approach, and keep in mind the specific needs of the lower income countries as well as the vulnerable countries.[35] It is a "positive step" for the world that the US and China are cooperating on sustainable finance within G20.[36]

Nevertheless, visible obstacles still stand in the way of China-US cooperation, bringing uncertainties to sovereign debt governance within the G20 framework. To jointly work out effective solutions for debt problems in the developing world, we believe that the two countries need to strengthen communication and coordination in the following areas.

First and foremost, the two countries should put politics right and prioritize cooperation on sovereign debt treatment and sustainable development. China and the US ought to seek cooperation rather than confrontation in the DSSI and the Common Framework, both as stakeholders for sustainable growth of the world.

[34] "Interviews on G20 Finance Ministers and Central Bank Governors Meeting", Ministry of Finance, People's Republic of China, http://wjb.mof.gov.cn/ywwz_14955/news/mn/202011/t20201104_3616895.htm.

[35] "G20 Sustainable Finance Working Group", April 16, 2021, https://www.g20.org/g20-sustainable-finance-working-group.html.

[36] "U.S.-China cooperation on sustainable finance "positive step" for world: IMF chief", Xinhua, April 15, 2021.

Especially the US should perceive China's participation in international debt treatment in a rational manner, rather than based on fallacies, such as the so-called "debt trap diplomacy". During the Trump administration, the spread of the pandemic further exacerbated geopolitical containment against China, among which the sovereign debt issue was hyped up by US politicians as an easy tool to frame and attack China. Although slanders like the "debt trap" and "predatory country" have been refuted by solid research findings of many renowned international scholars,[37] such toxic allegations linger, posing serious impediments to China-US cooperation. This discourse must be reversed.

On the other hand, China should also address the concerns of the US and outside world, such as the issue of debt transparency. The two countries should tackle the issue of development finance transparency, which is far beyond China's debt transparency alone, as a common challenge they face. It takes time for China to build its central monitoring system for its overseas development projects; but a clear commitment is useful. The G20's DSSI and the Common Framework are evidences of China's progress on this aspect. China International Development Cooperation Agency (CIDCA), together with Chinese Ministry of Foreign Affairs and Ministry of Commerce, co-issued the new Administrative Measures for Foreign Aid in August 2021, mandating establishment of foreign aid statistical system for collection and aggregation of foreign aid data and information.[38] This commitment is a very timely one and should be implemented in a solid approach. It can also serve as a milestone for China to enhance coordination with Organization for Economic Co-operation and Development (OECD) on rules of aid and broader development finance instruments. In sum, both sides need to work on basic facts, clarify the substance of the issue, bridge understandings, build consensus, and eventually find a way for rational communications and collaborations on practical terms. Only when the China-US political relationship is back on track, can the two countries achieve meaningful cooperation in developing countries, and advance concerted efforts of the entire international community to tackle urgent challenges, so as to harvest for early recovery of global industrial chain, value chain and the world economy at large.

Second, the two countries should lead in coordinating macroeconomic policies, managing the global debt risks and mobilizing new resources for alleviating the debt burdens of the debtor countries. China and the US need to formulate respective macroeconomic policies more from the perspective of global development and stability, by means of leveraging new and much-needed financial assistance to

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[37] Deborah Brautigam, "A Critical Look at Chinese 'Debt-trap Diplomacy': the Rise of a Meme", Area Development and Policy, Vol.5, No.1, 2020; Lee Jones, Shahar Hameiri, "Debunking the Myth of 'Debt-Trap Diplomacy': How Recipient Countries Shape China's Belt and Road Initiative", Chatham House, August 20, 2020; Roland Rajah, Alexandre Dayant, Jonathan Pryke, "Ocean of Debt? Belt and Road and Debt Diplomacy in the Pacific", Lowy Institute, October, 2019; Deborah Brautigam, Meg Rigmire, "The Chinese 'Debt Trap' is a Myth", The Atlantic, Feb.6, 2021. https://www.theatlantic.com/international/archive/2021/02/china-debt-trap-diplomacy/617953/.

[38] "Administrative Measures for Foreign Aid", China International Development Cooperation Agency, together with Chinese Ministry of Foreign Affairs and Ministry of Commerce, Aug. 31, 2021, http://www.cidca.gov.cn/2021-08/31/c_1211351312.htm.

alleviate debt burdens of the DSSI countries. In particular, as the US occupies the high ground in the global debt chain, both as the issuer of the US dollar and regulator with de facto judicial jurisdiction over relevant debt contracts, the US plays a definitive role in shaping the global liquidity and the debt situation in underdeveloped countries. The extraordinary policies formulated as the US response to the pandemic may expedite the world economic recovery. However, the accompanied rising inflationary pressures throughout the world as well as the markets' expectation of an increase in interest rates will consequently bring about uneven benefits between the North and the South and may deteriorate the debt burden in developing countries. In this context, apart from the joint implementation of the DSSI and the Common Framework, the two countries should work together to enhance global liquidity governance and ease the impact of the adjusted macroeconomic policies on the debtor nations. As the biggest official bilateral creditor, China should also persistently strengthen debt sustainability governance for overseas projects and constructively participate in the multilateral debt governance. In addition, China and the US should jointly promote the increase of assistance, both bilaterally and multilaterally, by the major economies to the developing countries, ensuring early conclusion of agreements on the re-allocation of IMF's new SDR issuance as well as the advanced 20th IDA replenishments to benefit the underdeveloped.

Third, the two countries should work together in exploring truly multilateral and public-private partnership approaches of dealing with the unsustainable debts, based on a case-by-case approach, ensuring equitable and fair burden-sharing among all categories of creditors, so as to achieve the new version of Brady Plan. China and the US need to collaborate from a long-term standpoint to call on both official creditors and private creditors to support multilateral debt cooperation within the framework of G20 and the international financial institutions. Significant changes have taken place in terms of development financing landscape, debt composition, approaches for debt governance in the lower income countries.[39] This requires the non-Paris Club creditor countries like China to strengthen dialogue and cooperation with the Paris Club countries like the US, so as to leverage participation of the commercial creditors.

Although differences remain in priorities and approaches of development financing between China and the US, such a gap should not serve as an excuse for finger-pointing. Conversely, the two sides can build on a more effective system of global debt governance through mutual respect and comparative advantages.[40] As said above, for the first three applicants for the Common Framework treatments, i.e., Chad, Ethiopia and Zambia, the US is not one of their official bilateral creditors, but an important source or stakeholder of private creditors. Therefore, the US

[39] Zhou Yuyuan, "Global Debt Governance in Transformation: Process, Function and Prospect", *Pacific Journal*, No. 12, 2020.

[40] Kevin Acker, Deborah Brautigam, and Yufan Huang, "Debt Relief with Chinese Characteristics," CARI Working Paper, No. 2020/39, School of Advanced International Studies, Johns Hopkins University, Washington, DC, 2020.

government will not be able to participate in the official bilateral creditors' committee, but still can play an important leveraging role for its commercial creditors. In the Chad's case, official bilateral creditors have reached an agreement quite efficiently under the co-chairmanship of Saudi Arabia and France,[41] and now negotiation shifts to private creditors. Ethiopia's case will be a real test, however, due to the much more complicated structure. But positive progress is being made. The Creditors' Committee was already established for Ethiopia, with China as a co-chair for the first time together with France.[42] This is a great chance for China to "learn by doing", which also provides a perfect opportunity for the US and China to have more constructive coordination so as to get private creditors on board as early as possible.

The Brady plan of the 1980s-90s is generally believed as a successful debt treatment approach in history through close cooperation between public and private sectors. The key of the success lies in the potent credit enhancement by the then US government to support debt conversion and the multilateral aid cooperation between the developed economies of Europe and Japan and the international financial institutions, which leveraged the cooperation of private sectors as well as reforms of debtor countries in the most market-oriented way. For now, though being the DSSI countries' largest official bilateral creditor, China is subject to the check and balance of the US as the "super-regulator" in the global debt chain. What's more, still categorized as a middle-income country by the World Bank, China is unable to unilaterally provide the HIPC-like debt relief on a systemic and large scale in the short term. Therefore, the implementation of the Common Framework must be based on a multilateral approach with cooperation of the developed economies like the US and the international financial institutions, while strengthening the participation of private creditors. The IMF and the World Bank must be able to play constructive roles in leveraging all parties' participation and promoting equitable solutions.

Fourth, the two countries should also take the opportunity of debt treatments in fostering green and sustainable development in debtor countries, while respecting their ownership and payment capacities. It remains a lasting challenge to strike a balance between debt relief and long-term development, so as to get the debtor countries on track to green and sustainable growth. This requires enhanced China-US collaboration, together with the countries concerned, to tackle the problems from the development needs of the debtor nations. With the debt problem ultimately being an issue of development, the solutions to it should not only focus on debt relief,

[41] "Statement of the 4th Meeting of the Creditor Committee for Chad under the Common Framework for Debt Treatments beyond the DSSI", June 11, 2021, https://clubdeparis.org/en/file/3686/download?token=bLbB-g1e.

[42] "Statement, 1st meeting of the creditor committee for Ethiopia under the Common Framework for Debt Treatments beyond the DSSI", September 28, 2021, https://clubdeparis.org/en/communications/press-release/1st-meeting-of-the-creditor-committee-for-ethiopia-28-09-2021.

but also work more on the capacity-building of the developing countries in economic recovery and sustainable development. Toward this end, China and the US need to work together on a comprehensive, complementary and coordinated system for international development, covering trade, investment, aid and financing, so as to provide larger market access for developing nations. In addition, the Biden-Harris administration has been actively promoting the agenda on climate cooperation, meanwhile the Chinese government has first announced the goals of peaking carbon dioxide emissions and achieving carbon neutrality. On the visit of John Kerry, the US Special Presidential Envoy for climate, the two countries announced that "both countries intend to take appropriate actions to maximize international investment and finance in support of the transition from carbon-intensive fossil fuel based energy to green, low-carbon and renewable energy in developing countries."[43] This marks a vital progress achieved in global climate cooperation. Likewise, the two countries need also take the opportunity of debt collaboration to promote green economy in the developing world. Meanwhile, the prospective green economy should take into consideration the development level and payment capacities of the debtor states and fully respect their sovereignty, in prevention of unrealistic promotions of the green economy and larger development gaps.

Finally, China and the US should further explore opportunities for broader development cooperation in the future. International development is an area that the two countries can cooperate with relative ease and common interests compared to broader geopolitical and economic domains. Considering the difficulties of China in fully joining in the OECD Development Assistance Committee and its regulatory system in the short term, it is more feasible for China and the US to deepen candid dialogue, experience sharing and development cooperation in the third countries. The G20's Common Framework cooperation based on a case-by-case approach should be regarded as an opportunity for broader and more in-depth cooperation on this sphere for both sides. This is also beneficial for the two to construct a comprehensive and fact-based knowledge on the common points, differences, and comparative advantages of their financing models. In this respect, these practical communication and cooperation could be a starting point for the two countries to explore more potential chances to cooperate, among the governments, official financing institutions, private sectors, and likely more other stakeholders.

[43] "China-US Joint Statement Addressing the Climate Crisis", Xinhua, April 18, 2021, http://www.china.org.cn/world/2021-04/18/content_77417219.htm.

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