**Testimony of**

**Scott A. Morris**

**Senior Fellow, Center for Global Development**

**Before the**

**House Committee on Financial Services**

**Subcommittee on National Security, International Development and Monetary Policy**

**Hearing on**

**"Examining Belt and Road: The Lending Practices of the People's Republic of China and Impact on the International Debt Architecture"**

**10:00 a.m., Tuesday, May 18, 2021**

Thank you Chairman Himes and Ranking Member Hill for the opportunity to testify today.

Twenty-five years ago, this committee was instrumental in putting forward the Heavily Indebted Poor Country initiative (or "HIPC") to relieve the debt burdens of 37 poor countries when it became clear that they could no longer sustainably service this debt. At the time, the United States agreed to forgive nearly $2.5 billion in debt owed to US government agencies, making it one of the largest of the 55 creditor countries to participate. Little noticed at the time: Costa Rica was a bigger creditor to poor countries than was China.

Today, nearly all the low-income HIPC countries are again at risk of debt distress, with debt vulnerabilities that have been greatly exacerbated by the economic shock of the COVID pandemic. But on the creditor side, the picture has changed dramatically. The United States government today is one of the smallest creditors to low-income countries, with just $370 million in outstanding claims. China, on the other hand, with over $31 billion in outstanding claims to the HIPC countries, is a bigger creditor than all other government creditors combined. And that picture holds true well beyond the poorest countries. China today is by far the largest official creditor in the world, with estimates of outstanding claims on the order of $350 billion.

So, when we consider how best to address a potential widescale debt crisis in developing countries, we must grapple with China's dominant position. That starts with an understanding of not just *how much* China lends but *how* China lends—not just lending volumes and interest rates, but the full array of conditions that Chinese lenders might attach to their loans.

I would like to focus the balance of my remarks on the findings of a new report that I co-authored with Anna Gelpern and Sebastian Horn (both also on the panel today), as well as Brad Parks and Christoph Trebesch.[1] This report, submitted along with my testimony, was published jointly by AidData, the Center for Global Development, the Kiel Institute for the World Economy, and the Peterson Institute for International Economics. We assessed the provisions of 100 Chinese debt contracts, the first assemblage or study of Chinese contracts on this scale. Our findings have implications for the debt relief agenda, which I will address at the end of my statement. And while there are other important factors when it comes to debt vulnerabilities

[1] Gelpern, A., Horn, S., Morris, S., Parks, B., & Trebesch, C. (2021). *How China Lends: A Rare Look into 100 Debt Contracts with Foreign Governments*. Peterson Institute for International Economics, Kiel Institute for the World Economy, Center for Global Development, and AidData at William & Mary.

in the developing world, including the increased role of commercial creditors, I will limit my remarks to the behavior of Chinese government lenders, as evidenced by their debt contracts.

***

Four main insights emerge from our research:

**First, Chinese contracts contain unusual confidentiality clauses that bar borrowers from revealing the terms or even the existence of the debt**. In commercial loan contracts, confidentiality provisions are typically aimed at protecting sensitive information about the borrower, with non-disclosure restrictions imposed on the lender. But what we see in the Chinese contracts are clear non-disclosure requirements imposed on borrower governments. Importantly, these restrictions are waived when they conflict with domestic laws. But should no domestic reporting requirements exist in the borrowing country (and they typically don't), borrowing governments are bound by the terms of the contract, which could include restrictions on reporting to the IMF, the World Bank, the Paris Club, or any other creditor groups.

These non-disclosure restrictions are problematic: they hide government borrowing from the taxpayers who are bound to repay it; they impede budget transparency and sound fiscal management; they hide the borrower's true financial condition from its other creditors; and they can serve as an obstacle to timely and orderly debt restructurings, which depend on a full accounting of a debtor government's obligations to all its creditors.

**Second, Chinese lenders seek advantage over other creditors through collateral arrangements such as lender-controlled revenue accounts**. Chinese lenders appear to use escrow accounts and other formal and informal collateral arrangements far more frequently than other lenders, government or commercial. Chinese lenders use such arrangements to mitigate risk of non-payment in otherwise risky lending environments. But it's important to recognize the problems these arrangements can pose for the borrowers, particularly in distressed environments. Cash accounts of this sort encumber scarce foreign exchange and fiscal resources of developing country governments. And when the accounts are hidden through strict non-disclosure requirements, they can distort the overall economic picture for a country in the eyes of the IMF and other creditors. Revenues that are assumed to be flowing to the developing country government are in fact flowing to an offshore account controlled by the Chinese lender. Again, such arrangements may serve as a barrier to timely and efficient debt restructurings.

**Third, Chinese lenders also seek advantage over other creditors through requirements to keep the debt out of collective restructuring efforts** by the Paris Club of creditors or any other multilateral arrangements. We have dubbed this contract feature the "no Paris Club" clause, and no other lender we are aware of, private or government, employs it. The clause unambiguously seeks to set Chinese creditors apart from, and ahead of, other creditors in restructuring situations.

The provision prohibits the borrower from seeking any debt restructuring from the Chinese lender on terms that are comparable to those obtained through the Paris Club of creditors, a forum the United States and other governments established nearly 70 years ago to coordinate debt restructurings. A core principle of the Paris Club is that a debtor government, in exchange for obtaining relief from the United States and other club members, must commit to seeking comparable relief from its other creditors. By prohibiting such comparable relief in its contracts, China is putting debtor governments in an impossible position should they need debt relief—either violate the terms of the Chinese debt contract or violate their commitment to the Paris Club. Importantly, China itself is not a member of the Paris Club, but it has signed onto the G20's Common

Framework for Debt Treatments[2], which adopts key Paris Club principles, including the requirement for comparable treatment.

**Fourth, cancellation, acceleration, and stabilization clauses in Chinese contracts have broad scope and imply significant policy leverage over the borrowing country**. These provisions, which enable the Chinese lender to accelerate payment or cancel a loan, are broadly written, giving the lender substantial leverage across a wide array of policy issues. Cross-default clauses also reinforce ties across Chinese government lenders. As we observe in the case of Ecuador, China Development Bank is empowered to accelerate or cancel its $1 billion loan facility due to any harm experienced by any Chinese government entity in Ecuador. Given the scale of financing, this amounts to considerable leverage with extraordinary reach across Chinese entities and policy issues.

***

With these findings in mind, I would like to turn to the US government's policy agenda. As you consider appropriate responses to China's lending behavior, I would urge you to keep the interests of developing countries and their citizens in mind, particularly during the current crisis. The poorest populations in the poorest countries are also the most vulnerable to the COVID pandemic. And as we have heard repeatedly from public health experts, their vulnerability is ultimately our vulnerability. These countries need extraordinary support right now, and I would urge you to make that your leading objective in considering how best to respond to China's lending in the months ahead.

That means:

- The US government should work with partners to mobilize as much aid and concessional financing as possible. Some low-income countries are already in debt distress and will need some form of debt relief. But debt vulnerability is a symptom of a broader problem that nearly all developing countries are experiencing right now—a massive economic shock resulting from the COVID-19 pandemic. Debt relief alone is neither sufficient to respond to this shock, nor is it appropriate in every circumstance. What is needed is the sort of financial support that can help these countries mount an appropriate health and economic response to the crisis and get their economies growing again. To date, crisis response in developing countries measured in economic terms has been meager compared to the measures taken in the United States and other advanced economies. If these countries are going to do more, they will need support from wealthier countries.

  The United States is already stepping up with direct support for COVID relief and access to vaccines for these countries, and the faster we can move on these measures the better. When it comes to economic support, we should continue to look to multilateral institutions like the World Bank and International Monetary Fund as leading partners. Our contributions to these institutions are effectively leveraged many times over by matching contributions from other donors and additional borrowing in financial markets. This year, the World Bank will be seeking new commitments from the United States and other donor governments to support its financing efforts in the poorest countries. Our current contributions to the bank amount to a fraction of one percent of our total aid budget. There is scope to do far more. And by the way, a strong US pledge will likely motivate the Chinese government to give more to the Bank. That would be another good outcome.

- The United States should have clear objectives and take a tough line with the Chinese when it comes to debt relief and sustainable lending, particularly under the auspices of the G20 Common

[2] "Common Framework for Debt Treatments beyond the DSSI," G20 Finance Ministers and Central Bank Governors, November 13, 2020.

Framework for Debt Treatments, an initiative launched last year to better organize efforts to provide debt relief to poor countries. As the largest of the government lenders to indebted countries, the Chinese government should bear the largest cost of any debt relief initiative. But that outcome will not be automatic, and the United States should take a number of steps to seek to ensure that China bears its share of the burden.

Under the Common Framework, the United States should work with other countries to obtain a more comprehensive definition of government creditors such that Chinese government-owned creditors are not shielded from debt relief commitments. China Development Bank ought to meet that definition, despite the Chinese government's assertions to the contrary.

The United States should also insist that the Chinese government disavow "no Paris Club" clauses in debt contracts and soften restrictions on borrower disclosure when those restrictions are at odds with reporting obligations to the IMF, World Bank, and the Paris Club. These commitments should apply retroactively to existing debt and should also take the form of a commitment to keep such restrictions out of future debt contracts.

- When it comes to responding to China, don't punish the victims. Where China has been an imprudent lender, we should be careful about punitive measures that are borne by the borrowing countries and that ultimately harm the citizens of those countries, particularly during a COVID-19 crisis that was not of their making. Measures that would withhold financing from developing countries due to their borrowing from China would greatly harm crisis response efforts and would ultimately set back US efforts to strengthen ties in these countries. Similarly, suggesting that these countries could selectively default on their legal obligations to Chinese lenders is misguided and would ultimately be damaging to these countries.

- The United States should lead by example when it comes to government contract transparency. The degree of secrecy we observe in Chinese contracts is unusual, particularly when it comes to restrictions imposed on the borrower, but the reality is that secrecy is the prevailing norm when it comes to government lending globally. The IMF and World Bank have sought to use various carrots and sticks over many years to promote greater disclosure among borrowing governments, with limited success.

  But there are two parties in any government-to-government debt transaction and the case for transparency is equally strong on both sides of the loan. Just as citizens in borrowing countries ought to be able to know what commitments their governments are making to foreign lenders (particularly when that lender is another government), I ought to be able to know what commitments my government is making as a lender to foreign governments. In short, public debt ought to be public in creditor and debtor countries alike.

  While the burden of transparency has fallen almost exclusively on borrowing countries to date, the United States could lead in expanding this agenda to creditor governments as well. That should start with a commitment to proactively publish government-to-government debt contracts where the US government is a creditor, whether through US Exim Bank, the US International Development Finance Corporation (DFC), the Department of Agriculture or any federal agency that is lending money to a foreign government. There is no downside in being a first mover on this agenda, and it will put the United States in a strong position to seek similar commitments from other G7 and G20 countries, with China being the primary target among the G20 governments.

- Finally, as the United States seeks to compete with China in offering development finance, our government should be vigilant about avoiding China's mistakes in lending imprudently into vulnerable environments. There's a particular risk that a legitimate desire to support US firms in foreign markets, along with a legitimate desire to provide financing to developing countries, can make us indifferent to the risks of too much lending or lending on terms that are too costly for debt-vulnerable borrowers.

  There's no doubt that the US government, through agencies like USAID, Exim Bank and the DFC, could be doing more to support high quality infrastructure projects in developing countries. But doing so in a manner that protects the US taxpayer and reliably generates benefits in these low-income countries will require focusing on independent measures of project quality and safeguards, financing terms that are appropriate to country circumstances, and strong alignment with IMF and World Bank financing frameworks.

Thank you.