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Subcommittee on National Security, International Development and Monetary Policy

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

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Chairman Himes, Ranking Member Hill, thank you for the opportunity to testify today. I would like to use my time to highlight findings from a recent research project with Carmen Reinhart and Christoph Trebesch.[1] I would also like to share my personal views on why I believe that greater debt transparency needs to be a cornerstone in all efforts to reform the international debt architecture.

Our research analyzes the volumes, terms and implications of China's overseas lending boom. Over the course of just 15 years the Chinese government and its state-owned enterprises and banks have lent at least 500 billion USD to developing and emerging market countries across the globe. This lending boom has turned the Chinese government into the world's largest official creditor, with outstanding claims surpassing those of the IMF, those of the World Bank or those of all Paris Club members combined (see Figure 1). Chinese overseas lending has filled a void left by traditional development donors and has contributed to meeting the enormous funding gap for infrastructure and reliable energy sources in the developing world. This has potentially large positive effects on economic growth and development.

At the same time, outstanding debt to Chinese creditors has risen fast and has contributed to debt servicing difficulties in multiple developing and emerging countries. For the 50 most indebted developing countries to China, we estimate that outstanding debt stocks have risen

[1] Horn, Sebastian, Carmen M. Reinhart, and Christoph Trebesch. 2019. China's Overseas Lending. NBER Working Paper 26050.

from almost zero in 2005 to an average of more than 15 percent of GDP in 2017. In more than two dozen developing countries, outstanding debt stocks to China now exceed 10 percent of recipient country GDP. The large majority of loans has been extended at commercial terms, meaning with interest rates that are close to those in private capital markets and with comparatively short grace periods and maturities. As a result, Chinese creditors are going to play a dominant role in the debt service payments of many low and middle-income countries for years to come.

Furthermore, the opacity surrounding Chinese lending practices has made it difficult to assess the exact debt burdens of recipient countries. Our analysis reveals that around 50% of Chinese lending to developing country public sector recipients has gone unreported, meaning that these debt stocks do not appear in the "gold standard" data sources provided by the World Bank and other international organizations. The unreported lending from China has grown to more than $200 billion USD as of 2016. Most of these liabilities are held on the books of state-owned enterprises and special purpose vehicles and are therefore outside the often narrowly drawn perimeter of public debt statistics.

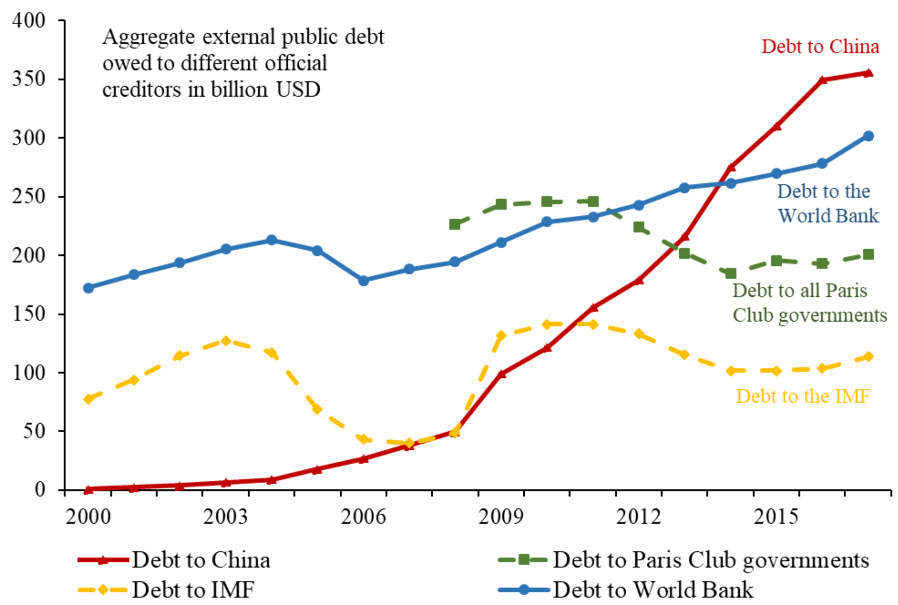
"Hidden" debt problems are wide-spread and not exclusively linked to Chinese lending. However, the opacity of the Chinese lending process has fueled the build-up of the problem and Chinese authorities so far have done little to address the issue: The Chinese government does not publish detailed statistics on its outstanding claims and lending activities and does not share information with the OECD Creditor Reporting System or the Paris Club. Furthermore, Chinese state-owned banks often include expansive confidentiality undertakings in their loan contracts that prevent the debtors from revealing the terms or even the existence of the loans.

Failing to account for unreported debts distorts the views of the official and private sectors in significant ways. First, macroeconomic surveillance work and debt sustainability analyses are undermined when parts of a country's debt are not known. Second, the private sector will misprice debt contracts, such as sovereign bonds, if it fails to grasp the true scope of debts that a government owes. Finally, in the case of debt restructurings, uncertainty about the amount and terms of outstanding claims erodes trust and coordination between creditors and leads to longer and ultimately more costly debt restructuring processes. All of these problems are aggravated by the fact that a substantial share of Chinese loans relies on formal and informal means of collateralization, so that Chinese creditors may be treated preferentially in case of repayment problems.

Maybe most importantly, the lack of transparency prevents citizens in both the borrower and creditor countries from holding their governments accountable for their borrowing and lending decisions. Exposing public debt to public scrutiny can help to reduce the risks of unsustainable debt build-ups and helps to mitigate the severity of recurring cycles of debt and financial crises.

The Covid-19 crisis has exposed debt vulnerabilities in developing countries along with the deficiencies of the international debt architecture. Broad action on debt is needed to ensure that developing countries can mobilize the resources they require to address the ongoing health crisis. While greater debt transparency alone cannot overcome all issues, it is a prerequisite to broader attempts to reform the international debt architecture. The best way for advanced countries to support such efforts is to lead by example.

Figure 1. China is the world’s largest official creditor



Note: This figure shows aggregate public debt to different official creditors for all 122 developing and emerging market countries contained in the World Bank International Debt Statistics (excluding China). Debt to Chinese state-owned creditors is based on estimates introduced in Horn, Reinhart and Trebesch (2019). Debt to all 22 Paris Club governments is taken from the Paris Club website (available since 2008). Debt to the IMF and the World Bank Group (IBRD plus IDA) is from the World Bank's International Debt Statistics.