Centre for International
Governance Innovation

Policy Brief No. 179 — October 2023

How to Make Sovereign Debt Restructuring Work Now

C. Randall Henning

Key Points

- Institutional arrangements for sovereign debt restructuring must facilitate negotiation progress and agreements even if a significant official bilateral creditor is slow or refuses to participate.
- The creditor majority and the International Monetary Fund (IMF) should require a commitment from the government undergoing restructuring not to service or redeem debt to any official holdout creditor until that creditor agrees to comparable treatment.
- The durability of such a commitment beyond the end of the IMF program can be reinforced by enhancing the debtor's transparency and post-program surveillance and multilateral development banks' capacity for new lending.
- The consent channel and the third criterion of the criteria channel should be eliminated from the Lending into Official Arrears (LIOA) policy; IMF management and staff should exploit the flexibility in the recently amended Financing Assurances policy to allow adoption of programs, if necessary, before a holdout creditor has accepted the need for restructuring.

Introduction

Advocates of international financial stability, economic development and process efficiency are broadly critical of global institutional arrangements for sovereign debt restructuring. When low-income and emerging-market countries get into debt trouble, these arrangements deliver reductions in debt obligations that are generally judged to be "too little, too late." Critics focus their objections on the Group of Twenty's (G20's) "Common Framework for Sovereign Debt Restructuring after the DSSI" (hereafter the Common Framework), which has been in place for nearly three years, but has, so far, agreed in principle on substantial debt relief in only one case, Zambia. Negotiating debt restructuring, which has been a slow and inconsistent process historically, has been complicated by the rise of new creditors — China, certainly, but also Brazil, India, Saudi Arabia, South Africa, Turkey, the United Arab Emirates (UAE) and others (see, for example, Chabert, Cerisola and Hakura 2022). The United States and China disagree on whether the agreement for Zambia should be a template for future cases. The likely prospect of a growing wave of severe debt distress and defaults among emerging market and developing countries (EMDCs) during the mid-2020s greatly compounds the scale of the problem.[1]

1 According to the IMF, 11 low-income countries (LICs) are in debt distress and 25 are at high risk of it as of May 2023. Several more middle-income countries are assessed to be in these categories. See IMF (2023a, 32) and www.imf.org/external/pubs/ft/dsa/dsalist.pdf. See, also, United Nations Conference on Trade and Development (2023) and World Bank (2022a).

About the Author

C. Randall Henning is professor of international economic relations in the School of International Service at American University in Washington, DC. He has published widely in the fields of global governance and international and comparative political economy, focusing on institutional arrangements for crisis finance, regional integration and Europe's monetary union. He has recently co-edited a special issue of the *Review of International Political Economy* on international regime complexity and published articles in several other academic journals. He is author, co-author or editor of numerous books, including *Tangled Governance: International Regime Complexity, the Troika, and the Euro Crisis* Oxford University Press, 2017); *Global Financial Governance Confronts the Rising Powers* (CIGI, 2016, with Andrew Walter); *Fiscal Federalism: US History for Architects of Europe's Fiscal Union* (Bruegel, 2012); *Accountability and Oversight of U.S. Exchange Rate Policy* (Peterson Institute, 2008); *East Asian Financial Cooperation* (2002); *Transatlantic Perspectives on the Euro* (Brookings Institution, 2000); and *Currencies and Politics in the United States, Germany, and Japan* (Peterson Institute, 1994). Among other activities, he led the financial cooperation research team for CIGI and INET's New Thinking and the New G20 project. His previous appointments include serving as visiting fellow at the Peterson Institute for International Economics. Currently, he is conducting projects on sovereign debt restructuring and the evolution of regime complexes.

This policy brief advocates changes to policies and procedures relating to debt restructuring and the IMF in order to overcome the unwillingness or inability of non-Paris Club official creditors, including but by no means limited to Chinese lending agencies, to participate in a multilateral debt restructuring. In a nutshell, these changes would facilitate debt restructuring agreements with a majority of creditors by having the debtor agree, as a stipulation of an IMF program, not to service or redeem debt to an official holdout creditor until the holdout agrees to provide comparable treatment. Such a provision would clarify and apply existing norms and regularize a procedure to which creditors and international institutions have already gravitated, but do so in a way that facilitates agreements in future cases. The provision should be accompanied by complementary amendments to the IMF's LIOA policy and changes to the implementation of the Financing Assurances policy. Although the posture of Chinese creditors in recent debt negotiations motivates this analysis, the problem is general: restructuring arrangements should be robust to the involvement of large new creditors with little experience or appreciation for negotiation on a multilateral basis.

The brief focuses mainly on the official debt of low- and middle-income countries, specifically the debt these governments owe to other governments and international financial institutions. Countries' obligations to the private sector are an important part of debt restructuring, and mechanisms for restructuring must seek the participation of private banks, bondholders and corporations on comparable terms; restructuring of official and private debts are closely related. Owing to space constraints, however, this analysis does not discuss this relationship (see, alternatively, IMF 2020; Bretton Woods Committee Sovereign Debt Working Group 2023).

Diagnosis

Sovereign debt restructuring continues to grapple with a problem that was becoming evident at least 15 years ago: the rise of creditors, principally China, that are not part of the Paris Club and otherwise disengaged from the processes by which restructuring agreements had previously been reached. Efforts to persuade China to join the Paris Club as a permanent member failed in 2016 (Brautigam and Huang 2023a; Henning 2023). The

G20's solution was to create a new forum under the Common Framework in which China, India, Saudi Arabia and others could negotiate debt treatments along with Paris Club countries, with the French Treasury representing the Paris Club itself. Lacking protocols of its own, the official creditor committees that were therein constituted largely followed the norms and procedures of the Paris Club, which had been honed over several decades.

Although defenders might argue that it simply needs more time to work, the Common Framework is widely regarded as unsatisfactory on the basis of recent experience. First, it applies only to the 73 LICs that qualify for International Development Association financing through the World Bank. Second, it operates excruciatingly slowly for observers who seek to restart stricken economies. Of the four countries that have applied for debt treatment under the framework — Chad, Ethiopia, Ghana and Zambia — only Zambia has received significant debt treatment as of this writing and its value remains to be seen.[2] Third, as a consequence, finance ministers of countries in even severe debt distress avoid and delay requests for treatment.

As far as the diagnosis is concerned, much of the criticism is focused on the role of China. US officials have often led this charge, but the arguments are largely shared by others, so that China is often isolated on debt issues in discussions in the G20. One principal complaint is that Chinese lending agencies are extremely resistant to recognizing losses and, when they eventually accept them, refuse to write down the face value of loans when confronted with a genuine solvency problem (Neiman 2022). Chinese officials counter that the focus on their role is unfair; as the largest lender, China is asked to shoulder disproportionately greater losses, and China granted more forgiveness than others under the Debt Service Suspension Initiative (DSSI) (Brautigam and Huang 2023b). Chinese officials insist that private commercial lenders participate in debt restructuring, argue that private participation typically falls short of comparable treatment in Paris Club cases and that Western governments should enforce comparable treatment more forcefully. Chinese officials have also insisted that the multilateral development banks (MDBs) restructure their claims, citing the precedents of the Heavily Indebted Poor County Initiative and the Multilateral Debt Relief Initiative in the 2000s (Liu 2020).

China is profoundly fragmented when it comes to international finance (see, for example, Jones and Hameiri 2021, 166–214; Brautigam 2022, 1352; Henning 2023). China cannot be understood as a unitary actor on this matter, and theoretical perspectives or policy paradigms that adopt the unitary-actor assumption are misleading. Instead, Chinese agencies hold different positions on the need for debt restructuring in cases of distress, the speed with which it should be provided and institutions through which it should be negotiated with other creditors. These agencies range from the People's Bank of China (PBoC) to the Ministry of Finance, Ministry of Foreign Affairs and Ministry of Commerce (MOFCOM), among the government agencies, plus the "policy banks," Export-Import Bank of China (China Eximbank) and China Development Bank (CDB), the state-owned commercial banks, such as the Industrial and Commercial Bank of China, and the insurance company Sinosure. PBoC is known to be the most favourable toward participation in multilateral restructuring, having favoured the country's membership in the Paris Club, while MOFCOM and the policy banks are generally opposed.

The premier and State Council could, in principle, coordinate agencies' various approaches to debt restructuring, but, by all accounts, central guidance has generally been sparse and loose. That pattern might be puzzling for observers who understand the Chinese political system to be a command structure. But the policy agenda is crowded at the top and addressing the particular fashion in which Chinese agencies engage in the debt restructuring process has not been among the top leadership's highest priorities. What is more, Chinese lending agencies have strong incentives to carve out as much autonomy as possible. We are left with a situation in which, at least for the time being, different approaches of Chinese agencies persist and manifest externally. Because it generally has the greatest exposure, the China Eximbank has represented the Chinese creditor group within the official creditor committees established under the Common Framework. Nonetheless, although

2 Chad received a modest reprofiling of part of the debt service due on private loans in 2024, but only a promise to reassess its official obligations if that proves to be necessary before the end of 2024, a "contingent restructuring." Ethiopia's treatment has been delayed by creditors on account of the civil war in that country. Zambia's, the largest and most complicated, was concluded in mid-June 2023, two years and five months after its initial request for treatment (Brautigam 2022; Setser 2022; 2023a). Ghana's official creditor committee has just recently been constituted. See, also, Henning (forthcoming).

China acceded to the Common Framework, Chinese lenders as a group have not embraced debt restructuring within it proactively.

The fragmentation of China as a creditor and its rivalry with the West — the United States in particular — place the creation of a unitary, multilateral Sovereign Debt Restructuring Mechanism out of reach. Such a mechanism might be desirable and a worthy long-term objective (Krueger 2002; Hagan 2005), but is not possible over the relevant planning horizon. Impossibly indebted countries need a strategy that can be implemented now, to provide relief during the current (and growing) wave of defaults. An institutional strategy should not rest on hopes that China achieves substantial internal coordination of its approach to country-specific debt renegotiation. Rather, it must be assumed that China remains a fragmented creditor and we should design institutional arrangements that can work in that context. Such arrangements would continue to provide multiple paths to restructuring (Rieffel 2003; Sobel 2022) and avoid veto points whereby a single creditor or small group of minority creditors can block a restructuring agreement favoured by the majority.

The IMF continues to play a central role in the institutional arrangements for debt restructuring (Buchheit et al. 2019; Hagan 2020). Under the Common Framework, as with the Paris Club, a country undergoing a debt treatment must negotiate a financing program with the IMF. The Fund's debt sustainability analysis underpins the program and establishes the amount of debt relief that will be required in one form or another, consistent with the terms of financing and other conditions. Three policies of the Fund are particularly germane to debt restructuring cases: the Lending into Arrears (LIA) policy, the LIOA policy and the Financing Assurances policy.[3] The LIOA policy permits the Fund to lend to a country notwithstanding arrears to an official bilateral creditor, provided certain conditions are met. Concerned that China could hold out and extract full payment or other concessions at a later date, however, the United States and other Group of Seven (G7) countries have shied away from triggering certain provisions of the policy.[4]

The approach advocated below for accelerating the debt restructuring process takes inspiration from some of the recent cases outside the Common Framework, where Chinese lenders have negotiated separately from the majority of official bilateral creditors. Consider the recent debt restructurings of Ecuador and Suriname, and the ongoing case of Sri Lanka.

Ecuador, whose debt had become unsustainable before the onset of the COVID-19 pandemic, is a case that predates the Common Framework. The Ecuadorian government's external debt was held primarily by commercial bondholders and Chinese creditors, principally the China Eximbank and the CDB. Because debt to Paris Club creditors was only about one percent of the total, the government decided to forgo a Paris Club restructuring and proceeded directly to negotiate an exchange with commercial bondholders, which was agreed in summer 2020. At about the same time, the CDB and China Eximbank agreed to a 15-month suspension of payments, paving the way for an agreement with the IMF on an Extended Financing Facility (EFF) arrangement in September. The two Chinese creditors agreed to provide more substantial relief two years later, in September 2022, and the EFF was concluded the following December. Some Western observers, including World Bank President David Malpass, criticized the approach of the Chinese agencies for providing shorter-term cash-flow relief when an outright principal reduction was needed (see, for example, IMF 2019). The present-value relief provided by the Chinese creditors more than matched that provided by the bond exchange, although both are likely to have to be revisited in coming years.

As a middle-income country, Suriname falls outside the coverage of the Common Framework. Its case is particularly interesting because China was the largest single official bilateral creditor, representing well over 20 percent of total claims when arrears are included, yet did not participate in multilateral negotiations (IMF 2022a, 48).[5] China and India explicitly declined to join the Paris Club meetings as ad hoc participants.[6] The Paris Club countries, which held only about three percent

3 These build upon the Non-Toleration of Arrears policy. See IMF (2022c).

4 Sean Hagan (2022) advocates using the full scope of flexibility under the policy to permit IMF programs to go forward even when commitments to restructuring might be ambiguous (see below).

5 Arrears to China, India and the Paris Club were US$61 million, US$7 million and US$22 million, respectively (IMF 2022a, 19). See, also, Suriname Debt Management Office (2020).

6 Not-for-attribution interviews with officials of national governments and international organizations, June and July 2022.

of total claims, therefore proceeded on their own, and, in June 2022, reached agreement with the Surinamese government consistent with an EFF arrangement from the IMF. Importantly, both China and India provided consent for the program to go forward under the LIOA policy of the Fund (discussed below). The two non-Paris Club creditors were nonetheless called upon to provide comparable treatment on terms they had no direct role in shaping, and although India has agreed, China's participation is still pending as of this writing. Notably, the Surinamese government committed not to service or repay such credits until China Eximbank agrees to provide comparable treatment (IMF 2021, 14),[7] which creates an incentive to come to terms. Meanwhile, Suriname concluded an exchange offer on two bond issues that provided modest relief (see Maret 2023a).

Sri Lanka, also too prosperous to fall under the Common Framework, owed about US$35 billion to external creditors as of 2022. Of this, China accounts for around 19 percent, Paris Club 12 percent, multilateral banks 27 percent, commercial creditors 42 percent and others six percent (Sri Lanka Ministry of Finance 2022). Between 2008 and 2021, the country borrowed at least US$12.3 billion from the two Chinese policy banks to build transport, energy and other infrastructure projects,[8] of which at least US$6.8 billion still needs to be repaid. Rather than form a common creditor committee, the official creditors began negotiations on a bilateral basis, providing financing assurances sequentially. The IMF balked at China Eximbank's initial assurances, at which point the bank provided a letter offering a two-year moratorium on debt servicing that was deemed sufficient (Maret 2023a; Setser 2023a; 2023b). The Fund thus approved a 48-month EFF program in the amount of US$3 billion in March 2023, conditioned as usual on early progress on restructuring. At the subsequent spring meetings of the World Bank and the Fund, Indian, Japanese and French (representing the Paris Club) officials announced that they would coordinate their debt treatments and invited the Chinese to join. Chinese creditors have so far chosen to negotiate separately. Nonetheless, the same incentive to come to terms in the Surinamese case applies in this instance as well: the government in Colombo is committed to not servicing official holdouts until they agree to comparable treatment (Wickremesinghe 2023).[9]

These cases demonstrate that the problem of the organization of negotiations over sovereign debt restructuring remains unresolved. Chinese creditors participate defensively rather than proactively within the Common Framework. Outside the Common Framework, there is no common forum for the treatment of official debt, let alone debt owed to the private sector. Chinese lenders remain suspicious of entering into multilateral debt negotiations, although their reticence is undoubtedly shared by other non-Paris Club creditors, and refuse to extend the Common Framework to middle-income countries. Nonetheless, recent cases illustrate that progress on debt treatments remains possible, albeit messier than advocates of a streamlined debt process would prefer, and suggest a path forward.

Remedy

Future cases in which official non-Paris Club holdouts threaten to prevent agreement on debt restructuring can be dealt with in the same fashion as the problem was treated in the Surinamese case. The following approach is proposed.

First, as is standard practice within and outside the Common Framework, all official creditors would be invited to the creditor committee to review the situation of the debtor, analyze its (in)ability to service debt and negotiate the debt treatment. As is also already the case, the debtor would go to the IMF for a program and the Fund staff would provide a debt sustainability analysis and macroeconomic framework, from which the debt treatment would be derived. The negotiations, the equivalent of the Agreed Minute of the Paris Club, and the pursuit of comparable treatment from private sector creditors would proceed as usual.

Second, however, in the case that the China Eximbank or other official creditors cannot or will not participate, the others representing a majority of the creditors would follow the usual procedure for negotiating and implementing a

7 Listen, also, to Zettelmeyer (2022).

8 See Boston University, Global Development Policy Center, Global China Databases, www.bu.edu/gdp/research/databases/global-china-databases/.

9 Negotiations are ongoing as of this writing.

debt treatment — on the understanding that the official holdout(s) will eventually provide, in one way or another, comparable treatment. Advancing negotiations in this way would require that the IMF continue to accept the arrears that the borrower will thereafter run with the holdouts as financing assurances.

Third — and this provision is fundamental to the success of the procedure — *the borrower must agree in writing (in the Memorandum of Economic and Financial Policies with the Fund and with the majority of creditors) not to service or redeem debt owed to the non-participating creditors until those creditors restructure their claims on comparable terms.* Such creditors can negotiate separately and at their own pace, but will not be serviced in the meantime.[10] Crucially, this commitment solves the problem of inter-creditor coordination. On the understanding that even the holdout official creditors will eventually be subject to comparable treatment, the debtor can negotiate its restructuring of claims by the private sector. In this way, when all goes well, the country's finances are stabilized, regular market access restored and the program concluded.

Fourth, it is necessary to ensure that the holdouts do not recoup their arrears when market access or other sources of financing are restored after the end of the program. This requires post-program monitoring and regular IMF surveillance but also the debtor's adherence through domestic legislation to full transparency of its external debt profile. Adopting legislation to compel disclosure of all public debt, including the full details of terms and any collateralization or escrow provisions, should thus be a condition that is written into the memorandum with the IMF. There is precedent in programs for conditions that mandate legal reform for debt transparency (IMF 2023d, 36–37); such conditionality should be made more robust and enduring in future programs associated with debt restructuring.

Lee Buchheit and Mitu Gulati (2022) offer a clever proposal for a "most favoured creditor" clause that is similar but differs in important ways. Buchheit and Gulati recommend that, in debt restructuring contracts, the sovereign debtor agrees to sweetening the deal if it were ever to later settle with a holdout creditor on more favourable terms. Such a clause would effectively preclude debtor governments from acceding to holdouts' demands for richer terms — thus providing assurance that the majority creditors require to conclude deals. Both proposals seek to circumvent holdout creditors in the restructuring negotiations via a commitment from the debtor not to provide better-than-comparable treatment to holdouts. But the present proposal operates explicitly in the context of an IMF program and provides instead for an outright prohibition on repayment of debt to official bilateral creditors.

A couple of circumstances might limit the viability of the remedy proposed here. First, in cases where an official holdout creditor holds a majority of a country's debt — China's position in Laos comes to mind — there may be no practical path forward except through its preferred forms of debt relief, which it might insist be administered bilaterally. Second, where debt to the holdout is secured by collateral arrangements, revenue sequestration or escrow accounts, the borrower could have difficulty committing to not servicing that portion of its debt. The IMF and World Bank (2020) and Anna Gelpern et al. (2021) report collateralization in a significant but distinct minority of sovereign loan and bond issues of low- and middle-income countries. If collateralization cannot be broken, restructuring becomes more complicated and negotiations more attenuated (as in the recent case of Chad). But the commitment not to service the holdout would nonetheless be applied to non-collateralized obligations.

The more formidable potential obstacle to the provisions offered here is the prospect that a non-participating official creditor or creditors might hold out for the duration of the IMF program and afterward tempt the debtor to renege with the offer of new money. Given their lending history, Chinese creditors might be in a position to dangle the prospect of new money for development projects in the future more credibly than Western officials and private creditors. However, the reset on the Belt and Road Initiative toward less capital-heavy projects, the overhang of real estate debt in China and the stagnation of the Chinese economy are clouding such prospects. In either case, though, debtors will look through their immediate debt troubles and restructuring negotiations to consider their ability to attract new resources over the long term.

10 The comparable treatment stipulation also prevents collection of interest on arrears that would be out of line with other creditors or program parameters.

The new money "problem" can be addressed proactively by mobilizing the MDBs to provide more resources in lieu of a large holdout creditor. There are two promising developments in this regard. After a meeting in April, the Global Sovereign Debt Roundtable announced that MDBs would provide higher volumes of low-interest rate and concessional financing from MDBs in the context of debt treatments (as opposed to restructuring their claims, as had been advocated by Chinese officials) (IMF 2023b; Gold and Saldinger 2023). This is also the thrust of the ongoing review in the G20 and among the MDBs of their capital adequacy frameworks to mobilize their balance sheets more aggressively (G20 2022; World Bank 2022b). Owing to space constraints, further discussion of that topic is not included in this brief.

The possibility that Chinese (or other holdout) officials could block IMF disbursement during a review halfway through the program, as would be their prerogative under the consent track of the LIOA policy, could present another complication. Advocates of debt restructuring could cross their fingers and bank on Chinese officials' forbearance as they have done in the Surinamese case. But a forward-looking strategy for restructuring should have a more dependable foundation, which calls for reconsideration of the LIOA policy and implementation of the Financing Assurances policy.

LIOA Policy

During the review published in May 2022, the policy with respect to arrears to private sector and international financial institutions was revised, but the policy on arrears to official bilateral creditors was left unchanged (IMF 2022b; Makoff 2022). The LIOA policy was, in fact, affirmed to be working well, notwithstanding abundant evidence to the contrary. In light of the recent cases of debt restructuring and the delays in IMF programs, the Fund should now revise the LIOA policy and its implementation.

As it currently stands, the LIOA policy allows the IMF to lend into arrears to official bilateral creditors under one of three circumstances: an agreement to restructure on the part of the Paris Club or another representative standing forum is in place; official creditor(s) provide consent; or three particular criteria hold.

First, the IMF should simply eliminate the consent track and rely instead on the criteria track. The consent track has been used in 12 out of the 37 cases where the LIOA policy was activated between 2015 and 2022 (IMF 2022b, 36–37). But it suffers from at least two substantial drawbacks. Consent does not in itself commit the creditor government to negotiate or join a debt restructuring agreement — which is what the Fund wants to see in support of the program and to protect its resources — and raises misgivings on the part of other official creditors.[11] Furthermore, as noted, the prospect that consent could be revoked at one of the program reviews casts uncertainty over the program.

Second, the IMF should modify the criteria track by eliminating the third criterion and instead rely on the good-faith criterion. As the policy now stands (IMF 2022c), the Fund can lend into official arrears when prompt support is essential for a debtor that is making good-faith efforts to negotiate with the creditor and, when doing so, "would not have an undue negative effect on the IMF's ability to mobilize official financing packages in future cases" (the third criterion).

The rationale for the third criterion was to protect the Fund's ability to mobilize supplemental financing for future programs for other countries. By insisting on this provision in the original LIOA policy in 2015, G7 members of the IMF Executive Board sought to avoid alienating large member-state shareholders that top-up financing packages or influence other international financial institutions' contributions to them. The ability to attract supplemental financing is important to protect, but the Executive Board can and should do so in the course of exercising its authority over policies and programs generally. The third criterion applies to other programs in the future, not the merits of the program and country at hand; raises matters that go substantially beyond the matter of arrears; and is so difficult to assess as to make effective implementation impractical in the context of a particular program. Given China's domestic financial troubles, for example, its contribution to future packages is uncertain regardless of whether the IMF withholds lending into arrears to Chinese banks. Moreover, if future packages must be supplemented, the international community can turn to alternative sources to fill the gap. Other official creditors should prepare to step up, as Western governments and Japan

11 The author is indebted to Sean Hagan for a conversation on these points.

did by offering to satisfy financing assurances for Ukraine recently (IMF 2023c). And, as noted above, the MDBs can be mobilized similarly.

Historically, the United States and other Paris Club creditors maintained hurdles to the IMF's lending into official arrears because those arrears were largely to themselves. Under current circumstances, however, these particular provisions of the LIOA policy do not protect the interests of traditional creditors as much as delay the Fund's help to the borrower and debt restructuring, and thus become self-defeating and obsolete. With the further worsening of debt distress among EMDCs and the accumulation of cases of program delays, a number of governments and their executive directors might thus be persuaded to withdraw the consent requirement and third criterion. While there might be a preference to make decisions by consensus, a simple majority of the Executive Board can decide the question in a crunch.

Third, while amending these elements of the LIOA policy, the Executive Board should also recognize the Common Framework as a "representative standing forum." Prior to the rise of China as an important official bilateral creditor, the Paris Club's credits constituted the lion's share of the debts of countries undergoing restructuring. An Agreed Minute of the Paris Club thus involved most of the relevant official creditors in a restructuring, allowing the IMF to "deem away" any arrears to remaining creditors on the Paris Club's comparable treatment principle (that is, on the understanding that the debtor would seek comparable treatment from residual official creditors along with private creditors). The Executive Board in 2015 anticipated the possibility that the IMF would want to recognize additional fora, as non-Paris Club governments were expected to eclipse traditional ones as lenders in many cases (IMF 2015, 1–2), but declined to recognize the Common Framework in 2022 (see Dauchy 2022; Maret 2023a). Doing so now would help to avoid holdups caused by non-Paris Club creditors with small exposures — such as the UAE and Bahrain — and pave the way for recognition of official creditor forums for middle-income cases, which are not covered by the Common Framework.

Financing Assurances Policy

Changes to the LIOA policy should be accompanied by a pair of changes to the manner in which the IMF's Financing Assurances policy is implemented.

The Financing Assurances policy requires that the official sector provide "firm commitments" to fill any financing gap during the first 12 months of the program and "good prospects" that there will be adequate financing for the remainder of the program period. The policy seeks to ensure the success of the program and repayment of the Fund. It is this policy that requires, when the borrower's debt is not sustainable, creditors to commit to entering restructuring negotiations with a view to reaching agreement prior to completion of the first or second program review. Arrears to official creditors also fill the financing gap as well as new credits on concessional terms. In these ways, the Financing Assurances and LIOA policies are intertwined.

But in the course of recent restructuring cases,[12] the financing assurances requirement became a potential veto point, where a recalcitrant official creditor could potentially block the progress of a program.[13] To remove this, first, staff should be given greater discretion in deciding what exactly constitutes sufficient financing assurances, so that they can finalize a program and present it to the Executive Board even when a holdout official creditor might be ambiguous about what it is willing to provide. Second, staff should, however, track financing assurances and report on them more fully in each program review. Under current practice, treatments of financing assurances in most reports of quarterly or semi-annual reviews are quite thin. Requiring elaboration and specificity in these reviews will maintain scrutiny of holdouts to provide comparable treatment and, if necessary, highlight the need for alternative sources before funding gaps emerge. Moreover, because progress in negotiating restructuring with holdouts, or lack of it, affects the form and quantity of financing, staff should monitor

12 By withholding financing assurances, Chinese lenders delayed the initiation of IMF programs in the cases of Ghana, Sri Lanka and Suriname by several months. In the case of Suriname, for example, listen to minute 16, Zettelmeyer (2022) and see Maret (2023b).

13 The Executive Board amended the Financing Assurances policy in March 2023, in order to speed resources to Ukraine. The changes apply to cases of exceptionally high uncertainty and provide for official bilateral creditors to pledge at the outset to cover a borrower's obligation to the Fund via additional financing or further debt relief if one of these prove necessary (IMF 2023c). But it could also be used to provide additional flexibility for meeting financing assurances in cases of sovereign debt restructuring.

financing assurances in combination with the debtor's adherence to the good-faith criterion.[14]

Aside from removing hurdles to timely assistance from the IMF, provision of its debt sustainability analysis (which specifies the amount of relief required), and progress in restructuring negotiations, these recommendations would collectively have the incidental benefit of simplifying the LIOA and Financing Assurances policies — intertwined sets of operational rules that have become overly complex (see, for example, Maret 2022).

Conclusion

This policy brief has diagnosed the "too little, too late" syndrome in sovereign debt restructuring. It highlights the rise of China as a leading creditor, the posture that its lending agencies have taken with respect to multilateralized restructuring, and the weakness of domestic mechanisms for coordinating those various agencies as important factors that distinguish the present from earlier rounds of debt restructuring. China's posture confronts institutional arrangements for sovereign debt restructuring that constitute a regime complex — a set of overlapping, sometimes competing, usually collaborative institutions (Henning 2021; Henning and Pratt 2023). As designers of the international financial architecture, the challenge is to make these institutions work together effectively and expeditiously in the face of variegated preferences among an increasingly diverse set of creditors.

The brief makes four principal recommendations, which are interrelated and mutually reinforcing.

First, it must be acknowledged that it is possible, perhaps likely, that China will not coordinate its lending agencies internally any further than it has done so far or promote debt restructuring proactively over the time horizon of the present debt crisis. Debt restructuring arrangements must be designed to provide for negotiations in the absence of Chinese lending agencies, if need be. Chinese lenders should continue to be welcomed in multilateral talks, of course, but institutional arrangements must allow for progress on debt restructuring even if a significant creditor is slow or refuses to participate.

Second, to avoid an unravelling of creditor cooperation in the face of an intractable collective action dilemma, majority creditors and the IMF should require a commitment from the borrower, as part of program conditionality, that any official holdout creditor not be serviced or repaid until it agrees to comparable treatment (that is, treatment equivalent to that agreed by the majority of creditors). This provision would follow long-standing norms, regularize a practice that most creditors and the IMF have converged upon out of necessity in some recent cases, and apply as a matter of policy to any official holdout creditor in future cases.

Third, concerns that an official holdout creditor could nonetheless avoid restructuring its claims or recoup losses associated with restructuring after an IMF program is concluded can be addressed by enhancing transparency and post-program surveillance, as well as by providing alternatives to the holdout for new financing through more highly leveraged MDBs in the future, among other sources.

Fourth, the staff and Executive Board of the IMF should update the LIOA policy by eliminating the consent channel and the third criterion of the criteria channel for proceeding with a program for a country in arrears. At the same time, management and staff should exploit the flexibility that is allowed under the recently amended Financing Assurances policy to ensure that programs can be approved, if necessary, before all official creditors fully accept the need for debt restructuring. The Executive Board can approve programs with the knowledge that disbursements can be withheld at early program reviews if necessary, pending agreement from holdouts on restructuring.

Adopting these measures would go a long way toward delivering faster, deeper debt relief without having to create new institutions, alter the basic mandates of existing ones or undergo an attenuated, risky process of ratifying new mandates or funding.

This policy brief has been informed by the experience of recent debt negotiations and the need to chart pathways forward even when certain Chinese lending agencies might be reluctant

14 Compare to Buchheit's (2023) other intriguing proposal to abolish the Financing Assurances policy altogether. The policy is less redundant in restructuring cases if the hurdles to LIOA are lowered, as recommended here, and still relevant in cases that do not require debt restructuring.

to participate. Its purpose, however, is general and applies to any official bilateral creditor that would potentially block a restructuring that was agreed multilaterally by a large majority of creditors. As other emerging-market countries become increasingly large creditors, we could see a repetition of current debates as yet another group of new lenders must be "socialized" into the global creditor community. The institutional arrangements that are set in place today should be robust to changes in the identity of the dominant creditors in coming decades.

Acknowledgements

The author acknowledges the excellent research assistance of Frieder Dengler, Sisir Bhandari and Mateo Maya, graduate students at the School of International Service at American University. He also wishes to acknowledge Bob Fay, Paul Samson and the Centre for International Governance Innovation for their support of the project. The policy brief benefits from not-for-attribution interviews with, and insights from, numerous officials and former officials in national governments, central banks and international financial institutions, for which the author is also grateful. James Boughton, Daniel Bradlow, Lex Rieffel and two anonymous reviewers provided excellent comments on an earlier draft. The author alone is responsible for any possible errors in fact or judgment. Comments are welcome at henning@american.edu.

Acronyms and Abbreviations

CDB	China Development Bank
DSSI	Debt Service Suspension Initiative
EFF	Extended Financing Facility
EMDCs	emerging market and developing countries
Eximbank	Export-Import Bank of China
G7	Group of Seven
G20	Group of Twenty
IMF	International Monetary Fund
LIA	Lending into Arrears
LICs	low-income countries
LIOA	Lending into Official Arrears
MDBs	multilateral development banks
MOFCOM	Ministry of Commerce
PBoC	People's Bank of China
UAE	United Arab Emirates

Works Cited

Brautigam, Deborah. 2022. "China and Zambia: creating a sovereign debt crisis." *International Affairs* 98 (4): 1347–65. https://doi.org/10.1093/ia/iiac109.

Brautigam, Deborah and Yufan Huang. 2023a. "China and the Global Regime for Sovereign Debt Restructuring." Paper presented to the ISA meetings, Montreal, QC, March 17.

———. 2023b. "Integrating China into Multilateral Debt Relief: Progress and Problems in the G20 DSSI." China-Africa Research Initiative Briefing Paper No. 9. April. Washington, DC: School of Advanced International Studies, Johns Hopkins University.

Bretton Woods Committee Sovereign Debt Working Group. 2023. "Private Sector Engagement and Equitable Burden Sharing: A New Paradigm." June. Washington, DC. www.brettonwoods.org/sites/default/files/documents/BWC-SDWG-Paper3-PrivSectorEng-2023-FNL-web1.pdf.

Buchheit, Lee. 2023. "Time to scrap 'financing assurances'?" *FT Alphaville*, January 3. www.ft.com/content/acfaf9fb-b44a-4c04-a5bf-23f6983fb0dc.

Buchheit, Lee C., Guillaume Chabert, Chanda DeLong and Jeromin Zettelmeyer. 2019. "How to Restructure Sovereign Debt: Lessons from Four Decades." Peterson Institute for International Economics Working Paper No. 19-8. May. www.piie.com/sites/default/files/documents/wp19-8.pdf.

Buchheit, Lee C. and Mitu Gulati. 2022. "Enforcing Comparable Treatment in Sovereign Debt Workouts." Virginia Public Law and Legal Theory Research Paper No. 2022-67. https://papers.ssrn.com/sol3/papers.cfm?abstract_id=4229061.

Chabert, Guillaume, Martin Cerisola and Dalia Hakura. 2022. "Restructuring Debt of Poorer Nations Requires More Efficient Coordination." *IMF Blog*, April 7. www.imf.org/en/Blogs/Articles/2022/04/07/restructuring-debt-of-poorer-nations-requires-more-efficient-coordination.

Dauchy, Jill. 2022. "Ways to fix the lender of last resort." *FT Alphaville*, September 22. www.ft.com/content/6890bf1a-b172-4d78-98f6-6562b4a376d9.

G20. 2022. "Boosting MDBs' Investing Capacity: An Independent Review of Multilateral Development Banks' Capital Adequacy Frameworks." www.g20.utoronto.ca/biblio/CAF-Review-Report.pdf

Gelpern, Anna, Sebastian Horn, Scott Morris, Brad Parks and Christoph Trebesch. 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. March 31. www.aiddata.org/publications/how-china-lends.

Gold, Shabtai and Adva Saldinger. 2023. "IMF official: China agrees to 'breakthrough' compromise on debt impasse." *Devex*, April 12. www.devex.com/news/imf-official-china-agrees-to-breakthrough-compromise-on-debt-impasse-105338.

Hagan, Sean. 2005. "Designing a Legal Framework to Restructure Sovereign Debt." *Georgetown Journal of International Law* 36: 299–402.

———. 2020. "Sovereign Debt Restructuring: The Centrality of the IMF's Role." Peterson Institute for International Economics Working Paper, 20-13. Washington, DC. July. www.piie.com/sites/default/files/documents/wp20-13.pdf

———. 2022. "The IMF's arrears lending policy: Just Use It." *FT Alphaville*, September 28. ft.com/content/8b9340a5-b4ca-4e1f-b4b7-cb5003fdb27e.

Henning, C. Randall. 2021. *Designing Institutional Collaboration into Global Governance.* CIGI Policy Brief No. 167. Waterloo, ON: CIGI. www.cigionline.org/publications/designing-institutional-collaboration-into-global-governance/.

———. 2023. "China as a Fragmented Creditor and the International Regime Complex for Sovereign Debt Restructuring." Paper presented to the International Studies Association Meeting, Montreal, QC, March 17.

———. Forthcoming. *Institutional Arrangements for Sovereign Debt Restructuring: Navigating Creditor Fragmentation and Institutional Complexity* [working title]. CIGI Paper. Waterloo, ON: CIGI.

Henning, C. Randall and Tyler Pratt. 2023. "Hierarchy and Differentiation in International Regime Complexes: A Theoretical Framework for Comparative Research." *Review of International Political Economy*. http://dx.doi.org/10.1080/09692290.2023.2259424.

IMF. 2015. "Reforming the Fund's Policy on Non-Toleration of Arrears to Official Creditors." IMF Policy Paper. Washington, DC: IMF. December. www.imf.org/external/np/pp/eng/2015/101515.pdf.

———. 2019. "Decoding Debt: Getting Transparency Right." Seminar, Washington, DC, October 17. www.imfconnect.org/content/imf/en/annual-meetings/calendar/open/2019/10/17/decoding_debt_gettingtransparencyright_1488145.html.

———. 2020. "The International Architecture for Resolving Sovereign Debt Involving Private-Sector Creditors — Recent Developments, Challenges, And Reform Options." IMF Policy Paper. October 1. Washington, DC: IMF. www.imf.org/en/Publications/Policy-Papers/Issues/2020/09/30/The-International-Architecture-for-Resolving-Sovereign-Debt-Involving-Private-Sector-49796.

———. 2021. "Suriname: Request for an Extended Arrangement under the Extended Fund Facility." IMF Country Report No. 21/280. December 23. Washington, DC: IMF. www.imf.org/en/Publications/CR/Issues/2021/12/23/Suriname-Request-for-an-Extended-Arrangement-under-the-Extended-Fund-Facility-Press-Release-511294.

———. 2022a. "Suriname: First Review under the Extended Arrangement under the Extended Fund Facility, and Financing Assurances Review." IMF Country Report No. 22/90. March 25. Washington, DC: IMF. www.imf.org/en/Publications/CR/Issues/2022/03/25/Suriname-First-Review-under-the-Extended-Arrangement-under-the-Extended-Fund-Facility-and-515732.

———. 2022b. "Reviews of the Fund's Sovereign Arrears Policies and Perimeter." IMF Policy Paper. May 18. Washington, DC: IMF. www.imf.org/en/Publications/Policy-Papers/Issues/2022/05/18/Reviews-of-the-Fund-s-Sovereign-ARREARS-Policies-and-Perimeter-517997.

———. 2022c. "The IMF's Policies on Sovereign Arrears." IMF Policy Paper. May 18. Washington, DC: IMF.

———. 2023a. *Global Financial Stability Report: Safeguarding Financial Stability amid High Inflation and Geopolitical Risks*. April. Washington, DC: IMF. www.imf.org/en/Publications/GFSR/Issues/2023/04/11/global-financial-stability-report-april-2023.

———. 2023b. "Global Sovereign Debt Roundtable Co-Chairs Press Statement." April 12. Washington, DC: IMF. www.imf.org/en/News/Articles/2023/04/12/pr23117-global-sovereign-debt-roundtable-cochairs-press-stmt.

———. 2023c. "Changes to the Fund's Financing Assurances Policy in the Context of Fund Upper Credit Trance Financing under Exceptionally High Uncertainty." IMF Policy Paper. March 17. Washington, DC: IMF. www.imf.org/en/Publications/Policy-Papers/Issues/2023/03/17/Changes-to-the-Funds-Financing-Assurances-Policy-in-the-Context-Of-Fund-Upper-Credit-531091.

———. 2023d. "Making Public Debt Public — Ongoing Initiatives and Reform Options." IMF Policy Paper. July. Washington, DC: IMF. www.elibrary.imf.org/view/journals/007/2023/034/007.2023.issue-034-en.xml.

IMF and World Bank. 2020. "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers." Policy Paper No. 2020/010. January 24. Washington, DC: IMF. www.imf.org/en/Publications/Policy-Papers/Issues/2020/02/19/Collateralized-Transactions-Key-Considerations-for-Public-Lenders-and-Borrowers-49063.

Jones, Lee and Shahar Hameiri. 2021. *Fractured China: How State Transformation Is Shaping China's Rise*. Cambridge, UK: Cambridge University Press.

Krueger, Anne O. 2002. *A New Approach to Sovereign Debt Restructuring*. April. Washington, DC: IMF.

Liu, Kun. 2020. "Written Interview with Finance Minister Liu Kun on G20 Debt Agenda." Ministry of Finance, The People's Republic of China, November 20. www.mof.gov.cn/en/Cooperation/mulid/202011/t20201120_3626593.htm.

Makoff, Gregory. 2022. *Lending to Defaulters: The IMF Updates Its Lending into Arrears Policy*. CIGI Policy Brief No. 175. Waterloo, ON: CIGI. www.cigionline.org/publications/lending-to-defaulters-the-imf-updates-its-lending-into-arrears-policy/.

Maret, Theo. 2022. "Suriname: blurred lines between IMF policies." *Sovdebt Oddities* (blog), November 7. https://theomaret.substack.com/p/suriname-blurred-lines-between-imf.

———. 2023a. "Sri Lanka: who blinks next?" *Sovdebt Oddities* (blog), February 8. www.sovdebtoddities.com/p/sri-lanka-who-blinks-next.

———. 2023b. "Suriname's sovereign restructuring on the move." *Sovdebt Oddities* (blog), May 10. www.sovdebtoddities.com/p/surinames-sovereign-restructuring.

Neiman, Brent. 2022. "Cross-border debt, sovereign debt restructuring, and recent challenges for the global financial infrastructure." Speech to the Peterson Institute for International Economics, Washington, DC, September 20. www.piie.com/events/speech-counselor-us-treasury-secretary-brent-neiman.

Rieffel, Lex. 2003. *Restructuring Sovereign Debt: The Case for Ad Hoc Machinery*. Washington, DC. Brookings Institution.

Setser, Brad W. 2022. "Zambia's chance to set the global financial architecture." *FT Alphaville*, October 6. www.ft.com/content/e8e95a2d-97bd-46ab-b55d-6542a9e92ad3.

———. 2023a. "Getting Debt Restructuring Terms Right." *Follow the Money* (blog), May 3. Washington, DC: Council on Foreign Relations. www.cfr.org/blog/getting-debt-restructuring-terms-right.

———. 2023b. "The Common Framework and Its Discontents." *Follow the Money* (blog), March 26. Washington, DC: Council on Foreign Relations. www.cfr.org/blog/common-framework-and-its-discontents.

Sobel, Mark. 2022. "Sovereign debt architecture is messy and here to stay: deal with it." *FT Alphaville*, August 16. www.ft.com/content/b7133f4e-797f-4c25-b70b-346fa8870478.

Sri Lanka Ministry of Finance. 2022. "Quarterly Debt Bulletin." September. www.treasury.gov.lk/api/file/d857ad94-e632-4fc6-a221-cab9965d7085.

Suriname Debt Management Office. 2020. "Republic of Suriname — Central Government Debt Stock as of Dec. 2019 and Jun. 2020." November. https://sdmo.org/documenten/debtpack/Debtstock.pdf.

United Nations Conference on Trade and Development. 2023. "Trade and Development Report Update: Global Trends and Prospects." April 12. Geneva, Switzerland: United Nations Conference on Trade and Development. https://unctad.org/system/files/official-document/gdsinf2023d1_en.pdf.

Wickremesinghe, Ranil. 2023. "Sri Lanka: An Open Letter to Official Bilateral Creditors." *Sri Lanka Guardian*, March 14. https://slguardian.org/sri-lanka-an-open-letter-to-official-bilateral-creditors/.

World Bank. 2022a. *International Debt Report 2022*. Washington, DC: World Bank. www.worldbank.org/en/programs/debt-statistics/idr/products.

———. 2022b. "Evolving the World Bank Group's Mission, Operations, and Resources: A Roadmap." Washington, DC: World Bank. December 18. https://documents1.worldbank.org/curated/en/099845101112322078/pdf/SECBOS0f51975e0e809b7605d7b690ebd20.pdf.

Zettelmeyer, Jeromin. 2022. "Updates to the Arrears Policy of the International Monetary Fund," July 25, in *Sovereign Debt with Jill Dauchy*, podcast, episode 18. https://podcasts.apple.com/us/podcast/sovereign-debt-with-jill-dauchy/id1590877150.

About CIGI

The Centre for International Governance Innovation (CIGI) is an independent, non-partisan think tank whose peer-reviewed research and trusted analysis influence policy makers to innovate. Our global network of multidisciplinary researchers and strategic partnerships provide policy solutions for the digital era with one goal: to improve people's lives everywhere. Headquartered in Waterloo, Canada, CIGI has received support from the Government of Canada, the Government of Ontario and founder Jim Balsillie.

À propos du CIGI

Le Centre pour l'innovation dans la gouvernance internationale (CIGI) est un groupe de réflexion indépendant et non partisan dont les recherches évaluées par des pairs et les analyses fiables incitent les décideurs à innover. Grâce à son réseau mondial de chercheurs pluridisciplinaires et de partenariats stratégiques, le CIGI offre des solutions politiques adaptées à l'ère numérique dans le seul but d'améliorer la vie des gens du monde entier. Le CIGI, dont le siège se trouve à Waterloo, au Canada, bénéficie du soutien du gouvernement du Canada, du gouvernement de l'Ontario et de son fondateur, Jim Balsillie.

Credits

Managing Director of Digital Economy Robert Fay
Director, Program Management Dianna English
Program Manager Jenny Thiel
Senior Publications Editor Jennifer Goyder
Graphic Designer Abhilasha Dewan

67 Erb Street West
Waterloo, ON, Canada N2L 6C2
www.cigionline.org