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IN FOCUS

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Sovereign Debt Concerns in Developing Countries

The Coronavirus Disease 2019 (COVID-19) pandemic and Russia's war on Ukraine has had significant economic and financial consequence for low-income countries. The World Bank estimates that the pandemic pushed 97 million more people into poverty in 2020. Several countries, including Argentina, Russia, and Zambia, have defaulted on their sovereign debt, and many others are at high levels of debt distress. Congress may consider the effects of high debt levels across developing countries for the economic development outlook in these countries, debt recovery efforts, and stability in the international financial system.

The United States is participating in two G20 creditor country-led debt relief initiatives. The Biden Administration requested $52 million in FY2022 from Congress to support the G20 efforts. Congress appropriated these funds in P.L. 117-328, Consolidated Appropriations Act, 2023.

Members of Congress have also introduced legislation aimed at improving the transparency of the scale and scope of creditor countries' sovereign lending (e.g., S. 1169, the Strategic Competition Act of 2021, in the 117th Congress). China is now the largest creditor to developing countries, and some Members have raised concerns about the opacity of China's lending practices and participation in multilateral debt relief initiatives.

Debt Vulnerabilities

The debt stock of low- and middle-income countries rose on average 5.6% in 2021 to a total of $9 trillion. According to the International Monetary Fund (IMF) and the World Bank, a majority (60%) of low-income countries are in "debt distress," meaning that that there is a risk that a country may be unable to meet its financial obligations without debt restructuring or possibly debt forgiveness.

According to the IMF, as of January 31, 2023, nine countries are in debt distress, 28 countries are at high risk and 25 countries are at moderate risk. The IMF also noted that from 2019 to 2020, overall borrowing jumped by 28 percentage points to 256% of GDP, with government borrowing accounting for about half of this increase.

Alongside increased borrowing, since the end of 2019, nine countries (Argentina, Belize, Ghana, Ecuador, Lebanon, Sri Lanka, Russia, Suriname, and Zambia) have defaulted on sovereign debt obligations.

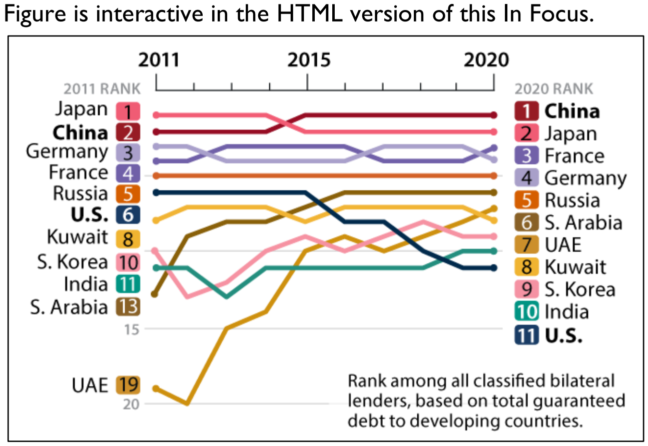
The landscape of sovereign borrowing has changed over the past few decades. Following a sharp decline after the 2005 G8-led Multilateral Debt Relief Initiative, sovereign debt began accumulating during the 2007-2009 global financial crisis, and has continued to rise through the COVID-19 pandemic. According to World Bank figures, total external government debt of low- and middle-income countries increased from $1.7 trillion in 2011 to $3.5 trillion in 2021. While the earlier waves of sovereign debt accumulation in the 1970s and 1980s consisted primarily of bank loans and bilateral borrowing from advanced economies and the multilateral development banks, increases since around 2015 in aggregate sovereign debt are largely attributable to China's emergence as a key developing country creditor, and to the rising use of private sector bonds to finance developing country public debt. These trends have raised new challenges in resolving sovereign defaults.

China's Lending to Developing Countries

China, since 2015, has been the largest creditor to low-income countries (**Figure 1**), surpassing the Paris Club (a core group of traditional donor governments including the United States and 21 other countries), the IMF, and the World Bank. Unlike the IMF, the World Bank, or the Paris Club, China rarely discloses the amounts or terms of its bilateral debt agreements. According to one 2019 National Bureau of Economic Research study, half of China's official lending to developing countries is not reported in World Bank/IMF debt statistics. China is not a member of the Paris Club.

Figure 1. China is the Largest Creditor for Developing Countries

Figure is interactive in the HTML version of this In Focus.

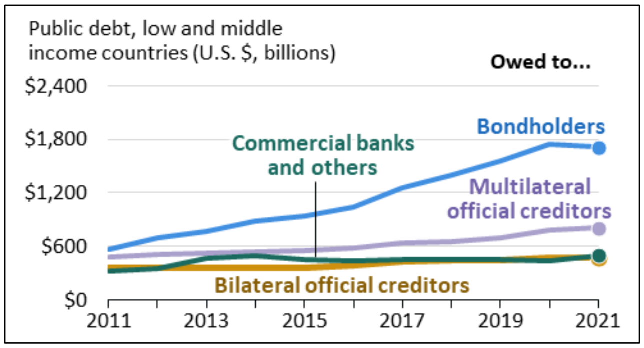


Source: Created by CRS based on World Bank International Debt Statistics 2022 data.

Proliferation of Debt Instruments

In the early 1990s, private financing to developing countries shifted from private bank loans to government bonds. As a result, the bond market has become a key source of public financing globally. Between 2011 and 2019, sovereign bond financing to low- and middle-income countries tripled (**Figure 2**).

Figure 2. External Public/Publically Guaranteed Debt



Source: World Bank International Debt Statistics (IDS). Chart, CRS.

Debt Service Suspension Initiative

On April 15, 2020, the G-20 finance ministers, in conjunction with private creditors, announced a temporary debt payment suspension through the end of 2020. Formalized as the Debt Service Suspension Initiative (DSSI), the effort temporarily suspended interest and principal repayments on G-20 official bilateral loans. The DSSI was later extended through December 2021. According to the World Bank, the DSSI delivered more than $8.9 billion in official debt relief to more than 48 of the 73 eligible countries.

From Debt Suspension to Debt Forgiveness

While DSSI is providing temporary debt restructuring, the G-20 and the 22 members of the Paris Club, comprising 39 countries (including China), endorsed a new "Common Framework for Debt Treatments beyond the DSSI" in November 2020 for providing permanent debt forgiveness. Debt treatment options under this framework include extending the duration of sovereign debt and in extreme cases, debt write-offs or cancellation.

Unlike the DSSI, Common Framework debt restructuring requires a formal process similar to earlier Paris Club debt treatments, including backing by an IMF lending program and assurances that the debtor will seek treatment from all its creditors, public and private, on comparable terms. Three of the eligible countries have requested Common Framework debt relief: Chad, Ethiopia, and Zambia. One of those countries—Chad— has secured an agreement and, that agreement reschedules rather than cancels payments.

While China is participating in multilateral debt discussions, including a new sovereign debt roundtable chaired by the IMF and India (as chair of the G20 in 2023), some U.S. and international officials are concerned that China's unwillingness to provide comparable debt relief treatment is slowing these efforts. China is also pressing for the IMF and the World Bank to participate in multilateral debt relief efforts.

At the February 2023 G20 meeting, an Indian financial official, Amitabh Kant, pushed back on China, saying "It can't be that the International Monetary Fund takes a haircut, and it goes to settle Chinese debt." Furthermore, according to Kant, "China needs to come out openly and say what their debt is and how to settle it." This came after Treasury Secretary Janet Yellen called China a "barrier" to debt reform during her January 2023 trip to Zambia.

Governments of many eligible countries may be concerned that seeking debt restructuring, especially with commercial creditors, will lead to ratings downgrades and reduce their future access to financing. They have seen cases of that happening. Moody's downgraded Ethiopia's sovereign bonds, in part due to the possibility that a Common Framework agreement might cause private creditor losses.

The risk of private sector debt downgrades has been less of an issue with the DSSI, which has been limited to official sector debt. Despite calls from the IMF and others for the private sector to participate in the DSSI, the private sector did not participate. The Institute of International Finance (IIF), an industry group, has argued that a comprehensive agreement on private sector debt forgiveness could risk reducing countries' access to the private capital markets.

U.S. Debt Relief and the Role of Congress

Congressional authorization is necessary for the United States to participate in multilateral debt relief efforts. Under authority first granted by Congress in 1993 (P.L. 103-87), an appropriation by Congress of the estimated amount of debt relief is required in advance. The FY2022 budget requested $52 million for the DSSI and Common Framework. According to Treasury, this funding was necessary to restructure and lower U.S. interest rates charged to the 48 countries that had requested payment suspensions under the DSSI.

Some in Congress have raised concerns about sovereign debt risks, notably with respect to the lack of transparency of China's lending. For example, in the 117th Congress, S. 4112, Economic Statecraft for the Twenty-First Century Act, would have required any applicant for U.S. assistance to disclose any debt owed to any entity owned or controlled by China. In the 116th Congress, Congress passed P.L. 116-283, which directs U.S. representatives at the IFIs to "seek to secure greater transparency with respect to the terms and conditions of financing provided by the government of the People's Republic of China."

Legislation was also introduced in the 116th Congress, H.R. 6086, the IMF Reform and Integrity Act of 2020, that would have prohibited the United States from voting in favor of a quota increase for China, or any other country, that is not "committed to the rules and principles of the Paris Club."

In the 118th Congress, Members may also consider the increased complexity of sovereign debt markets and various public and private efforts to improve coordination among creditors. As debt instruments become more diverse and the creditor base becomes more fragmented, debt risks and the costs of restructurings are increasing.

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