Remarks by Assistant Secretary of Treasury for International Finance Brent Neiman at John Hopkins School for Advanced International Studies

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As Prepared for Delivery

Thank you for the invitation to speak here today at SAIS. As an academic, I've had brilliant colleagues and former PhD students of mine join your faculty. As a policymaker, I get to work closely with your impressive alumni, many of which are on the Treasury team and working across the U.S. government. It's an honor -- and it's also productive -- to speak at a school that produces so many bright minds and influential careers in international economic policymaking.

About one year ago, I gave a set of remarks at the Peterson Institute on the international debt landscape. I described a particularly difficult environment for vulnerable low-income countries and emerging markets. Governments, rightfully, used up a lot of their available fiscal firepower to respond to the Covid-19 pandemic. Russia's brutal war in Ukraine, in addition to the terrible loss of life and other human costs, caused food, fertilizer, and energy prices to surge. The debt-to-GDP ratio for developing and emerging markets in late 2021 sat at 64 percent, about 10 percentage points above the pre-Covid level. A majority of low-income countries were at high risk of, or were already in, debt distress.

Some of these countries have needed restructurings of their debt to allow them to achieve a stable and sustainable growth path. Without these restructurings, new lenders understandably fear that their new funds will be used to repay old debts, hindering investment. My remarks last year detailed how changes in the international debt landscape – particularly the rapid growth of non-traditional official creditors including, most notably, China – have complicated and, unfortunately, have slowed the sovereign debt restructuring process. Some borrowers have found themselves stuck, unable to obtain an agreement from key creditors. While waiting, these borrowers can experience sharply deteriorating conditions and, unable to access financing from the IMF, they often cannot advance their reform programs or return to stable growth.

It is one year later, and global macroeconomic conditions remain difficult for many vulnerable countries. As Secretary Yellen has repeatedly stated, "Ending Russia's war is the single best thing we can do for the global economy." But Russia's war rages on, and Russia's abandonment of the Black Sea Grain Initiative continues to threaten food security. Financial conditions have also tightened as central banks fight inflation. Global growth is projected to be slower this year than it was last year. And yet, today, we see a few signs of potential improvement. Some borrowers are becoming unstuck in their restructuring processes and are progressing to later stages in their debt treatments and IMF programs.

We clearly haven't gone far enough or fast enough and much more work remains. The critical test of any progress will be whether it is sustained when, as seems likely, more countries come forward requesting debt treatments. But, I am hopeful that our recent efforts are yielding some movement toward an improved international debt architecture that can help low- and middle-income countries when they need it.

1. SOME MOVEMENT IN KEY COUNTRY CASES

Let's look at some key country cases, starting with Zambia. In early 2021, Zambia requested a debt treatment as part of the G20's "Common Framework" – a mechanism that aims to make it easier for Paris Club creditors like the United States and non-Paris Club creditors such as China to work together. Despite reaching a staff-level agreement with the IMF at the end of 2021, Zambia waited for seven months to obtain promises that its official creditor committee members, including its largest bilateral official creditor, China, would offer a debt treatment in line with the IMF's program, promises that are referred to as "financing assurances." With these assurances in hand, the IMF Board was finally able to approve Zambia's program and disburse $185 million. From there, Zambia waited almost another year before its creditors reached agreement on the broad terms of their debt restructuring this past June, unlocking another IMF disbursement of similar size. But there has been some progress since then, and Zambia a few weeks ago reached agreement on the specifics of the restructuring with its official creditors.

Zambia's case clearly took far too long, and those delays involved significant costs and risks to their reforms and growth. But Zambia is now yielding some benefits. It has reduced its fiscal deficit while, at the same time, doubling targeted social protection spending to reach 1.4% of GDP, in line with its regional peers. Zambia's reserves are now twice what they were in 2020, and the IMF forecasts that growth in 2024 will exceed 4%.

Also, consider Ghana, which ran double-digit fiscal deficits in 2021 and 2022 before getting an IMF staff-level agreement for a program and requesting Common Framework treatment last December. Creditors delivered financing assurances this past May, five months after Ghana reached staff-level agreement with the IMF. Though this was still too slow and involved too much uncertainty, it was quicker than the equivalent stage for Zambia, and the assurances allowed the IMF to quickly approve Ghana's program and disburse $600 million. After rapidly depreciating in 2022, Ghana's currency, the cedi, started to stabilize this year. Significant macroeconomic challenges remain, but market sentiment has improved and Ghana's reserves have doubled.

Another key case is Sri Lanka, which defaulted on its debts and experienced a crisis that led to the rationing of fuel and medicine and required humanitarian assistance from the United States and other partners. It took six months after reaching a staff level agreement with the IMF in September of last year to receive the needed financing assurances from official bilateral creditors. Once again, this is too long a delay, and meant that Sri Lanka's IMF program could only be approved this past March. But, fortunately, the program has indeed helped to stabilize their economy. Reserves increased $1.5 billion between March and June this year, there are fewer shortages of essential goods, and inflation has dropped from above 70% one year ago to below 2% now.

2. IMPROVEMENTS IN THE OVERALL DEBT ARCHITECTURE

What helped push each of these restructurings forward to the next stage? I think it has made a big difference that global leaders have decided to elevate this topic toward the top of the international economic agenda. President Biden and Secretary Yellen both view low-income and emerging-market debt distress as a critical issue and make a point of raising it in discussions with their counterparts. Likeminded partners including India, this year's G20 president, have helped to land the subject front and center in high level deliberations and communications of the G20.

Further, Treasury frequently engages on debt with a wide range of countries and institutions. We view it as important and helpful that the leadership of the international financial institutions and the leaders of countries requesting debt treatments have had discussions themselves at the highest levels with key official creditors. Our ability to discuss this topic directly with China has also been helpful. Sovereign debt in developing and emerging markets is not a bilateral issue between the United States and China, but it is one where the world's two largest economies need to be able to work together. The Secretary and her Chinese counterpart recently decided to launch two working groups, which we hope will allow for continued dialogue in this and related areas.

What else has led to progress? The most critical elements are typically unique to each particular country or situation. But there are also common holdups or technical issues that are relevant across multiple restructurings. Such issues have been discussed in a new multilateral forum helpfully conceived and stood up by the IMF, World Bank, and India as G20 president. The Global Sovereign Debt Roundtable, or GSDR, brings together borrowers, international institutions, and both official and private sector lenders to discuss and work through key technical issues that might improve the restructuring process.

State Contingent Debt

For example, the GSDR has discussed state-contingent debt instruments, or SCDIs, which were used to make progress in Zambia's restructuring. SCDIs are securities whose payouts depend on some uncertain factor. They can be specified to pay more interest when growth is higher or when a key commodity price rises. They can be designed so interest payments are suspended if there is an extreme weather event or a natural disaster, along the lines of climate resilient debt clauses, an innovation recently championed by the G7 and others. Since SCDIs can automatically lower debt repayments in times of economic stress, the hope is that they can reduce the need for debt treatments in the first place.

But even if a country is already in a sovereign debt restructuring process, SCDIs can play a helpful role when creditors disagree on a borrower's future prospects. Imagine a borrower in distress happens to be an oil exporter. A creditor that is optimistic regarding the future price of oil may not see a need for restructuring, whereas a different creditor that is pessimistic about the future price of oil may acknowledge that a reduction in the debt is required to restore sustainability. Such a disagreement, which is out of the control of the borrowing country itself, can lead to meaningful delays and hold things up. But in such a case, if a restructuring were to include SCDIs with interest payments linked to the price of oil, both creditors may find it easier to agree to a treatment.

This is not to say that the use of SCDIs in restructurings should be the norm. Examples of SCDIs with design flaws abound. Mexico in 1990 issued one that suffered from an overly complex payout formula. Bulgaria in 1994 issued an SCDI that was linked to GDP, but the legal contract specified an unreliable source for the GDP data. Argentina earlier this year was ordered by a U.K. court to pay $1.5 billion to investors in its GDP-based SCDI as a result of Argentina's decision to recalculate growth in a manner that reduced payouts. The fact that most SCDIs have not to date been eligible to include in fixed-income indices means they can command large liquidity premia, which may make them a bad deal for the borrower.

Ideally, the securities would be linked to state variables that are exogenous, closely tied to the borrower's repayment capacity, and easy to monitor and verify. Zambia's SCDIs are linked to a calculation of debt carrying capacity made by the IMF, but private creditors are reportedly considering indexing their treatment to the price of copper, Zambia's largest export.

SCDIs lock in, ahead of time -- with no future discretion – a commitment to adjust the level of repayments in different pre-defined states of the world. By reducing uncertainty, and by bridging heterogeneous expectations about the future, SCDIs have the potential to speed up restructurings. The official creditor community should continue to work on their development and remain open to their possible use.

Domestic Debt

In Ghana, one factor that may have smoothed the process for external debt restructuring was its decision to also restructure its domestic bonds. Unlike external debt, domestic debt is issued in the local currency and typically held by domestic investors. In principle, reducing domestic debt servicing costs could increase the fiscal resources available to pay external creditors. The appeal of such burden sharing is understandable, not least because some holders of domestic debt are, in fact, foreign investors.

But a simple insistence that it is best for domestic and external debt to be treated as equivalent and restructured in tandem with the same reduction in net present value – a situation referred to as exhibiting "comparability of treatment" – ignores the fact that domestic debt restructurings can carry particularly large economic costs. Domestic debt holders are typically subject to a range of economic and financial factors that external debt holders may be insulated against. And domestic bond holdings could be concentrated in local banks and financial institutions, so reducing these claims can pose financial stability risks and may impede the ability of the banking system to extend credit during what typically is a critical time for macroeconomic recovery. There is also a risk that inadequate transparency or poor execution can damage the liquidity in domestic capital markets. These costs can be large enough to imply that domestic debt treatments reduce, rather than increase, the funds that would be available to repay external lenders. And, unless a domestic debt restructuring impacts non-resident holders of the debt, it does not free up resources at the country level.

It is helpful that the GSDR has recognized this complexity and highlighted that the costs and benefits of domestic debt treatments differ country-by-country and case-by-case. We hope that a simple insistence on achieving comparability of treatment between domestic and external debt will not in the future hold up any restructuring cases.

Commitment Letter from the Borrower

In Sri Lanka and in Suriname, public commitments to transparency and to comparability of treatment helped pave the way to movement in their processes. In restructurings in general, creditors understandably worry that the reductions of their own claims could be used to repay other creditors more fully. Monitoring for such a possibility is not trivial – sovereign borrowers often lack strong financial controls, and even when repayments are made in error, the funds are often not returned. For example, the IMF discovered in Suriname that funds were deposited in error in an escrow account controlled by China's Ex-Im Bank at a time when China had agreed to remain in arrears.

To help on this front, Sri Lanka published its portfolio of sovereign debt in late 2022 to avoid data concerns. And, crucially, Sri Lanka's President in March issued a public letter to its creditors committing explicitly to both full transparency on external debts and to comparable treatment for all external creditors. This letter, easily found on the internet, helped mitigate friction and distrust across creditors and helped elicit the needed financing assurances for their IMF program. Similarly, Suriname – in its publicly available letter of commitment to the IMF – made a commitment not to repay or to settle with bilateral holdout creditors in a way that violated comparability of treatment with others. We view Sri Lanka's letter, and Suriname's commitment in public IMF documents, as new tools that are welcome additions to the international financial architecture. They may be helpfully used by other borrowers when in similar situations.

Central Bank Swaps

Another increasingly relevant question with scope to delay progress in resolving debt distress is whether central bank swap lines should be inside the perimeter for debt restructurings. Central bank swap lines are arrangements for one central bank to lend its currency to another central bank, taking the other's currency as collateral. These transactions can reflect a simple technical desire to ease short-run foreign exchange pressures, but sometimes look more like strategic sovereign lending. Scoping central bank swaps into debt restructurings can pose balance sheet risks to partner central banks, but scoping them out can place an unfair burden on more-traditional forms of lending. After all, lending from a central bank, or lending to a central bank, is not a get out of jail free card if the borrower needs to restructure other sovereign debts. If swaps are offered to countries with unsustainable debts as a substitute for medium-term sovereign borrowing, without requiring macroeconomic policy adjustments, they should generally be included in the restructuring perimeter and the IMF should stand ready to call out such lending as unhelpful and inappropriate.

Standstills

Finally, Treasury has pushed to find a way to introduce debt service standstills at the time low-income countries applying for Common Framework treatment reach a staff level agreement with the IMF. Such a reform would incentivize debtors that need it to seek treatment and, likewise, would incentivize creditors to move quickly to reach a restructuring agreement. One critical issue in operationalizing such a proposal is to find a way to avoid the standstill causing rating agencies to declare the country in "technical default," which can have adverse consequences on borrowing costs and cross-default clauses and could potentially cause private financial institutions to stop providing services to the country.

Improving the overall debt architecture and offering relief and a productive path forward to countries in debt distress is a major priority for Treasury, and we have discussed these and other technical issues through our participation in multilateral fora like the GSDR, through engagements with the private sector and the international financial institutions, and through meetings of the Paris Club.

3. NEXT STEPS

So, where does all that leave things now? As I mentioned earlier, we've seen at least some helpful progress with key cases like Zambia, Ghana, and Sri Lanka over the past year.

In Zambia, the recent agreement by official creditors paves the way for the program to move forward and for discussions with private creditors to continue. We hope that Ghana will reach agreement on the details of its official external restructuring in the coming weeks.

And just last week, Sri Lanka completed its relevant reforms and reached a staff-level agreement with the IMF. We also note that China Ex-Im and Sri Lanka recently announced a preliminary deal on a debt treatment. The details will be important and we look forward to seeing them. But if the treatment is in line with IMF program parameters and appropriately addresses Sri Lanka's debt sustainability, this would constitute positive progress for Sri Lanka. I anticipate the rest of the financing assurances will come soon and will allow the first review to swiftly move to the board.

Moving beyond these cases, it is important that we avoid lengthy delays in future sovereign debt restructurings for low-income countries and emerging markets. In addition to their direct economic costs, such delays risk that the borrower's government loses momentum or that popular and political support for reforms erodes. I heard repeatedly from borrowing countries during the recent IMF-World Bank Annual Meetings in Marrakech that they are looking for further improvements, including timetables and greater transparency around each step in the restructuring process, to minimize economic uncertainty and to avoid stalling investment.

We should also think creatively about how to potentially proceed were there to be an extreme case where economic circumstances are truly dire and the debtor has met IMF conditions, but where a holdout official creditor keeps a program from moving forward. For example, borrowers could make a public commitment to uphold comparability of treatment. Participating creditors could include clawback provisions that nullify their debt relief if the borrower violates that commitment. And the IMF could carefully monitor payments from the borrower and consider its program off-track if its commitments aren't upheld. Such an arrangement might bind even after the IMF program is over since any violations could be factored into future IMF decisions to lend to that borrower.

To be clear, advancing an IMF program when a creditor does not participate in a restructuring is not a good outcome and should only be considered once all other options are exhausted. The added uncertainty could stall private investment and make the program itself less effective. It's much better, of course, to avoid any holdout creditors in the first place.

CONCLUSION

This past year brought some positive progress in debt restructurings and associated IMF programs. Several existing cases are moving in the right direction, and the international community is increasingly having difficult, but essential, conversations about key sticking points in the debt restructuring process. And we are exploring improvements in technical issues that shape the sovereign debt landscape. Borrowers and creditors must solidify and build on this progress, and the IMF and World Bank must continue to aggressively facilitate this. Debt distress in low-income countries and emerging markets will remain a major priority for us at Treasury and, I hope, will continue to be a key focus of international economic policymaking.

Thank you, and I look forward to the discussion.

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