

## **Bringing all creditors on board!**

# What the German government can do to ensure the participation of all creditors in comprehensive debt cancellation

**Position paper by erlassjahr.de, Brot für die Welt and Misereor<sup>1</sup>**

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## Introduction

Following the COVID-19 pandemic, many debt restructurings in countries of the Global South are either underway or have already been implemented. It is clear that complex creditor coordination is hindering the rapid and sustainable resolution of debt crises, despite the creation of new formats and mechanisms. The restructurings negotiated under the Common Framework for Zambia and Chad - as well as outside of it for Suriname or Sri Lanka - all follow the same pattern. In order to obtain the consent of all creditors, real debt cancellation is minimal. As a consequence, the agreements fail to restore debt sustainability. While risks for creditors are hedged, downside risks for debtor countries are not addressed. Holdout creditors continue to sue and threaten to undermine debt restructuring negotiations, a problem that has existed for decades. Geopolitical tensions between China and the West threaten to further complicate negotiations. The resulting lowest common denominator policy comes at the expense of citizens in critically indebted countries. It threatens people's fundamental economic and social rights, and by constraining the fiscal space of debtor countries it undermines the Sustainable Development Goals (SDGs) and international climate targets.

To address this problem, and bring all creditors onboard without settling for the lowest bar, *erlassjahr.de*, *Brot für die Welt* and *Misereor* are demanding that the German federal government supports the following measures:

### Reform proposal 1: Make transparency a binding creditor principle

It is still not possible for citizens, civil society or creditors to identify all of the creditors of a particular debtor country. This is particularly true for private creditors. For example, only one in four bonds can be clearly assigned to a holder.<sup>2</sup> In most cases, the terms and conditions of lending (and therefore the costs of a loan transaction in terms of interest, amortisation, fees and other contractual conditions) are also not publicly available. The same applies to the terms of debt restructuring agreements. The *Paris Club*, for example, keeps its debt restructuring agreements secret, which means that debtor countries lack important information on past debt restructuring processes that could be helpful for their own negotiations.

Furthermore, the majority of private creditors do not comply with voluntary transparency initiatives, including those of the OECD and the *Institute of International Finance*.<sup>3</sup> Transparency benefits all parties involved. It gives lenders more security for responsible lending and leads to lower interest rates for the borrowing country due to more predictable risks. Furthermore, transparency enables parliamentarians and civil society to scrutinise lending and borrowing, as well as debt restructuring agreements. Development cooperation often focuses on the debtor country and aims to build capacity in the debtor country for better, more transparent debt management. The debtor country is also sanctioned if there is a lack of transparency, for example by postponing the disbursement of IMF loans. However, creditors also have a clear duty. Transparency must be established and enforced as a binding responsibility for all creditors. To this end, the German government should take the following measures:

- The German government should set a good example and **report transparently at a central location on its own claims in relation to individual loan agreements**. This should also include the lending of publicly owned commercial financial institutions. It should also proactively clarify data differences between its own reporting and the World Bank's reporting, which is based on information provided by debtor countries.
- The German government should make **its own debt restructuring agreements publicly available** and work towards the publication of *Paris Club* debt restructuring agreements.

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<sup>2</sup> See Munevar, D. (2021): "Sleep now in the fire. Sovereign Bonds and the Covid-19 Debt Crisis". P. 20 ([https://www.eurodad.org/sovereign\\_bonds\\_covid19](https://www.eurodad.org/sovereign_bonds_covid19)).

<sup>3</sup> See Debt Justice UK (2023): "Hidden billions: The secrecy of bank loans to governments" ([https://debtjustice.org.uk/wp-content/uploads/2023/07/Hidden-billions\\_07.23.pdf](https://debtjustice.org.uk/wp-content/uploads/2023/07/Hidden-billions_07.23.pdf)).

- The German government should **advocate for, and provide financial contributions to, the creation of an international debt register**, housed at an independent institution.<sup>4</sup>
- The German government should ensure that **a lack of transparency is sanctioned on the creditor side**, for example by ensuring that claims that have not been made public can no longer be sued for.

### **Reform proposal 2: Support debtor countries politically and financially to threaten or enforce payment suspension for uncooperative creditors**

Most creditors only participate in debt restructurings if they expect to be able to recover more funds from their participation than if they refuse to negotiate. As long as creditors are paid on time, the willingness to cancel part of their claims is low. This applies in particular to commercial creditors, who have no development mandate and whose interest in the long-term economic and political stability of the debtor country is overshadowed by their short-term profit interest. The most important method available to debtor countries to persuade uncooperative creditors to participate in debt cancellation is therefore to temporarily suspend debt repayments and/or credibly threaten to do so. The German government can support debtor countries in this regard in several ways:

- The German government should **publicly encourage debtor countries to stop repaying uncooperative creditors**.
- The German government should **grant its own comprehensive debt cancellation** if the debtor country has temporarily suspended repayments to other uncooperative creditors. In order to prevent Germany's debt cancellation from ultimately financing a bailout of uncooperative creditors, the cancellation should be made dependent on debtor countries suspending their repayments to these creditors as long as they are not prepared to make comparable concessions.<sup>5</sup>
- The German government should **ensure that other countries within the G7 and the Paris Club follow this example**.
- Finally, The German government should **provide financial support to debtor countries during the critical period of suspension of payments** and encourage friendly governments and international organisations to do the same.

### **Reform proposal 3: Take legislative action to make it more difficult for uncooperative private creditors to undermine international restructuring agreements**

Lawsuits filed by private creditors against states endeavouring to restructure their debts have steadily increased over the last thirty years. This practice poses a serious problem for the fair and early resolution of debt crises.<sup>6</sup> For many debtor countries, especially smaller ones, the costs and human resources involved in protracted legal disputes are a heavy burden. In addition, lawsuits lead to unequal treatment of different creditors and favour hedge funds that act in a particularly aggressive way. The fear of lawsuits and the associated negative consequences also often prevents debtor states from entering into debt restructuring negotiations in the first place. This prevents an early solution to debt crises. The German government can take the following measures to make it more difficult for uncooperative creditors to undermine international restructuring agreements:

- The German government should **introduce a law that limits the amount that can be claimed and enforced to the amount agreed in international debt restructurings**. A

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<sup>4</sup> See Jones, T. (2019): „Licht ins Dunkel bringen! Mehr Transparenz in der internationalen Kreditvergabe“, in: erlassjahr.de; Misereor: „Schuldenreport 2019“. (<https://erlassjahr.de/produkt/schuldenreport-2019/>).

<sup>5</sup> Currently, the German government makes the granting of its own debt cancellation dependent on the debtor country having successfully negotiated comparable concessions with its other creditors. However, if the other creditors do not agree to comparable concessions, this requirement leads to a stalemate.

<sup>6</sup> See Stutz, M. (2023a): "The power of legislation: How national legislation can contribute to a fair solution for the global debt crisis" in: erlassjahr.de; Misereor (2023), pp. 44-47 (<https://erlassjahr.de/wordpress/wp-content/uploads/2023/04/GSDM23-online.pdf>).

corresponding law should be designed in such a way, that debt restructurings can be resolved not only more quickly and efficiently, but above all more equitably.<sup>7</sup>

- The German government should **lobby friendly countries to introduce comparable laws themselves**. It is particularly important that corresponding laws be passed in New York and England, as the majority of loan agreements are concluded under their laws. In both New York and England, the parliaments are already attempting to pass corresponding laws. However, as of yet, these progressive forces have not been successful.
- The German government should **recognise the UN principles for debt restructuring**.<sup>8</sup> In the event of a lawsuit against a debtor country's payment suspension, debtor states could then refer to these principles before German courts.

#### **Reform proposal 4: Include multilateral creditors in debt cancellation**

To date, members of the *Paris Club*, including Germany, have insisted on maintaining the *preferred creditor status* of multilateral creditors. This is a remarkable political step backwards after the HIPC/MDRI initiative of 1996, which included multilateral institutions in debt restructuring. The fact that Western governments are now once again insisting on a pre-1996 policy is neither compelling nor sensible in terms of the legal status of the institutions concerned. The argument of favourable financing is often used to justify full exemption status, which would supposedly be jeopardised by the inclusion of the institutions. However, this argument is not tenable. First, only a third of multilateral loans are granted on concessionary terms. Second, the concession granted can be taken into account when calculating a comparable participation in debt cancellations, meaning that creditors who have granted loans on concessionary terms are required to cancel less in nominal terms than commercial creditors.

The complete exclusion of all multilateral claims is problematic in several respects. First, in some cases multilateral creditors hold such a large proportion of a debtor country's claims that it is difficult to achieve a sustainable debt situation without including these claims. Multilateral creditors hold more than 50 per cent of the claims in at least 44 critically indebted countries.<sup>9</sup> Second, the privileged status of multilateral creditors makes it difficult to persuade other creditors to participate in debt cancellation. If multilateral claims are generally excluded from restructuring, bilateral and private creditors will have to make greater concessions in order to achieve a sustainable debt situation. It is therefore understandable that China in particular, as the most important bilateral creditor, is calling for the comparable participation of multilateral creditors. In order to overcome the exceptional status of multilateral claims, the German government can take the following actions:

- The German government should work towards **involving multilateral creditors in the debt restructuring of countries in which it is itself a creditor** (for example in the cases of Sri Lanka and Ghana).
- The German government should **initiate a structural process within the World Bank**, (the largest multilateral financial institution) to include multilateral claims, especially those of the World Bank in debt restructurings. This could be modelled on the HIPC initiative of the mid-1990s.
- The German Government should **support an independent review to determine whether the arguments regularly put forward against the inclusion of multilateral organisations are tenable**.

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<sup>7</sup> For more information see Stutz, M. (2023): "Focus Paper 9: The Potential of National Legislation for the Fair Resolution of Global Debt Crises" ([https://erlassjahr.de/wordpress/wp-content/uploads/2023/07/Focus\\_Paper\\_9\\_2edition.pdf](https://erlassjahr.de/wordpress/wp-content/uploads/2023/07/Focus_Paper_9_2edition.pdf)).

<sup>8</sup> UN General Assembly (2015): "Basic Principles on Sovereign Debt Restructuring Processes" ([https://unctad.org/system/files/official-document/a69L84\\_en.pdf](https://unctad.org/system/files/official-document/a69L84_en.pdf)).

<sup>9</sup> See Stutz, M. (2023b): "Creditors worldwide: an analysis of the creditor landscape and political accountability for debt relief" in: *erlassjahr.de*; Misereor (2023), p. 20 (<https://erlassjahr.de/wordpress/wp-content/uploads/2023/04/GSDM23-online.pdf>).

- In individual cases, the German government should support an independent review to determine **whether debt sustainability in critically indebted countries can be established without the involvement of multilateral creditors.**

### **Reform proposal 5: Work constructively with China, while insisting on comprehensive debt cancellation**

China is now the most important public bilateral creditor of countries in the Global South. Western politicians have therefore repeatedly blamed China for the debt crisis in the Global South.<sup>10</sup> However, compared to the claims of multilateral and private creditors, China's public claims at an aggregated level are still comparatively low. As a public creditor, China holds around seven per cent of the claims against very critically indebted countries.<sup>11</sup> Nevertheless, China's public claims against a large number of countries are very relevant. The Chinese state holds more than 50 per cent of the claims against three critically indebted countries (Tonga, Djibouti and Laos) and more than 20 per cent of the claims against a further 16 critically or very critically indebted countries. This includes Zambia, which has finally concluded a restructuring with its public creditors after more than two and a half years.<sup>12</sup> In current restructuring negotiations - be it with Sri Lanka, Zambia or Suriname - Beijing does not appear to be prepared to provide genuine debt cancellation. Instead, attempts are being made to counter the crisis in the short term by extending payments and adjusting debt service payments. As is currently the case in Zambia, this threatens to repeat the mistakes of the 1980s, in which the crisis was continually protracted by inadequate cancellation agreements. To avoid this, it is important to work constructively with China, whilst also insisting on sufficiently deep debt cancellation:

- The German government should fulfil its own responsibility and **advocate for the binding participation of private and multilateral creditors in comprehensive debt cancellation.** Only then will appeals to China be credible.
- The German government should **stop the harmful discourse that China is primarily responsible for the Global South debt crisis.** This particularly applies when the German government is failing to fulfil its own responsibilities and is not advocating for the binding participation of all private and multilateral creditors.
- The German government should **remain open to dialogue and work constructively with China** through existing channels to find a joint solution in restructuring processes.
- If the aforementioned steps have been exhausted and China does not participate in debt cancellation on comparable terms, the German government should **offer debtor countries that temporarily suspend their repayments to China the comprehensive cancellation of their own claims and the provision of new financing.** In order to prevent debt cancellation by Germany and other cooperative creditors ultimately financing China's bailout, the cancellation should be made dependent on debtor countries suspending their repayments to China (whilst it is not prepared to make comparable concessions).<sup>13</sup>

<sup>10</sup> See e.g. Reuters (ed.) (2022): "China's lending policy could trigger new debt crisis - Germany's Scholz" (<https://www.reuters.com/article/germany-religion-scholz-idUSKCN2ND11V>).

<sup>11</sup> See Stutz, M. (2023b).

<sup>12</sup> *ibid.*

<sup>13</sup> Whether such a strategy is attractive for debtor countries and can therefore exert serious pressure on China depends on the extent of the relief and the new financing granted to debtor countries. Germany should therefore lobby friendly governments and international financial organisations to pursue a joint strategy. If Western countries offer debtor countries extensive cancellations of their own bilateral claims and also ensure the participation of Western private creditors and multilateral financial institutions, such as the IMF and World Bank, in the relief, they can offer debtor countries a credible opportunity to overcome debt crises quickly and thereby exert serious pressure on China.