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The Paris Club, 1978-1983

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The Paris Club, 1978-1983

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At the International Conference Center in Paris, in a meeting room used by the Paris Club, there hangs a magnificent eighteenth-century tapestry depicting an elegant damsel, leaning against the statue of a goddess. As she is being courted by a dashing young man, a small terrier plays with leaves and a pair of angels observes from above. One popular interpretation given this scene is that the virtuous maiden represents the creditor countries, and the young man on bended knee is a developing country seeking debt relief. The goddess represents the principles of the Paris Club, and the angels are the International Monetary Fund (IMF) and the International Bank for Reconstruction and Development (World Bank).¹ The little dog is the United Nations Conference on Trade and Development (UNCTAD).

* * * *

The Paris Club was “born” in 1956 when a group of creditor governments met in Paris to negotiate a debt-relief arrangement with Argentina.¹ In the late 1950’s and early 1960’s, the countries that sought debt relief were primarily Latin American countries that had been the all-too-eager recipients of suppliers’ credits, vigorously promoted by the governments of the industrial countries. Commercial banks were not asked to provide relief because they were not major creditors and the debt problems did not appear to be associated with bank lending.²

* U.S. Department of Treasury. During the period described, the author was the U.S. Treasury Department’s technical expert on debt relief relating to credits extended or guaranteed by the U.S. government. The views expressed, however, are not necessarily those of the U.S. Treasury Department. Acknowledgement is given to Russel L. Munk, Ricki Rhodarmer Tigert and Ciro DeFalco for their encouragement and thoughtful suggestions.

1. The debt-rescheduling process is organized from the perspective of the creditors, not the debtors. Credits extended by governments or by private lenders with a creditor-government guarantee are rescheduled in the Paris Club. Credits extended by commercial banks without any creditor-government guarantee are rescheduled in the London Club. Credits extended by non-bank lenders without any creditor-government guarantee are not rescheduled through direct negotiations with the lenders but generally are rescheduled by the debtor country on terms similar to those offered by the other creditor groups. In other words, a debtor-government guarantee does not influence where the credit is rescheduled.

2. The following definitions may be useful in connection with foreign debt negotiations. “Debt reorganization” and “debt renegotiation” are virtually synonymous and are the broadest terms describing any changes in the payment arrangements associated with an ex-

In the late 1960's, creditor governments experimented with the use of debt relief as a form of development assistance, with India and Pakistan being the principal beneficiaries.

In the early 1970's, creditor governments faced the first cases of what might now be called debtor-country insolvency: Indonesia and Ghana. In each case, the creditor governments granted a long-term rescheduling at concessional interest rates. There was still no pressure for debt relief from banks and other private creditors.

The mid-1970's was a transitional period. Official creditors abandoned debt relief as a form of aid and commercial banks were faced with handling reschedulings on their own. Zaire in 1976-78 was the test case for the banks. The banks argued that friendly governments should provide whatever debt relief and new financing was necessary to ensure that Zaire would remain current on its bank debt. The governments insisted that the private banks provide "comparable" debt relief, and in this instance the banks eventually found an acceptable form of relief.

I. THE BASIC PRINCIPLES OF DEBT RELIEF

In some larger context, the interests of creditors and debtors may be similar, but in the context of debt-relief negotiations, the debtor tries to pay as little as possible, while the creditors try to get paid as much as possible.³

The first principle of debt relief is known as *imminent default*, which guards creditors against constant requests for relief from debtor countries.⁴ In brief, creditor governments will not entertain a

isting stock of debt mutually agreed upon by the debtor and the creditor. "Debt relief" is any deferment or cancellation of arrears or of scheduled payments, or any interest rate concession, granted by a creditor. "Debt restructuring" is a form of debt reorganization in which the entire schedule of amortization payments relating to an existing stock of debt is modified, normally to extend the period of repayment. "Debt rescheduling" is a form of debt reorganization in which payments of principal and/or interest falling due in a specified interval are deferred for repayment on a new schedule. "Refinancing" is new borrowing primarily for the purpose of meeting specific payment obligations on existing debts. "Re-funding" is new borrowing undertaken primarily to retire (prepay) existing debt, usually to take advantage of better terms or to obtain a more favorable maturity structure. In this paper, "guarantees" by official creditors are understood to include insurance (and other forms of protection or cover) against inconvertibility for a private lender.

3. Agreement is possible only because the creditors would rather have a promise to pay later than accept an outright loss, and the debtor would rather pay a little now than risk an abrupt and perhaps lengthy suspension of trade and financial relationships with the creditors. The common meeting ground is some period of time in the future when the debtor thinks he will have the wherewithal to pay and the creditor thinks he cannot get a better deal.

4. Since 1978, the only clear case where debt relief was granted by official creditors in the absence of imminent default was the Pakistan rescheduling of 1981. Arguably, the sec-

request for debt relief unless there is strong evidence that the debtor country will default on its external payments in the absence of such relief. There is a straightforward, analytical test of "imminent default": the existence of an *ex ante* financing gap.⁵ When a debtor country's uses of foreign exchange, which are usually projected for one year in advance, exceed its sources,⁶ there is *prima facie* evidence that a situation of imminent default exists.⁷

The case of Senegal illustrates the principle of imminent default. Senegal began experiencing debt-servicing difficulties in 1980 and expressed interest in Paris Club negotiations. Some creditors were prepared to negotiate but others argued persuasively that the balance of payments projections offered by Senegal (and endorsed by the IMF) failed to support a finding of imminent default. Within two years, however, the balance of payments numbers worsened, to the point that substantial arrears had accumulated and most loans were in default. Senegal's first Paris Club agreement was signed in October 1981. Senegal's creditors, however, might have been better off by agreeing to reschedule at an earlier stage since Senegal might have passed through its debt crisis faster and less traumatically. Yet it seems just as likely that Senegal would have taken advantage of earlier relief to postpone necessary economic reforms.

A second principle of debt rescheduling is *conditionality*. Debt relief does not solve debt problems. Rather, their solution comes from the adoption and effective implementation of sound economic policies. This may be the most important lesson of the last six years. In the absence of sound policies, debt relief is wasted.

Consequently, in the early history of the Paris Club, the practice evolved of making debt relief conditional upon the existence of an economic program supported by a borrowing arrangement with the IMF,⁸ involving drawings in the upper credit tranches.⁹ The

ond year of relief granted to Peru in 1978 also was not based on imminent default. Peru informed its creditors that because of its improved balance of payments situation it would not need the second year of relief that had been granted.

5. In some cases, default already has occurred at the point the request for debt relief is made. These are cases where substantial arrears have built up and foreign-exchange reserves have been exhausted.

6. The sources include exports of goods and services, workers' remittances, private and official transfers, loan disbursements, direct investment, borrowing from the IMF, and foreign exchange reserves. The uses include imports of goods and services and debt-service payments.

7. *Ex post*, of course, sources must equal uses. If nothing more can be done to increase sources, and cutting imports would be economically damaging or politically unacceptable, then balance can be achieved only by reducing debt-service payments.

8. The IMF was established to assist countries experiencing balance of payments difficulties, and a debt-servicing problem is the most extreme form of balance of payments diffi-

current practice is quite strict. Official creditors will not enter into negotiations with a debtor country until a new standby or extended arrangement has been approved by the IMF Executive Board.¹⁰ The economic program accepted by the IMF is what the creditors are "buying" with their debt relief, and it is the frame of reference for determining the appropriate terms of debt relief.

There is a fundamental contradiction in the principle of conditionality: the better the adjustment efforts of the debtor, the less debt relief is needed. The Paris Club's slowness in recognizing this contradiction may have contributed to the low Paris Club "success" rate since 1978. One reaction to the contradiction might be to grant every debtor requesting debt relief (where imminent default clearly existed) the same initial terms. Debtors with weaker policies would have to come back for more relief and creditors could demand more policy reform. Debtors with stronger policies would get an extra boost from the relief and would reestablish their creditworthiness that much sooner. The problem with this approach is that there has been a distinct tendency for the debtors to delay reforms past the early stages of debt-servicing difficulties.

The most uncomfortable period for the creditors comes when arrears begin piling up and the debtor shows no signs of negotiating seriously with the IMF. Debt relief would make it possible to eliminate the arrears, but relief cannot be given because the conditionality principle has not been met.¹¹ The pressure on commercial banks to reschedule generally is greater than pressure on governments.¹²

cuties. The staff of the IMF has the greatest expertise of any international organization in the relationship between specific economic policies and the balance of payments, and it regularly reviews economic developments in each member country.

9. The arrangement must involve borrowing in the upper credit tranches (above 25% of a country's quota) because drawings in the first credit tranche do not require meaningful policy reforms by the member country.

10. If the debtor country is not a member of the IMF, the official creditors negotiate policy reforms directly with the debtor country. Poland in 1981 was the first country to seek debt relief in the Paris Club that was not a member of the IMF. Cuba in 1982 was the second and Mozambique in 1984 was the only other to date. The efforts to achieve conditionality were frustrating and probably doomed to fail.

11. In the first half of 1982, the Paris Club sent a formal communication to the government of Venezuela calling attention to the arrears that were accumulating. The Paris Club did not receive an answer until the spring of 1984. In the meantime, arrears to the official lending agencies accumulated rapidly.

12. The official creditors, however, did not defend the principle of conditionality in the case of Nicaragua. To give the new Sandinista government the benefit of the doubt about its commitment to pursue sound economic policies, the Paris Club agreed to open negotiations in 1980 with the understanding that the debt-relief agreement that emerged would not go into effect until an IMF arrangement was in place. In fact, by the time the negotiations began in October, there was considerable evidence that meaningful reforms would not be adopted. Consequently, several major creditors (notably the United States) blocked any

As a consequence, the banks negotiated debt-relief arrangements without waiting for an IMF standby on several occasions during the 1978-83 period.

Burdensharing represents a third principle: all creditors must provide relief that is commensurate with their exposure in the debtor country. The application of the principle is one of the most complicated aspects of Paris Club negotiations.

There are four broad, competing groups of creditors: multilateral lending institutions; official creditors participating in the Paris Club negotiations; official creditors *not* participating in these negotiations; and private creditors, such as commercial banks.¹³

As of mid-1984, the multilateral lending institutions¹⁴ have established a superior position vis-à-vis the other three groups, and are exempt from providing relief commensurate with their exposure. There are two arguments for exempting multilateral institutions. First, the creditor countries are members and therefore benefit indirectly from the exemption. Second, multilateral institutions bear their share of the burden by continuing to lend to the debtor country. The major issue in this area is how long a list of multilateral institutions should be recognized as preferred creditors. As a temporary expedient, the Paris Club recently developed a rule of thumb. The Paris Club will accept the exemption of a self-proclaimed multilateral institution only when the institution provides net credit to the debtor country during the period of debt relief from the Paris Club.¹⁵

The essential "raison d'être" of the Paris Club is to ensure burdensharing among participating creditors. Despite 28 years of Paris Club negotiations, debtor countries still have a strong ten-

discussion of specific rescheduling terms and no Paris Club agreement was signed. Nevertheless, the political and financial pressures were so great that major creditors, other than the United States, extended relief on a bilateral basis. This exceptional approach has not been repeated for Nicaragua or any other country.

13. Foreign investors do not figure in debt-relief negotiations because earnings are not repatriated according to a fixed schedule. Convertibility problems are a calculated risk for these investors, but they have the option of reinvesting earnings. This is an area that warrants further study.

14. These include without question the IMF, the World Bank and the three major regional development banks: the Inter-American Development Bank, the Asian Development Bank and the African Development Bank. The category also has included other multilateral institutions such as the European Investment Bank and the OPEC Special Fund.

15. There is an unresolved debate over the status of private and official lenders that "co-finance" with multilateral institutions. The multilateral institutions would like to extend their exemption from rescheduling to their co-financing partners in order to attract more partners. Creditors that reschedule are opposed since such treatment simply would increase the debt-relief burden they must bear.

dency to seek bilateral relief before they accept a multilateral approach. They are rarely successful with creditor countries that belong to the Organization for Economic Cooperation and Development (OECD), but often succeed with countries that are not OECD members.¹⁶ Given the intense political pressures that can build up in such cases, the record of adherence to the multilateral approach is remarkable. There is, nevertheless, a serious burdensharing issue among the OECD creditors relating to new credits. In several of the recent cases (Sudan, Mexico, Brazil), official creditors have had to provide new credits in addition to providing debt relief. So far the pledging process has been ad hoc, and this has produced some tensions as some donors (notably the United States) came to feel they were pledging more than their fair share. Unless a stronger sense of equitable burdensharing emerges, official creditors may have to devise a burdensharing formula for new lending that corresponds to the formula used by the commercial banks.¹⁷

Burdensharing with non-participating official creditors is a fascinating aspect of the Paris Club process. The two main categories of non-participating creditors are centrally-planned countries and developing countries. The creditors participating in the Paris Club ensure burdensharing by non-participating creditors through a "non-discrimination" clause in the standard Paris Club agreement. This clause commits the debtor country to obtain relief on the same terms from non-participating creditors. If the debtor country makes larger payments to non-participating creditors than is consistent with the Paris Club terms, the non-discrimination clause gives the Paris Club creditors the right to demand larger payments from the debtor. To date, there has never been a serious ex post analysis of any specific case to determine if non-discrimination was achieved, and there has been no case where Paris Club creditors have sought to invoke the non-discrimination clause to get better treatment. Generally, compared with Paris Club creditors, debtor countries tend to get more relief from centrally-planned creditor countries and

16. The United States provided debt relief on a bilateral basis to Yugoslavia (1971), Egypt (1971), Turkey (1972) and Poland (1973 and 1981). Currently, the OECD country that seems most prone to grant relief on a bilateral basis is France which, by some reports, provided relief to Senegal before the 1981 Paris Club rescheduling, and to Iraq more recently.

17. Commercial banks use a very simple formula. New lending is expressed as a percentage of each bank's exposure in the debtor country on a specified date. This works better for institutions that are all lending for the same purpose (profit) and on the same terms (market-determined), than for governments that have lent for a variety of different purposes on very different terms.

less relief from less-developed country creditors.¹⁸

Burdensharing with private creditors is probably the “hot” issue of the mid-1980’s and is epitomized in the phrase “bailing out the banks.” Whereas before 1970 official creditors could reschedule without worrying much about what the banks were getting, by 1978 commercial banks were important lenders to almost all of the countries seeking debt relief in the Paris Club. Without some debt relief from banks, creditor governments would have had to provide 100% relief *plus* large amounts of new money to keep the debtor countries from suffering prolonged setbacks in their economic development. The banks accepted the need to provide debt relief without much of a struggle, and the questions of how to negotiate and how much relief to provide were also settled quite simply. The official creditors were not at all interested in bringing the commercial banks into Paris Club negotiations, and the banks did not push to come in. The two-track (London Club, Paris Club) approach evolved naturally.

Official creditors have struggled over the appropriate terms for relief from commercial banks. Extending the non-discrimination clause to banks would be too rigid an approach for two reasons. First, the motivations for lending by the two categories of creditors are quite distinct. Commercial banks lend as a business, to get the greatest return possible, and all of their loans are at market rates of interest. Governments, by contrast, lend for a variety of reasons: national security, commercial, humanitarian.¹⁹ Some official credits

18. Centrally-planned creditor countries seem to be soft on debt relief in order to preserve their anti-capitalist image. Arab creditor countries seem to be soft because of Islamic sensitivities about usurious lending. A good example of better treatment from lesser developed country creditors is the case of Uganda, where Tanzania and Zambia were larger creditors than most Paris Club participants. According to press reports, the terms of debt relief offered by these two countries appeared to be more favorable to Uganda than the Paris Club terms. The Paris Club creditors did not make an issue of it because that simply would have exacerbated the debt-servicing problems of Tanzania and Zambia.

19. For example, in the United States, the Agency for International Development makes project loans and the Department of Agriculture sells surplus agricultural commodities to poor countries on highly concessional terms: repayment over 40 years, including 10 years of grace, with interest at two percent during the grace period and three percent thereafter. Military equipment has been financed under a variety of terms at different times. Currently, all military loans are at non-concessional rates of interest (linked to U.S. Treasury borrowing rates), but the repayment terms vary from six to thirty years. The Export-Import Bank generally makes loans on commercial terms, but can offer various concessions to meet competition from other export credit agencies. The Commodity Credit Corporation (CCC) supports agricultural exports strictly by providing guarantees on commercial bank credits up to a maximum of three years. While there should be a “reasonable assurance of repayment” for all these loans, there have been a number of occasions when this criterion was overridden by foreign policy considerations. The most prominent example may be the CCC credits

are at commercial rates, some have small subsidies, and some are at rates so concessional as to approximate grants. These differences suggest that terms of rescheduling by official creditors should be more generous than those offered by banks. Second, rescheduling interest obligations has tax, income and regulatory implications for banks that do not exist for government agencies. To reflect these differences, the concept of "comparable treatment" evolved. In essence, the debtor government agrees to seek a measure of relief from the banks that is as generous in the context of normal commercial lending as the relief offered by creditor governments in the context of their lending.

II. THE PARIS CLUB PROCESS

Rarely does a country go to the Paris Club before trying other options first. One natural instinct when a country is beginning to strain to meet its debt-service obligations is to seek out a "friendly" creditor and try to negotiate a special deal. A country heavily dependent on official aid will ask its major donors to provide additional fast-disbursing grants or loans, or to shift the composition of their aid from project aid to balance-of-payments support. Debt-servicing difficulties are so widespread at the present time that almost all developing countries are getting some help of this kind from both multilateral and bilateral donors.²⁰

A debtor country under pressure may also "preemptively" reschedule with its commercial bank creditors. Jamaica tried to do this in 1978-81. Debt-service obligations to official creditors were relatively small, and Jamaica's request for "rolling over" principal obligations to the banks was moderate. The banks accepted without questioning the need for a Paris Club rescheduling.

The important point is that a request for debt relief from official creditors generally comes at a point when the extra money required from creditors to stay current on existing debt becomes excessive *in the eyes of the creditors*. In effect, the creditors "blow the whistle." Implicitly, they are saying that the debt-servicing problem must be addressed by more adjustment and less financing. It is a point of principle, however, that creditors never tell a debtor

provided to Poland in 1980. Recent military credits to Sudan and Zaire are another example.

20. An extreme example of this pattern is the decision by the U.S. Congress to increase grants to Israel from the Economic Support Fund for fiscal year 1984, with a rather explicit link to Israel's debt-service payments on military credits from the United States.

country to seek debt relief. The request for relief must be initiated by the debtor.

There are major frustrations for the creditor at this point in the process. The debtor seldom is reluctant to point out to the creditors that arrears could be avoided if a little more financing were provided. When export credit agencies begin paying off claims from private lenders whose loans they have guaranteed, there is a strong temptation for them to suggest to the debtor country that it seek debt relief. It is also natural for official creditors, when pressed for emergency balance of payments financing, to note the possibility of getting debt relief from commercial banks. Meanwhile, commercial bankers may be pointing out the possibility of getting debt relief from official creditors. Officials from the IMF and the multilateral development banks also may suggest that the time has come to request debt relief.

Once a debtor country has decided to seek debt relief, the normal procedure is for the country to contact the government of France regarding negotiations in the Paris Club. A debtor-country official stopping in Paris will generally find it easy to arrange a meeting (discreetly and on short notice) with an official in the French Finance Ministry to be briefed on the procedures of the Paris Club. If the country should prefer to begin with another OECD member, the country usually can find an official familiar with Paris Club procedures, but it is unlikely to find a member willing to provide debt relief outside the multilateral Paris Club framework. Alternatively, there are officials in the IMF and the World Bank who are familiar with the Paris Club and can respond to inquiries from debtor countries. Once the debtor country decides to go the Paris Club route, a formal request is sent to the Chairman for a meeting with official creditors.

In some respects "the Paris Club" is a misnomer, for it has no "members." Rather, it has "participating creditor countries." The Paris Club is less an institution and more an ad hoc procedure for renegotiation of debts owed to official creditors, normally under the chairmanship of a French Treasury official. There is no international secretariat funded by the creditor countries. Indeed, some creditors would argue that there is no secretariat at all; that the French officials who support Paris Club negotiations are violating the spirit of the procedure by calling themselves a secretariat. There have even been objections raised to the use of stationery with "Paris Club Chairman" in the letterhead.

The ad hoc character of the Paris Club reflects the creditor

point of view that debt rescheduling is an extraordinary event justified in only the most extreme circumstances. If the Paris Club were viewed as a permanent institution, it would be an admission that debt rescheduling is a normal financial transaction. This would undermine the concept of the sanctity of contracts, and would tend to encourage debtor countries to seek debt relief.

In principle, the Paris Club is open to any creditor country, and the Chairman invites all creditor countries that have significant exposure in the debtor country concerned to each negotiation. In practice, the creditor countries that have participated in Paris Club negotiations have been almost exclusively members of the OECD.²¹

A. Preparation by the Debtor

In theory, the debt-relief terms extended to a debtor country are not influenced by the form or content of the country's request for relief. They are determined strictly by an objective financial analysis of the country's ability to pay and by terms granted previously to other countries facing debt-servicing difficulties of a similar magnitude. In practice, however, the debtor country can place itself in a stronger negotiating position through thoughtful preparation.

Since the foundation of every negotiation is a financial analysis, the debtor country helps itself by providing the components of the analysis to the creditor countries at an early stage. The two principal components are a balance of payments forecast reflecting the results of the debtor country's new economic program and a detailed breakdown of outstanding debt and debt-service obligations.

The balance of payments forecast normally emerges from the

21. Exceptions include Abu Dhabi which attended negotiations with Zaire in 1979, Israel (Ecuador, 1983), Argentina (Peru, 1983), Mexico (Costa Rica, 1983) and South Africa (Malawi, 1982). The Mexican case demonstrates that a country can appear in Paris Club negotiations both as a debtor and a creditor.

Another point of confusion is that some French-chaired multilateral debt-rescheduling negotiations are not called "Paris Club" negotiations: Turkey in 1979-80 rescheduled in a Working Party of the OECD's Consortium for Turkey; Poland rescheduled in a special creditors' meeting (1981); Mexico rescheduled at the OECD (1983). To the creditors participating in the negotiations, these have all been Paris Club negotiations in the large sense. There are only two reasons for calling them something else. First, the debtor country is afraid that going to the "Paris Club" will damage its creditworthiness or will create domestic political problems. Second, the creditors may anticipate some departures from conventional procedures or terms. They want to avoid creating a negative precedent for future cases, so they call it a non-Paris Club rescheduling. The best examples of the second approach are the rescheduling negotiations with non-IMF members: Poland (1981) and Cuba (1983). Since the traditional link to an IMF arrangement was not possible in these cases, some creditors felt more comfortable "changing hats" for these negotiations. It should be emphasized, however, that the basic "rules of the game" do not change when the creditors change hats.

negotiations with the IMF for a standby arrangement. But this creates a dilemma which has been a surprisingly important element in some of the negotiations in the 1978-83 period. The IMF staff would like to present to its Executive Board a balance of payments forecast that has no financing gap. At the same time, the creditors refuse to negotiate debt relief terms until there is an IMF arrangement in place. Thus, the IMF staff is faced with the choice of assuming the terms of debt relief to be offered (thereby closing the gap) or sending the arrangement to the Executive Board with a gap (to be closed by some combination of debt relief, new financing or additional adjustment measures). The creditors have a strong preference for the second approach, and are less willing to give the debtor the benefit of the doubt when they feel boxed in by the IMF.

The creditors also advance a conceptual point in favor of the second approach: the creditors as a group always have the option of giving more new money in lieu of debt relief. The form of financial support should not matter to the IMF as long as the total is sufficient to close the financing gap. Recognizing this inherent tension between the IMF and the creditors, the debtor can help defuse it by providing the IMF and the creditors with an accurate and complete accounting of the main components of the financial analysis at an early stage so the creditors have plenty of time to study it and prepare their positions.²²

A principal issue regarding the preparation of a debtor country's request for relief is the use of outside advisors or consultants. The leading purveyors of this service are the investment banking "troika" consisting of Lazard Freres (Paris), Warburg and Co. (London), and Shearson Lehman/American Express (New York). For retainers that can exceed a million dollars, a financial consultant can: (1) prepare an economic memorandum on the debtor country tailored for the Paris Club similar to the economic memorandum routinely prepared for commercial banks; (2) undertake a major reconciliation effort to conform the debt records of the debtor country with the credit records of the creditor countries; and (3) provide tactical advice on negotiating in the Paris Club. The results of these

22. In the case of Zaire in 1983, the creditors asked for a "pre-meeting" with the debtor country to review (in the presence of IMF representatives) the country's new economic program, and to explain their reluctance to go beyond normal rescheduling terms. Because of uncertainties about how generous the creditors would be, the IMF Executive Board only granted conditional approval of Zaire's new standby arrangement for 1983-84. The standby arrangement became effective after the Paris Club negotiations with Zaire had been concluded and the IMF staff was satisfied that there would be no financing gap.

efforts have been mixed.²³

B. Preparation by the Creditors

There are two major aspects of preparations by the creditors: exchange of data on debts subject to rescheduling, and the formulation of negotiating positions. The debt data aspect is one of the weak points of the Paris Club process. An example is the case of the negotiations with Brazil in November 1983. During the negotiations with the IMF in the summer of 1983, a carefully balanced package of debt relief and new financing from both official and private creditors was worked out. Based on information available to the Brazilian government, the payments subject to rescheduling in the Paris Club for the August 1983-December 1984 period were on the order of \$2.3 billion, and this estimate was used to compose the package. When the creditors started exchanging information in September, there were early indications that the Brazilian estimate was low. By the time of the Paris Club negotiations, the creditors' own estimate was up to \$3.8 billion. The large discrepancy in this case (as in most) was associated primarily with credits extended by commercial banks or other private lenders that were guaranteed by export credit agencies in the creditor countries.²⁴ While shifting these debts into the Paris Club category increased the total amount of debt relief *ceteris paribus* (because the Paris Club rescheduled interest as well as principal obligations), the negotiations with Brazil almost unravelled because some creditors pointed out that harder terms on a larger stock of debt would generate the same amount of relief, and others argued that the additional amount of debt relief provided under the proposed terms should count against the commitments of the new financing they had made.

Until 1981, there was a fairly relaxed attitude toward debt statistics and the routine was for each creditor-country delegation to provide data on its credits to the Paris Club "secretariat" on the first day of the negotiations. The secretariat would compile the submis-

23. The low point was reached in 1979 when a New York lawyer, after the terms had been accepted, took the microphone for a debtor delegation and began to haggle over specific dates and words. This was considered in bad taste by the creditors. Since then, the debtors' advisors have tended to stay out of the negotiating room. Another problem with "hired guns" is that creditors sometimes get the feeling that the money paid to the consultants is money that could better be used to service their debts.

24. The debtor countries in most cases are not aware of which credits from private lenders are guaranteed by an official export credit agency. The lenders and the guarantors prefer to keep the debtor in the dark out of concern that the debtor might assign a lower priority to repayment obligations associated with guaranteed credits if the debtor encounters debt-servicing difficulties.

sions and return the results on the second day, often after agreement on terms had been substantially completed. Currently, the French are requesting creditor data at the time invitations for the negotiations go out, and a table showing both creditor and debtor figures is circulated on the first day of the negotiations. It is often the case, however, that several of the creditors do not submit their data in advance and the table is incomplete, or there are very large discrepancies between the creditor and the debtor data. In the wake of the Brazil experience, a more intensive effort has been undertaken in special cases (e.g., the Phillipines and Argentina). In particular, the IMF has requested that creditors provide data in advance of concluding its standby negotiations with the debtor country in order to ensure that discrepancies are dealt with at an early stage.

It is too soon to say how successful these efforts will be. The difficulty on the creditor side is collecting information on guaranteed credits, which are relatively more important than direct credits in the major debtor countries like Brazil and the Philippines, compared to the smaller countries like Senegal or Cuba. The difficulty with guaranteed credits is that the guaranteeing agency may not know from day to day what has been loaned out and what has been paid. This is particularly true for short-term trade credits where there are many commercial lenders that operate under blanket guarantees; there are a large number of borrowers, and the export credit agencies will not pay out on claims until the relevant documents have been checked.²⁵

The procedures for formulating a negotiating position vary considerably from country to country. The procedures of the U.S. government — which are probably more elaborate than most — are described here.

Beyond the collection and reconciliation of debt data, there is little a creditor can do until the IMF staff paper describing the debtor country's standby request is circulated to the IMF Executive Board. Copies are circulated immediately to the U.S. government agencies concerned, and intensive preparations begin. The first step is a financial analysis, done primarily by the Treasury Department, following a well-tested format. In brief, the balance of payments table in the IMF standby paper is adjusted and rearranged to highlight the foreign exchange available to meet debt-service obliga-

25. In the case of Mexico (1983), the U.S. Export-Import Bank estimated that there were 800 guaranteed exporters and 1,300 Mexican borrowers affected by its rescheduling. The bank's estimates of arrears and future payments subject to debt relief are in the \$250-650 million range.

tions. The initial adjustment is to take debt-service payments out of the current account and the capital account. The current account, less interest, will have a positive or negative balance. To this are added capital inflows: direct investment, loan disbursements from official and private sources, short-term flows (including capital flight), net IMF financing, bridge loans, and reserve changes (a reserve buildup would be a negative entry). This sum represents the amount of foreign exchange available to meet debt-service obligations in the period under consideration (usually a year).

In a separate table, all debt-service obligations in the period are totalled, including arrears at the beginning. If the sum of the obligations exceeds the foreign exchange available, there is *prima facie* evidence of a situation of imminent default; the difference represents the *ex ante* financing gap. In a third table, the available foreign exchange from the first table is allocated by making different assumptions for the different categories of creditor. First, it is assumed that all obligations to multilateral development banks will be met. Next an assumption for debt relief by commercial banks is selected after reviewing reports on negotiations between the debtor country and the banks. The payments that must be made to the banks after the assumed relief are deducted from the remaining foreign exchange, leaving a residual amount for official creditors.

Next, the payments that would have to be made to the Paris Club creditors if relief were granted on the terms requested by the debtor are compared with the residual amount. If the two amounts are roughly the same, the analysis might stop here. If not, alternative terms are tested. An important lesson here is that it helps to focus more on what the debtor must pay after relief than on the amount of relief.

The objective at this stage of preparation is to identify the largest stream of payments to official creditors consistent with the projections underlying the IMF standby arrangement, without exceeding the parameters of a standard rescheduling.

Once the analysis has been completed, a position paper is prepared that provides some background information on the specific debt problem, states the objectives of the U.S. government in the upcoming negotiations, describes in detail the U.S. government credits subject to negotiation, summarizes the financial analysis, and sets forth negotiating limits for each of the major variables of a debt-relief package. This paper is formally circulated to the agencies concerned through the secretariat of the National Advisory

Council (NAC).²⁶ As it becomes necessary, the paper is revised in response to comments received from the agencies. There is a discussion of the negotiating position at a weekly meeting of the NAC Staff Committee, further revisions may be made, and then there is a formal vote on the negotiating position.

C. *The Negotiation*

The contrast with the London Club negotiations is striking. In the Paris Club there are no expenses billed to the debtor, no lawyers with briefcases full of legal documents, and generally it is all over within 36 hours.

A typical negotiation begins at ten o'clock. The Chairman welcomes the delegations and invites the debtor to make the opening presentation.²⁷ Following the debtor's presentation, there are statements by the IMF representative, the World Bank representative and the UNCTAD representative.²⁸ Most of these statements are typed up and circulated. After a coffee break, the creditor delegations have an opportunity to direct questions to the debtor country or to the IMF and the World Bank. The process is completed by one o'clock and the negotiations are suspended for lunch.

After lunch, the creditors caucus without the debtor to discuss the request. (Usually the IMF observer is invited to join the caucus and occasionally the World Bank observer.) The Chairman opens the caucus by inviting general comments, but as quickly as possible he begins a "tour de table" on the main variables of a rescheduling package. When the range of views has been expressed, the Chairman suggests an initial offer, generally consisting of the hardest po-

26. The National Advisory Council on International Monetary and Financial Policies originated in the Bretton Woods Agreement of 1945. The Secretary of the Treasury chairs the NAC and other agencies that are members are the Departments of State and Commerce, the U.S. Trade Representative, the Federal Reserve Board, the Export-Import Bank, and the International Development Cooperation Agency (which includes as a subdivision the Agency for International Development (AID)). Other agencies that participate actively in the work of the NAC include the Departments of Agriculture and Defense, the National Security Council, and the Office of Management and Budget. The U.S. government's policy on reorganizing government credits to foreign countries was formally adopted in NAC Action 78-5 on Jan. 6, 1978.

27. The Chairman of the Paris Club from 1978 to 1984 was Michel Camdessus, who held the position of Director of the French Treasury at the end of his tenure as Paris Club Chairman. The Chairman himself presided only over the most important negotiations, such as the Brazil negotiations in 1983. In the 1978-83 period, less important negotiations were conducted by less senior officials, such as Philippe Jurgensen, who chaired the negotiations with Zaire, and Jean-Claude Trichet, who chaired the negotiations with Senegal.

28. For Latin American debtors, the observer from the Inter-American Development Bank generally makes a statement. Observers from other international agencies such as the European Investment Bank and the OECD are usually silent observers.

sition proposed for each variable. A coffee break is taken, and during the break the Chairman meets privately with the debtor to describe the initial offer. In most cases, the initial creditor offer is much harder than the terms requested by the debtor, and consequently the package is rejected. When the caucus resumes, however, the Chairman should be able to give the creditors a sense of which variables the debtor is most concerned about. The Chairman may suggest an alternative proposal, and another "tour de table" will firm it up, sometimes with an understanding that one or two delegations are not prepared to accept one variable or another. If it is after six o'clock and no contentious issues have surfaced, the caucus will adjourn for the day and again the Chairman will meet privately with the debtor to communicate the second offer, making it clear to the debtor that the creditors have very little room to maneuver at this point.

The next morning the Chairman reports the debtor's reaction to the creditor caucus. There may be some more "fine tuning," but generally agreement in principle is reached before noon. In the meantime, the "secretariat" has produced a first draft of the "Agreed Minute" for creditors to review. Eighty percent of the typical minute is boilerplate, so it is possible (with the help of word-processing equipment) to have agreed texts by one o'clock. To encourage the participants, a formal lunch is offered in a dining room at the conference center for all delegations as soon as the Agreed Minute is signed. (A French touch that is quite effective.) As the final act before lunch, the plenary meeting is resumed, the Chairman summarizes the agreement, the debtor acknowledges it, pleasantries are exchanged, and the texts are signed.

Two side-notes merit attention. First, the Chairman always speaks in French; most of the creditor delegations use English. The debtor may use a native language or French or English. Simultaneous translation into these three languages can be provided. The text of the Agreed Minute is done in both French and English. Second, the debtor country delegation is generally led by the Finance Minister or another senior official. The creditor delegations generally are led by an official at the senior staff level in the finance or economics ministry. (The U.S. practice since 1978 of having a head of delegation who is a sub-ministerial official from the foreign ministry is quite unusual.) Many creditor delegations have only one or two members. The largest might have six or seven members including representatives from the export credit agency, other lending agencies, the foreign ministry and their Paris embassy. The debtor delegation is often larger than any creditor delegation.

III. THE RESCHEDULING VARIABLES

Nine rescheduling variables are discussed in this article, but it is possible to have a longer or shorter list by subdividing some and adding others of less importance. Not all variables are equal, and naturally the creditors feel more strongly about some while the debtors feel more strongly about others.²⁹

A. *Eligible Credits*

All credits extended by official creditors or guaranteed by them are subject to rescheduling in the Paris Club, but generally several categories are excluded. This is an important technique the creditors use to reduce the amount of debt relief provided. The first category to be excluded is short-term credits (original maturity of one year or less). The creditors want to exclude these because the processing of short-term credits is extremely time-consuming, since most are guaranteed. The debtors usually are willing to exclude these because they recognize that renewal of short-term credit lines will be interrupted if they are rescheduled and that this will adversely impact on their recovery efforts.

In a number of cases, credits to private sector borrowers which are extended *without* a guarantee by the debtor-country government are excluded. This is always done in cases where there is a convertible local currency, such as in Franc-zone countries in Africa, and in Liberia which uses the U.S. dollar. In these countries, private sector borrowers do not face an inconvertibility problem; their commercial operations generate a currency that is acceptable to foreign countries in payment of their obligations, or convertibility is guaranteed. In one or two cases, rescheduling of private sector debt has not been "necessary" and excluding it from the rescheduling was seen as a means of preserving the creditworthiness of these borrowers.

Where creditors have extended debt relief under a previous Paris Club agreement, payments due under the earlier agreement (known as previously-rescheduled debt or PRD) are excluded. Though this is a point the creditors feel very strongly about, in several important cases PRD has been rescheduled.³⁰

Occasionally credits to a specific borrower are excluded, such

29. The procedures of the Paris Club for dealing with these variables have evolved by and large in an ad hoc fashion. In recent years, however, the French have tried to be more systematic and have held a series of "methodology" meetings to discuss ways of dealing with specific negotiation or implementation problems, such as the participation of non-traditional creditors, the formula for calculating grace and repayment periods, and comparable treatment of commercial banks.

30. Most notably in the cases of Turkey (1980), Sudan (1983) and Zaire (1983).

as credits for a regional aviation facility that happens to be located in the debtor country. There have also been heated debates among creditors about the treatment of credits repayable in kind or credits being serviced out of an off-shore payments facility or escrow account.³¹ Generally, the view has prevailed that equivalent debt relief must be provided by creditors that have specific reasons for wanting to exclude such credits. This is one of the dark corners of Paris Club rescheduling. It is an area where creditors can take actions that undermine the purpose of the exercise.

B. Contract Cut-off Date

After a country begins experiencing critical debt-servicing difficulties, any creditor that makes a loan to the country is doing other creditors a favor. This is the reason for having a contract cut-off date. Eligible credits signed after the specified contract cut-off date are expected to be serviced in full on schedule. Thus, the creditors tend to push for an earlier contract cut-off date and the debtor for a later one. By convention, the cut-off date is January 1 of the year in which the rescheduling agreement is negotiated, but this can be moved without too much resistance from creditors up to the first day of the consolidation period.

The major issue involving this variable arises in serial reschedulings. The "rule" of the creditors is to keep the original contract cut-off date in all subsequent reschedulings. This is especially important in cases where official creditors have contributed to a multilateral package of new credits in support of the debtor's economic program. In several recent cases, however, where the financing gap has been especially large the creditors have preferred to move up the contract cut-off date in lieu of rescheduling PRD, capitalizing interest, or promising new credits.

C. Treatment of Arrears

To discourage the accumulation of arrears and encourage debtors to address their problems at an earlier stage, the creditors generally have rescheduled arrears on less favorable terms to the debtor than consolidated debt.³² The "as of date" selected is generally the

31. For example, some export credit agencies made loans to Zaire's parastatal mining company which were to be serviced out of dollar accounts in New York into which proceeds of certain copper exports were deposited.

32. Another concern is that arrears often exist on short-term credits. If these are rescheduled over the same period as medium- and long-term credits, then a three-month credit might be transformed into a twelve-year credit. For some creditors, this is worse than extending a ten-year credit into a twenty-two-year credit.

day before the consolidation period. The creditors try to get the arrears repaid within a year or two, or at least before the end of the grace period. If necessary, however, arrears will be rescheduled on the same basis as consolidated debt.

D. Consolidation Period

Official creditors will not restructure the entire outstanding indebtedness of a debtor country seeking debt relief, as commercial banks sometimes do. In the first place, some official credits have very long maturities, as long as 50 years. It does not make financial sense to defer a payment due 50 years from now. In the second place, official creditors prefer a "short-leash" approach because they are more exposed to criticism (from parliaments and taxpayers) over their debt-relief decisions. Consequently, official debt relief normally extends to debt-service payments on eligible credits that fall due during a limited period of time, commonly referred to as the "consolidation period." The practice of the Paris Club is to limit the consolidation period to one year, roughly coinciding with the period of the debtor's IMF standby arrangement. The consolidation period can be stretched back in time to simplify the rescheduling by picking up arrears, or to begin on the day after the end of the consolidation period in a previous rescheduling.³³ The consolidation period can also be stretched forward by several months, but the Paris Club has never rescheduled a full two years of payments at one time.³⁴

In the 1978-83 period, eight reschedulings were done on a "one-plus-one" basis where a second year of relief on exactly the same terms as the first was granted to the debtor, conditional upon the debtor having an IMF standby arrangement covering the second year of relief and being able to draw under it. And there was one case where three consecutive years of relief were granted with an IMF link: Turkey in 1980. The practice stopped because several of the countries obtaining such arrangements failed to meet the IMF condition. In these cases, the creditors found it difficult to withhold the second year of relief. The lesson is that creditors cannot effectively take back debt relief once it has been granted.³⁵

33. At the London Summit in 1984, a commitment was made to provide "multi-year" rescheduling to countries successfully adjusting in cases where commercial banks also were prepared to provide multi-year relief.

34. Paris Club agreements are always careful to specify that the terms only apply to payments due "and not yet paid." This means that payments made in full on schedule after the beginning of the consolidation period do not have to be reimbursed by the creditors.

35. A debtor, however, can give back relief it has received. This has happened only once, in connection with the 1978 rescheduling with Peru.

The length of the consolidation period may be the most controversial variable in Paris Club reschedulings. Debtors invariably seek a "multi-year" rescheduling covering payments falling due over two or three years. Creditors have remained firm at seeking roughly one year. They do not want to give up the leverage of a new round of negotiations (and a new IMF standby) for debtors that are adjusting too slowly. And they believe the vicissitudes of the international economic scene are too great to make it possible to determine how much debt relief will be needed beyond the next year.

E. Including Interest Payments

Official creditors are more willing to reschedule interest payments than banks for several reasons. First, they are not constrained by regulators and do not have to make special provisions for loans made to borrowers unable to meet interest payments. Second, while it is relatively easy for banks to make new loans, governments often must go to legislatures for authority to make new loans and may obtain the authority at the expense of lending to some other (more creditworthy) country.³⁶ Third, rescheduling interest is one way the official creditors can compensate for the fact that their lending is influenced by non-commercial motives and may be more costly than commercial lending because it is procurement-tied or currency-tied or inconsistent with the economic value received. From the creditors' perspective, then, rescheduling interest payments is a low-cost concession, and that is why it has been done in the majority of cases in the 1978-83 period. Nevertheless, the financial principle still applies: if there is not an analytical basis for rescheduling interest, only principal is rescheduled.

36. The natural assumption is that debt relief is additional to normal flows of financing. In the case of the U.S. Agency for International Development, this is so because loan repayments go to the Treasury and not to the Agency. Consequently, shortfalls in receipts due to debt relief or arrears do not affect the Agency's lending level. In the case of the CCC, however, a lower level of reflows means that the CCC will be able to do less lending unless its overall lending ceiling is raised by the Congress. Where reflows affect new lending levels, individual agencies are tempted to reduce new lending to a country receiving debt relief in order to avoid offsetting reductions in lending to other countries. A related issue in the United States is that debt relief is provided outside the appropriations process. Since financial assistance to a particular country can be increased through debt relief far beyond the levels envisioned by the Congress, the Executive Branch must be very careful to ensure that debt relief is only granted in situations of imminent default where conditionality and burden-sharing have been obtained.

F. Percent Consolidated

One of the mysteries of the Paris Club is the distinction between consolidated and non-consolidated debt. The distinction may have arisen in some early reschedulings where it was not necessary to reschedule the full amount of the payments falling due in the consolidation period. The portion that was rescheduled became known as the consolidated debt (because payments under many different loans were "consolidated" within a single rescheduling agreement). The portion that was not rescheduled was to be paid according to the terms of the original contracts and therefore was called non-consolidated debt. Confusion was introduced in some relatively recent reschedulings when these non-consolidated portions were also consolidated, with a shorter deferral of repayment than for consolidated debt.³⁷

Creditors have worked hard to draw the line at a consolidation percentage of 90%, but they had to yield in the 1983 negotiations with Sudan, Cuba and Zaire. By contrast, creditors became quite generous in the 1978-81 period by stretching out non-consolidated debt over the grace period. Since then, they have insisted that relatively larger amounts be paid by the end of the consolidation period.

G. Repayment Terms

After the consolidation period, the most controversial variables in Paris Club reschedulings are the grace and repayment periods. Debtors naturally want longer grace and repayment periods, and the problems being experienced with serial reschedulings at the present time raise doubts even in the creditors' minds about the conventional repayment terms. A three-year grace period followed by a

37. The confusion may be alleviated by using an example. The sum of principal and interest payments on eligible credits falling due during the consolidation period might be \$20 million. If the creditors agree to a 90% rescheduling, the consolidated debt amounts to \$18 million and the non-consolidated debt to \$2 million. Repayment of the \$18 million might be deferred for nine years, including a three-year grace period, and the \$2 million non-consolidated portion might be deferred for three years with no grace period. But the non-consolidated portion might be split three ways. One quarter of the non-consolidated debt, or two and one-half percent of the total debt (\$500,000) would be due on schedule according to the original contracts. Another quarter would be due on the last day of the consolidation period. The remaining one-half would be due in two tranches, 12 months and 24 months respectively after the end of the consolidation period. There is also confusion surrounding the term "downpayment." Very loosely, it is synonymous with non-consolidated debt. More narrowly defined, it refers to any repayment of rescheduled debt due before the end of the consolidation period, or the portion that must be paid according to the original contracts. Most narrowly, it is a portion of the arrears that must be paid off at the beginning of the consolidation period, or as soon as bilateral implementing agreements are signed.

four-year repayment period ("three plus four" in the trade) is generally available to any debtor that goes to the Paris Club. The sticking point for the creditors is five years of grace and seven years of repayment. Only in the special case of Sudan have creditors been more generous, and it is possible that giving Sudan sixteen years (six plus ten) was a mistake.³⁸

H. Interest Rates

Another surprise to the uninitiated is that Paris Club reschedulings do not involve negotiations over interest rates.³⁹ The one immutable variable in Paris Club negotiations to date is that interest rates are negotiated bilaterally. This means that each creditor can charge different interest rates. The rationale is simple: interest rate structures and practices vary substantially among creditors. If a single rate is negotiated, this will lead to a windfall for some and a penalty for others.

The practice does not seem to lead to inequitable treatment among creditors. In part this may be due to the convention that concessional rates of interest are charged on credits that had concessional rates when they were originally extended, and market-related rates are charged on rescheduled non-concessional credits.⁴⁰ In

38. There is another point of confusion worth mentioning here: the starting point for counting grace and repayment periods. The logic is dubious and the bias is wrong, but the present practice of the Paris Club is the following. The grace and repayment periods are measured from the middle of the consolidation period. Take a "three-plus-four" arrangement with a consolidation period covering calendar year 1983. According to the present Paris Club "methodology," the grace period ends on Dec. 31, 1986, when the first of eight semiannual installments of principal must be paid, and the final payment is due on June 30, 1990. The extra six months in the grace period are necessary, when repayments are semiannual, to make the three-plus-four add to seven. Other methods of calculation are equally valid, and these account for the fact that the same arrangement will be described as a three-plus-four rescheduling by one source and a three and one-half plus three and one-half rescheduling by another source. These various distinctions appear to have evolved as a means of camouflaging a more generous repayment schedule. It is possible to drop the distinction between consolidated and non-consolidated debt and simply work out a schedule of repayment as follows: two and one-half percent on schedule, two and one-half percent at the end of the consolidation period (end of Year One), two and one-half percent at the end of Years Two and Three, eighteen percent at the end of Years Four through Nine. But this would eliminate one of the central mysteries of the process.

39. The interest charged on rescheduled payments, which often include interest payments, commonly is referred to as "moratorium interest."

40. Some creditors actually "negotiate" the interest rate with the debtor country. The long-standing practice of the United States is to charge the same rate to all debtor countries for each credit program. For AID and P.L. 480 loans, the moratorium interest is the average of the outstanding loans, generally between two and three percent, fixed for the period of repayment. For military credits, the rate is calculated in the same fashion but it is currently in the ten to twelve percent range because the original credits were at non-concessional rates. For Export-Import Bank loans, the rate is adjusted every six months to reflect the current

part, treatment is similar because the debtor can refuse to begin repayment until an acceptable interest rate is offered. This is another dark corner of the Paris Club. It would be useful to have a clearer picture of the current practices of the major creditors.

I. The De Minimus Level

Minor creditors do not have to provide debt relief since the major creditors accept that the smaller ones will receive full payment on schedule. The question is where to draw the line between major and minor creditors. The starting point is SDR⁴¹ one million of rescheduled debt. All creditors over this limit are considered major creditors. In smaller debtor countries, however, the *de minimus* level is reduced to SDR 500,000 or even SDR 250,000 (in the case of Sierra Leone in 1984, for example). Creditors that are *de minimus* may attend the Paris Club negotiations as observers (and can be quite vocal in the creditor caucus), but they do not sign the Agreed Minute.

J. Boiler Plate

In addition to setting forth the rescheduling variables, Paris Club Agreed Minutes contain numerous "boiler plate" paragraphs. The most interesting are described below.

Non-discrimination Clause. The debtor agrees to extend to all participating creditors "treatment not less favorable" than that provided to any non-participating creditor on similar credits. This is in effect a most-favored-nation provision directed at developing country and eastern-bloc creditors.

Comparable Treatment Clause. The debtor agrees to seek "comparable treatment" from private creditors on similar credits. This is to avoid a situation where official creditors are "bailing out" commercial banks. This clause was invoked in the case of Zaire after the 1976 and 1977 reschedulings. It is enforced by a refusal by the official creditors to extend further relief until comparable treatment has been obtained. It is extremely difficult, however, to measure comparable treatment in a specific situation. This may be another weak point in the Paris Club process.

Goodwill Clause. In cases where the debtor is anxious to have

borrowing costs of the agency. For CCC loans, the rate is adjusted at the beginning of each calendar year to reflect the rate at which the agency "rolls over" its outstanding indebtedness to the Treasury Department.

41. The SDR (special drawing right) is both the unit of account and principal financial asset of the IMF.

assurances that creditors will grant further debt relief after the agreed consolidation period, and the creditors suspect more relief will be needed, a "goodwill clause" may be included in the Agreed Minute. Varying degrees of goodwill can be expressed. In the most limited form, the creditors will agree to meet "to consider" the debtor's request for further relief if it meets various conditions (especially having an IMF arrangement in place for the new consolidation period). The most generous form of a goodwill clause is the one included in the Agreed Minute with Peru in 1983. There the creditors agreed to grant a second year of relief on the same terms as the first year, except for the percent of payments to be consolidated, subject to the obvious conditions.

Settlement Date. A date is usually fixed three months after the Agreed Minute is signed, by which time the debtor should have eliminated any arrears on payments *not* rescheduled in the Agreed Minute.

Bilateral Signature Date. Similarly, a date is set about six months after the Agreed Minute is signed by which all bilateral implementing agreements should be signed.

Exchange of Information. The debtor agrees that the IMF will keep the Paris Club Chairman informed of the status of its standby arrangement. The creditors agree to inform the Paris Club Chairman of the date of signature of their bilaterals, the amounts rescheduled thereunder, and the interest rates set. They also agree to provide to other participating creditors upon request copies of their bilateral agreement with the debtor.

K. Implementation

Unlike a London Club agreement, a Paris Club agreement is not the conclusion of the rescheduling process. It is only an umbrella or framework agreement signed *ad referendum* by the heads of delegation who have agreed to recommend to their respective governments the terms negotiated.

To give the rescheduling agreement the force of law, bilateral agreements between the debtor country and each of the participating creditor countries must be executed.⁴² For some countries, including the United States, a third step is required: implementing agreements with each individual creditor agency.

42. In the case of the United States, each bilateral agreement must be provided to the foreign relations and appropriations committees of the Congress 30 days before it goes into effect, and the effective date is the day the State Department notifies the debtor country that the agreement complies with all U.S. laws.

There is considerable diversity in the practices of creditors following the conclusion of a Paris Club agreement. Some creditors quickly draft a bilateral agreement and submit it to the debtor for signature. Others are notoriously slow. Some skip the bilateral stage and simply present agency implementing agreements. Others combine the two into a single agreement. Some creditors actually send officials out to the debtor country to negotiate the bilateral agreement, and occasionally the debtor country is able to obtain further concessions from individual creditors.⁴³ Other creditors prefer to sign in their own capitals. Sometimes the bilateral agreements for an initial Paris Club agreement are signed in Paris on the eve of a follow-up negotiation.

Even more variations are encountered at the final levels of implementation. For example, some agencies, such as the U.S. Agency for International Development, provide debt relief through a rescheduling agreement modifying the terms of the original loan agreement. Others provide relief through a "refinancing credit" that leaves intact the schedule of payments under the original credits. Some creditors may wish to exempt a particular credit from rescheduling and provide equivalent relief by "over-rescheduling" other credits.⁴⁴

A chronic problem in the implementation phase is the accumulation of arrears on newly rescheduled debt. The problem is aggravated by delays in concluding bilateral and agency-implementing agreements, since debtors have an excuse for not paying anything on the rescheduled debt until these are signed. In the 1983 Paris rescheduling with Zaire, a new procedure was introduced. After reaching agreement on the rescheduling terms, a careful calculation was made of the payments that would have to be made to the participating creditors during 1984. The total was divided by 12 to arrive at an amount of foreign exchange to be deposited by Zaire at the end of each month of 1984 into an account at the Federal Reserve

43. "Non-discrimination" between official creditors is a one-way street. If the debtor gives preferential treatment to one creditor, all the others are entitled to the same treatment. If a creditor gives more favorable terms to a debtor, however, the other creditors are not required to follow suit.

44. Some implementing agreements of export credit agencies extend the repayment procedures to the unguaranteed portion of private loans, as a convenience to the private lenders. In other cases, export credit agencies buy out loan amounts outstanding at the end of the consolidation to save themselves the trouble and expense of processing claims a year later if further debt relief is anticipated. In the 1978 rescheduling with Peru, loans guaranteed under the Housing Investment Program were excluded from the U.S. bilateral implementing agreement. In return, an equivalent amount of extra debt relief was provided on AID loans.

Bank of New York. As bilateral agreements are concluded, amounts due under these agreements may be drawn out of the special account. This arrangement is not intended to give official creditors preferential access to the debtors' foreign exchange resources. It is simply an administration procedure that helps assure that full payment will be made on newly-rescheduled debt. It also provides monthly evidence that Zaire is adhering to the economic program negotiated with the IMF that was the *quid pro quo* for debt relief. The new procedure is especially attractive in the case of countries that have demonstrated a chronic inability to service debts on schedule. (It has been duplicated in several cases in 1984.)

IV. CONCLUSION

The Paris Club system works. There have been more than 65 Paris Club agreements completed since 1956, and given the amounts involved, the conflicting interests of debtors and creditors, and the differing views among creditors, it is remarkable how smoothly the negotiations proceeded in all but a few cases.⁴⁵ It also is remarkable how little time, effort and expense has been involved in these negotiations.

The system, of course, could work better, perhaps through institutional reform. With negotiations at the rate of one a month, the pressures for giving the Paris Club process a more permanent form have increased. The high incidence of rescheduling, however, is not a permanent feature of the international economic landscape. It is hard to imagine any kind of institution that would be efficient handling only two to three negotiations per year. One small anomaly is the role of the French government. The Chairman of the Paris Club, during the 1978-83 period, Michel Camdessus, performed his role with distinction, but one of his predecessors was controversial. Perhaps it would be useful to consider other nationalities for this position. An American chairman can be ruled out because the United States is too often the largest creditor, and would not be considered sufficiently impartial by either the creditors or the debtors. A chairman from one of the smaller European creditor countries might be most appropriate.

Another suggested improvement is to get broader creditor participation, especially among developing and eastern-bloc countries. Yet, while appealing on the surface, experience suggests that both

45. In the 1978-83 period, 40 Paris Club agreements were concluded with 23 different countries. The amount of debt rescheduled was approximately \$22 billion, of which more than \$4 billion was rescheduled by the U.S. government.

sides are better off with an OECD-oriented group of creditors. The debtors seem to get better terms on their own from non-participating creditors, and having a larger number of creditors with more diverse interests would prolong and complicate the negotiations.

Combining the Paris Club with the London Club is a popular idea with developing country spokesmen. It does not appeal to anyone who has been involved in the process, for debt rescheduling procedures, to be effective, must be flexible and fast. Both of these features of the present approach would be sacrificed if the London and Paris Clubs were combined.

The Paris Club is also feeling a great deal of pressure on the terms of rescheduling arrangements. The negotiations could be completed more expeditiously and serial negotiations presumably would be less frequent if creditors were prepared to grant more generous terms. There are costs, however, to being more generous to all debt-relief candidates. First, it weakens the incentive for debtors to avoid debt-servicing difficulties, makes it easier for them to delay necessary adjustments, and makes the pain of adjustment more severe when it eventually is undertaken. Second, it discourages creditors from new lending. If lending is discouraged, this means that global output will be less than it could be. External borrowing is an important source of financing economic growth in the developing countries. It is hard to imagine any less-developed country becoming a newly-industrialized country without an increase in external borrowing. Even if a country does not borrow for investment, rising levels of trade will be reflected in rising levels of trade credit, which would be recorded as an increase in external debt.

The Paris Club process for rescheduling debt owed to official creditors will continue to evolve. Far-reaching institutional changes are unlikely, but there should be steady improvements in some areas: exchanging debt data in advance of negotiations; better coordination with the IMF; a clearer understanding of which multilateral lending institutions should be exempted from rescheduling; a better grasp of what constitutes "comparable treatment" between official creditors and commercial banks; and some rules of thumb for equitable burden-sharing among official creditors.

Within the next five years, only two major breakthroughs seem likely. The first relates to the treatment of countries like Sudan that seem to have no chance of becoming current on their existing stock of external debt. At some point, the creditors will decide that a long-term "workout" arrangement is better than coming back year after year to reschedule what already has been rescheduled. It will

be interesting to see whether the creditors are able to hold off doing this until the debtor country has a sound set of economic policies, and then whether they defer the outstanding debt without charging moratorium interest (as was done in the Indonesian workout of 1970) or capitalizing moratorium interest.

The second breakthrough depends on the evolution of the global economy. If the present economic recovery stalls before most of today's debt-relief candidates have reestablished their creditworthiness (by having sustainable current account deficits and satisfactory rates of gross national product growth at the same time), then the pressures for some form of generalized debt relief may become irresistible. In its mildest form, this could come through a decision by the OECD countries to reschedule automatically all outstanding aid loans to low-income, developing countries. A stronger form would expand the coverage to official export credits (direct and guaranteed), or include all developing countries as beneficiaries. The most sweeping form would be a decision by official creditors to buy out commercial bank debt to developing countries and reschedule it on favorable terms. Yet allowing this extreme situation to materialize would be a major misfortune, since it would represent the failure of the various parties involved to deal with debt problems constructively. Moreover, it probably would condemn both debtors and industrial-country creditors to an extended period of economic stagnation.

The experience of the last five years demonstrates a high degree of flexibility by creditors and an appreciation by debtors that the easy solutions in the short run are not the best in the long run. This author's personal assessment is that the odds are strong that the world will muddle through the current "debt crisis" successfully.