Workshop on Debt, Finance and Emerging Issues in Financial Integration

Financing for Development Office (FFD), DESA
8 and 9 April 2008

Clubbing in Paris: Is Debt Sustainability an Illusion?

Benu Schneider

Table of Contents

I. Introduction 1
II. Historical background of the present debate. 3
III. The changing role of the Paris Club. 5
IV. The relationship between the IMF and the Paris Club 6
IV.1 IMF as gatekeeper. 7
IV.2 Over optimistic forecasts. 8
IV.3 Debt relief and burgeoning conditionality. 9
IV.4 Assessment of Debt Sustainability. 11
IV.4.1 Frameworks for low income countries. 11
IV.4.2 Framework for middle income countries. 13
V. Issues in Paris Club debt resturcturing. 14
V.1 Serial Rescheduling. 16
V.2 Transparency. 20
V.3.1 Signals to the private sector. 22
V.3.2 Problems in comparability of treatment with private creditors 22
VI. Lessons for the future. 23
References 25
Chart 1: Debt Treatments Accorded at the Paris Club 1998 - Jan. 2008 15
Table 1: Serial Rescheduling 1980-2008 17
Chart 2: A typical representation of rescheduling under Houston terms 18
ANNEX I: List of Terminlogy used in Paris Club Agreements i
ANNEX II: Standard Terms of Treatment vii
ANNEX III: Arrears and Nominal Debt Relief in the HIPC Countries xiii
ANNEX IV: Evolution of Debt Service for Countries that had reached completion point xiv

[Work in progress. Not for quotation]
Draft 6 April 2008

Clubbing in Paris: Is Debt Sustainability an Illusion?

*Benu Schneider**
FFDO/DESA

I Introduction

Official debt restructuring poses numerous challenges. The challenge for the international community is to maintain the sanctity of loan contracts and contractual obligations, while at the same time strengthening arrangements for crisis prevention. This task requires timely action and mechanisms to address short-term liquidity constraints to prevent their escalation into unsustainable debt and at the same time provide a lasting solution to those debtors who are facing long-term debt sustainability problems. The arrangements have to be designed in a way that the level of debt stocks and the ensuing debt servicing is guided by the principle of ability to pay, thereby ensuring that debt servicing does not divert resources from growth and poverty reduction. In addition, it is desirable that such a restructuring mechanism functions according to the principles of neutral arbitration and assessment, transparency, adequate representation of debtors and creditors, efficiency and symmetry between creditor groups.

The Paris Club[1], whose secretariat is housed in the French treasury in Paris, has functioned as informal official debt restructuring machinery since 1956. Its membership comprises the OECD countries and the Bretton Woods institutions, with the IMF playing a significant role. The institution has evolved over time and is currently facing new

---

* The views expressed are those of the author and do not necessarily represent the views of the Financing for Development Office, Department of Economic and Social Affairs of the United Nations

[1] The 19 Paris Club permanent members are governments with large claims on various other governments throughout the world (the claims may be held directly by the government or through its appropriate institutions). The following countries are permanent Paris Club members: Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Russian Federation, Spain, Sweden, Switzerland, United Kingdom and United States of America. Russia is the only non-OECD country that is a member. Other creditor countries have been invited to participate in negotiations with individual countries where they have sizeable exposures.

challenges. A new debate is emerging on the reform of the official debt restructuring mechanism as a result of dynamic changes in the world economy where some developing countries have witnessed unprecedented growth. A direct consequence of this is the increase in contributions by developing countries in funding development in the South.[2] An emerging issue is the gap in debt restructuring architecture as regards the incorporation of new providers of development finance into official debt restructuring. Statements made in the General Assembly's informal review of the Monterrey consensus chapter on external debt in March 2008 reflect the view that developing country providers of development finance are un-willing to join the Paris Club as its modalities and rules were not reached in a transparent multi-lateral process. They propose setting up a multi-lateral International Debt Commission.

In addition, the growing importance of private debt in total external debt poses new challenges for the Paris Club, which requires its debtors to seek comparable treatment from other creditors, including private creditors. Strains are visible in implementing this principle as debtors are handicapped by the lack of legal status of Paris Club agreements. Apart from moral suasion and relationship based outcomes, the legal basis for private and official non-Paris Club creditors to provide treatment comparable to that of the Paris Club is weak and non-binding.

The present architecture has also shown signs of strain as some debtor countries are caught in a process of serial rescheduling of official debt owed to Paris Club creditors. An unpacking of this issue involves some understanding of the complex relationship between the IMF, Paris Club and debtors. It is also necessary to assess whether the IMF's role in official debt restructuring is neutral as a broker between debtors and creditors. There are also issues related to transparency and efficiency of the machinery. The ongoing process on the Review of the Monterrey Consensus on Financing for Development provides an excellent opportunity to evaluate the successes and failures of the existing machinery and agree on a universally accepted approach to debt restructuring.

---

[2] The Paris Club Secretariat and the Bretton Woods Institutions labeled creditors from the South "free-riders," riding free on the borrowing space provided by debt relief through the HIPC and MDRI initiatives. With growing opposition from the South to these attacks, references to "free rider" have gone down.

This discussion brief on official debt restructuring is based on the author's on-going research on the Paris Club. The objective is to highlight some issues which merit further discussion and research in evaluating the Club's role and success as an ad hoc official debt restructuring machinery. It is intended to kick off a forward looking discussion on possible ways to improve official debt restructuring, by building-up on its improvements and at the same time drawing lessons from its mistakes. This brief is structured as follows: section II outlines the historical background for the present debate; section III gives a succinct account of the changing role of the Paris Club; section IV analyses the relationship between the IMF and the Paris Club; section V explains some of the issues with the restructuring machinery; and section VI summarizes some lessons from experience.

II Historical background of the present debate

The Paris Club is an ad hoc creditor driven restructuring body[3] for debt owed to bi-lateral creditors. It emerged as a result of international cooperation in 1956 when the bi-lateral external debt of Argentina was restructured in order to avoid a default.[4] The first agreement was followed by others out of a series of negotiations with countries experiencing balance of payments problems in the 1950s and 1960s that restructured debt owed to bi-lateral donor agencies, including agencies providing financing for exports, development projects and other foreign policy objectives.

Developing countries have not had a voice in the design of the debt restructuring arrangements made at the Paris Club since its inception. This drawback resulted in an obscure process which was considered inequitable and insensitive to development goals leading to attempts by the G77 in the late 1970s in the context of the Trade and Development Board at the United Nations Conference on Trade and Development (UNCTAD)[5] to call for a process that would be more sensitive to debtor country interests. A proposal for the creation of a permanent machinery in the form of an International

[3] Trichet, J.C. (1989), p. 109 refers to it as a "non-institution."
[4] Although the first negotiation was carried out in 1956 with Austria, Belgium, Denmark, France, Germany, Italy, Luxembourg, the Netherlands, Norway, Sweden, Switzerland and the United Kingdom more than a decade was needed for France to develop an effective monopoly over the process and be labeled the "Paris Club." Agreements prior to that were help in other cities as well.
[5] For a history of the debt relief discussion in the 1970s in the G-77 and UNCTAD see Cohen (1982).

Debt Commission to ensure speedy and fair debt relief, was put also forward but ended in failure for the G77 as the advanced countries resisted this proposal. However, discussions at UNCTAD played a role in institutionalizing the Paris Club, and agreement was nevertheless reached to codify the principles and procedures that had guided the Paris Club negotiations during its first twenty years in a UN resolution. As a part of this North-South Dialogue the Paris Club secretariat agreed to invite the Secretary General of UNCTAD to send an observer to participate in such meetings on the same basis and terms as the representatives of other international organizations.[6]

By the 1980s the Paris Club members saw the futility of providing relief through rescheduling payments for low income countries and it began to negotiate debt reduction agreements with some of these countries. The number of agreements went up dramatically in the 1980s[7]. The treatment accorded was insufficient to deal with the debt overhang in these countries and in the late 1990s eligible[8] low-income countries were granted debt stock relief under the HIPC initiative. The IMF maintained a "preferred creditor status" until the launch of the Multi-lateral debt relief initiative (MDRI) in 2005 under which 100 percent of the eligible owed by HIPC completion point countries' debt to IMF, IDA and AfDB could be written-off. Non-HIPC countries continued to receive flow treatment at the Paris Club.[9] As regards the middle income countries and upper middle income countries, the Paris Club did not engage in debt reduction[10] but began to apply the principle of burden sharing (comparability of treatment between official and private sector debt relief) more broadly and unilaterally to force bondholders to reduce their claims on individual countries. In effect, the G-7(8) used the Paris Club for cutting back public resources required to resolve financial crisis in non-HIPCs by increasing the losses absorbed by bond holders.

---

[6] Trade and Development Board Resolution 132 (XV) 15 August 1975.
[7] See www.clubdeparis.org
[8] The eligibility criteria and the debt thresholds for entry into the HIPC and enhanced HIPC remain controversial as there was no well reasoned basis for defining the threshold levels for entry thereby excluding a number of low-income countries facing challenges in reducing poverty and freeing up resources for development.
[9] Pre-Evian approach notable politically motivated exceptions were agreements with Egypt and Poland which contained debt reduction.
[10] Barring some politically motivated debt reductions.

A second attempt was made at reform by the IMF during 2002 to establish permanent debt restructuring machinery with proposals to bring the Paris Club under the aegis of the Sovereign Debt Restructuring Mechanism (SDRM). This ended in failure not only to reform the Paris Club but also to move ahead with a Sovereign Debt Restructuring Mechanism. These discussions took place in the backdrop of the East Asian crisis which drew attention to the debt problems in some middle income countries. It led the G-8 to announce the Evian Approach[11] in 2003 which included consideration of the problems of middle income countries and the acceptance that their problems could not in each case be dealt with as a short-term liquidity problem. In addition it recognized the new reality of the dominance of private capital flows over official flows and thus stressed coordination between private and Paris Club creditors.

III The changing role of the Paris Club

Originally, rescheduling at the Paris Club was perceived to lead to an avoidance of default and debt relief was understood to be an unusual event. It was intended to be an exigent and short-term remedy to a liquidity problem and treated on merits alone without consideration of any long-term relief. It was not to be directly associated with development assistance. Over time, the Paris Club became increasingly involved with long-term debt problems and exigencies of development expenditure in low-income countries. Presently, the negotiations at the Paris Club deal with three sets of problems

1. Liquidity problems
2. Solvency problems
3. Debt relief for development expenditure

The three types of operations require assessments of debt sustainability, estimates of total financing required for development and financing gaps. The identification of the type of problem facing a country is crucial for the Paris Club terms applied and amount of debt relief granted. Although the Paris Club secretariat and its members are increasingly involved in new areas such as financing development expenditure through debt relief, there is no in-house technical capacity in the Paris Club secretariat to assess

[11] See Annex 1I for list and explanation of terms applied to Paris Club agreements.

such operations. The technical work[12] is carried out by the IMF for middle income countries[13] and by the World Bank and IMF for low-income countries though their HIPC debt sustainability framework and the joint debt sustainability framework for low income countries.[14] A country cannot reschedule its debt without a prior program with the IMF. The IMF is thus increasingly involved in mediating debt-rescheduling agreements between debtor countries and official creditors through its role in the Paris Club. The Fund's technical work in this area is of crucial significance in determining the amount of debt relief that a country can obtain and the terms of the agreement at the Paris Club.

IV The relationship between the IMF and the Paris Club

An IMF approved stabilization program indicates the IMF's "seal of approval" and makes it possible for a country to approach the Paris Club[15] and communicate its intent to negotiate. The conditionalities attached to the program signal the "credibility" of a country's reform efforts placed under IMF monitoring. It builds up the confidence of Paris Club creditors in the country's ability to meet its future obligations.

The analysis provided by the IMF in projecting a country's balance of payments and identifying the "over-all financing gap" captures the short-fall in the country's resources to meet its external obligations. The gap is expected to be met through 'exceptional financing" which includes IMF credits, bi-lateral and multi-lateral aid, expected private capital flows and resources released through the restructuring at the Paris and London club. The IMF determines the size of the "financing gap" to be met by Paris Club creditors by carrying out prior informal consultation with them to establish the gap that they would be willing to fill up through a rescheduling of debt. The amount to be deferred, the consolidation period, cut-off dates and the repayment period[16] are negotiated at the Paris Club.[17] The IMF's balance of payment projections has a bearing

[12] The staffs of the World Bank and IMF have been involved with the Paris Club since the early 1960s.
[13] The debt sustainability analysis is a model of "debt dynamics" which makes distinctions between liquidity and insolvency scenarios difficult.
[14] The framework for low income counties has also come under a lot of criticism discussed later in this brief.
[15] A notable exception is Cuba.
[16] See Annex 1 for definitions of terms used by the Paris Club.
[17] The negotiations on interest rates and list of debts covered are carried out in bi-lateral negotiations.

on the agreements reached at the Paris Club. Thus debt relief is intricately linked to the IMF program.

In practice the Fund is not as neutral as may be desirable for a neutral assessor and arbitrator of a fair debt restructuring mechanism. It is a creditor to the same countries it supports at the Paris Club, which weakens its role as an honest broker between debtors and creditors. Moreover, the conditionality tied to the Fund's programs have come under heavy criticism and its technical work in assessing financing gaps as well as debt sustainability are not without its detractors.

IV.1 IMF as gatekeeper

The relationship between the IMF, the Paris Club and debtor countries is a complex one presenting considerable risks of conflict of interest. The IMF is a creditor to the same countries that it represents at the negotiations. It is accountable to its Board for its balance sheet: protecting its own position is therefore a paramount objective in its operations. It accompanies countries to the Paris Club to reschedule debt based on financing scenarios which are met with deferred payments to finance its own programs. New lending by bilateral donors clears arrears on debt servicing accruing on the Fund's balance sheet. In practice, the financing of Fund Programs often becomes dependent on debt relief. There is thus, no compatibility between the role of the IMF as gatekeeper for concessional resources and, on the other hand, as creditor and therefore a stakeholder in the inflow of the same resources. Lending by BWIs has often prolonged the un-sustainability of the debt burden of many countries as cases of debt overhang were dealt with as short-term balance of payments problems. This also impacted lending by bi-laterals. An Independent Evaluation Report of the Policy and Operations Evaluation Department of the Ministry of Foreign Affairs of the Netherlands in 2003 highlighted that lending practices were encouraged by the interest of the IFI's to conclude new loan agreements. While the new multilateral flows trigger bi-lateral aid, it is increasingly used to repay early IMF and other IFI credits.[18] The IMF tacitly enjoys "preferred creditor

[18] Marchesi and Thomas (1999) explain that the adoption of an IMF program can function a screening mechanism that allows creditors to distinguish between those countries which intend to use "debt relief" for investment and later repay and those which do not (or cannot) do it. Marchesi (1999) found that the

status" in debt relief operations.[19] Increasing debt burdens through this process led to a considerable build-up of arrears culminating in the HIPC initiative, which to a considerable extent was a write-off of arrears, counted as a flow of aid thereby limiting the resources released to finance development.[20]

The objective of the IMF to protect its own balance sheet thus led to myriad processes culminating in the flow back of resources to the IMF and other IFIs through bi-lateral loans and debt relief operations.[21] As a consequence of this conflict of interest, countries may fail to receive aid, not because of a lack of good policies or governance, but because their debt is not high enough. This has led to adverse selection. In practice, the IMF could not play a neutral role between debtors and creditors because the Paris Club agreements are intricately tied to financing of its own programs.

IV.2 Over optimistic forecasts

In addition to the issue of conflict of interest, the technical work underlying IMF programs in making balance of payments projections has come under scrutiny. These assessments are static and do not take alternative financing scenarios and policies into account. Moreover, since multi-lateral surveillance has a strong country orientation, the impact of polices of the industrialized countries on global interest rates, commodity prices, etc. are not factored into these assessments. The significance of commodity price shocks and international interest rates, amongst other factors, are important explanatory variables accounting for default on external payments.

---

adoption of an IMF Program and the conditionality that goes with it could work as a sort of signal of a county's good behaviour that may induce bi-lateral creditors to concede a rescheduling of a country's debt.

[19] This has come under attack by the private sector as debtors reaching agreements at the Paris Club have a clause in their negotiated agreements to seek comparability of treatment from private creditors while the IMF retains its "preferred creditor status." It is only under the new MDRI initiative (2005) that the BWIs and other IFIs provide debt relief to the HIPC completion point countries, the relief funded by bi-laterals. Except for HIPC countries that benefit from the MDRI, multinational debt as a creditor class is excluded from debt negotiations because of their preferred creditor status

[20] See Annex III for an indication of the extent to which nominal debt relief was a writing-off of arrears

[21] Kuhn and Guzman (1990) find that the record number of rescheduling is largely a function of the record number of programs supported by the Fund. They document that prior to the debt crisis only a small percentage of Fund supported Programs required exceptional financing though official debt rescheduling. Between 1986-1990 four fifths of the programs supported by the Fund through Stand-by and extended arrangements and two-thirds of those supported by SAF and ESAF arrangements required financial support through Paris Club rescheduling. Debt relief became the biggest source of exceptional balance of payments assistance.

It has been established that the IMF's analytical work often yielded over-optimistic expectations of a country's performance. Its forecasts of growth, expected capital flows, and export earnings resulted in an overstated case of the county's ability to service debt. For example, the report of the IMF's Independent Evaluation Office (2006) acknowledged that the Fund functioned with a dominant bottom-up approach as surveillance had a strong country orientation which yields consistently overoptimistic forecasts for certain regions and does not sufficiently pick policy spillovers in a global context. Similarly the U.S. Accounting Office (2003) found that between 1990 and 2001 forecasts for growth and inflation were optimistically biased for 57 countries under IMF supported programs in its assessments in the World Economic Outlook.

This error in making realistic assumptions about a country's capacity to pay based on overoptimistic forecasts of economic performance played an important role in serial rescheduling which will be discussed under the section on issues in Paris Club debt restructuring in this paper.

IV.3 Debt relief and burgeoning conditionality

Countries with spiralling debt burdens, especially in the 1980s, came up for frequent rescheduling, which necessitated frequent Programs with the Fund and a series of structural adjustment programs. Indebted countries, therefore seeking redress from debt burdens, increasingly tied down their national policies to Fund conditionality. Conditionality applied by bi-lateral donors in their loans to developing countries was in addition to that of the IMF. In the late 1990s additional conditions became attached to HIPC debt relief.

Conditionality has increased significantly over the lifespan of the Fund. Although some element of policy conditionality has been attached to Fund financing since the mid-1950s, the scope of conditionality expanded in the early 1980s[22] particularly in the structural area. The expansion of structural conditionality was also reflected in increasing numbers of performance criteria, structural benchmarks, and prior actions. The problems

[22] The 1979 IMF guidelines on Conditionality underscored the principle of parsimony and the need to limit performance criteria to the minimum number needed to evaluate policy implementation. They also stressed that the Fund should pay due regard to the country's social and political objectives, economic priorities, and circumstances. But instead structural conditionality went up in Fund programs. Subsequently guidelines were issued in 2000 and 2002.

with conditionality fed a rich array of literature and international debate in the 1980s and 1990s. In view of the heightened criticisms, the International Monetary and Financial Committee at its September 2000 meeting welcomed the proposal by the Managing Director of the Fund to focus on and streamline conditionality[23]. Despite recent efforts at its streamlining, conditionality continues to be problem both in Fund operations and debt relief agreements. A recent evaluation carried out by the Independent Evaluation Office evaluating Structural Conditionality in IMF–Supported Programs (2007) examines factors influencing the effectiveness of IMF structural conditionality in bringing about structural reform, and assesses the impact of the streamlining initiative launched in 2000 and of the 2002 Conditionality Guidelines. The evaluation found that

> …during the period 1995–2004 there was extensive use of structural conditionality in IMF-supported programs, with an average of 17 conditions per program/year. Most of these conditions had little structural depth and only about half of them were met on time. …
>
> The streamlining initiative did not reduce the volume of conditionality, partly because structural conditions continued to be used to monitor other initiatives such as donors' support programs and the European Union (EU) accession process (Executive Summary p. 4).

The evaluation further find that effectiveness of structural conditionality found weak compliance and effectiveness in bringing about financial sector reform. Others (for example Killick (1995) argue that intrusive conditionality even impacted the capacity to grow. While austerity programs in countries cut back expenditure on social investments, conditionality under the Poverty Reduction Growth Strategy (PRGF) monitored investments in the social sector and left coutnries with no flexibility to utilize funds for productive investment. Imbalances were created in both cases. In the case of the latter, many countries under the HIPC initiative experienced surges of donor flows in a short-space of time. The countries engaged in expensive sterilization in order to keep inflation and overvaluation of the exchange rate under control. Program rigidity and donor presence in the recipient countries prevented the utilization of excess liquidity for investments in the productive sector. A well worked out strategy with reliance on imports to utilize the excess liquidity would have avoided the expensive build-up of domestic

[23] The UK was one of the first countries to remove privatization from its conditions applied to bi-lateral loans in recent years.

debt. Thus rigid conditionality attached to debt relief may have contributed to creating a problem in public debt sustainability and is the subject of further research.

IV.4 Assessment of Debt Sustainability

Assessments by the BWIs of the level of debt that is sustainable and judgments whether the country is facing a short-term constraint in meeting its external payments or a longer-term problem, is crucial for the outcome of negotiations. Three different approaches are in practice in IFIs to make judgments on a sustainable level of debt depending upon the income-classification of a country and the type of problem being considered. Separate functions are performed under each framework.

IV.4.1 Frameworks for low income countries

The first is the **HIPC framework** which defines the threshold levels beyond which debt is unsustainable. It assisted in identifying the debt overhang brought about by past borrowing which was determined by a threshold value for the ratio of debt to exports, and in certain cases, a percentage of fiscal revenues for countries whose annual per capita income was below the level for eligibility to access the IMF and World Bank concessional resources. The framework had its shortcoming in that there was no theoretical or empirical basis for the threshold adopted in the framework and the calculations were based on past historical values.

The second is the **joint debt sustainability framework (DSF) for low-income countries**, which is intended to assist countries to avoid unsustainable levels of debt and functions as a tool for IDA allocation.[24] The joint DSF of the Fund and Bank is a forward looking framework which guides the borrowing strategy of borrowers to ensure debt sustainability. It is based on the idea that domestic policies influence debt sustainability. The World Bank set out a Debt Sustainability Framework (DSF) in June 2004 and a revised version jointly with the IMF in (2006) for identifying countries in actual or potential distress situations leading to a formula for determining grant eligibility. The key principle in the framework is to reduce the risk of debt service problems though grant

[24] Annex IV is a chart showing that debt service in the HIPC countries in some cases is even above the levels at decision point.

funding while facilitating access to finance required by these countries to achieve the Millennium Development Goals.

IDA allocations are based on a performance based evaluation system and per capita income in this framework. The DSF selects three debt ratios to judge debt sustainability. These are the ratio of present value of public and publicly guaranteed external debt to gross domestic product and to exports, and debt service on the same debt to exports. The framework further uses Country Policy and Institutional Assessments (CPIA) for country polices and institutional capability, and vulnerability to shocks and to classify countries by performance and different thresholds for different indicators. The governance factor is given a higher weight relative to other factors. The framework is policy dependent — conditional upon a summary measure of policies (CPIA). It is to serve as a guide to lending and policy advice. The Country-specific framework is grounded in indicative policy thresholds and forward looking analysis of debt dynamics

DSF is based on the cost of borrowing. What is crucial is the allocation of borrowed money in investments which yield a rate of return higher than the cost to ensure debt sustainability. The BWIs only take the cost of borrowed funds into account. The DSA for low income countries place an excessive emphasis on governance and domestic policies through its CPIA indicator used in assessments. While these undoubtedly influence the overall policy orientation of a country, the use of borrowed money and the returns on it bear on debt sustainability and require to be factored into DSA frameworks. While the threshold levels have undergone considerable refinement in calculations; a forward looking approach relies on the reliability of forecasting critical values. Domestic debt is on the rise in many low-income countries. The DSA for low income countries does not integrate domestic and external debt. Private capital flows are also increasing to low-income countries. It is crucial that the total liability structure of public and private debt be taken into account while gauging debt sustainability. The framework is designed to limit borrowing from non-IDA window shareholders without the benefit of a cost-benefit analysis of such investments by other lenders to guide operations and lending from the IDA window and assess debt sustainability.

IV.4.2 Framework for middle income countries

The third is the debt sustainability framework for middle-income countries. The framework for middle-income countries is based on models of *debt dynamics* used to identify liquidity constraints. Debt Sustainability means the ability to continue to service debt without requiring a large future correction in income and expenditure. If a country has access to market borrowing, debt servicing is not a problem but can have the unintended consequence of building-up higher debt stocks. It is difficult to judge whether the country is meeting short-term liquidity constraints or is prolonging a default on a longer-term problem by looking at its ability to attract capital flows. The optimal mix of the composition of debt and levels remain a problem. The model is suited to flow rescheduling and does not lend itself to giving early warning signals for insolvency or the amount of debt write-off needed to keep the country on a sustainable path. In this framework unsustainable debt is generally associated with continually rising debt ratios over time but there is no evidence to prove that a default cannot occur with stationary ratios. Experience with debt problems have shown that liquidity problems can turn into solvency problems. Changes in international liquidity and the cost of borrowing or other internal and external shocks can singly, or in combination with other factors, be contributory factors. The framework does not explore the dynamics of the relationship between internal and external debt and its implications for debt sustainability. Given the rising levels in many developing countries, this is an area of concern. Although the new Evian approach includes consideration of debt-write offs for deserving middle-income countries, the underlying technical support does not easily lend itself to distinguishing liquidity from insolvency problems. Even if a threshold level was defined, a ratio which is good for one country may constitute a signal of distress for another, or the same ratio may not be good for a country at a different point of the economic cycle. The analysis is also limited in capturing the spill-over effects in debt currency and banking problems. Extrapolation exercises cannot factor in the variability caused by increase in interest rates and fiscal tightening. Contingent liabilities also need consideration. In the long run exchange rate misalignments in the world economy affect trade and capacity to repay.

Further research and technical support is need to work out an approach to gauge debt sustainability which places development objectives at the centre of the analysis

taking cyclicality of capital flows and ability to pay into account. The analysis requires inclusion of both, the cost of funds, as well as the return on their use, so that the level of debt is growth enhancing rather than a hindrance to development. It is difficult to distinguish between liquidity and solvency issues and we will perhaps never reach that goal but further improvements may be necessary, both as a tool of crisis prevention and for deciding on the type of treatment a country needs at the time of debt restructuring.

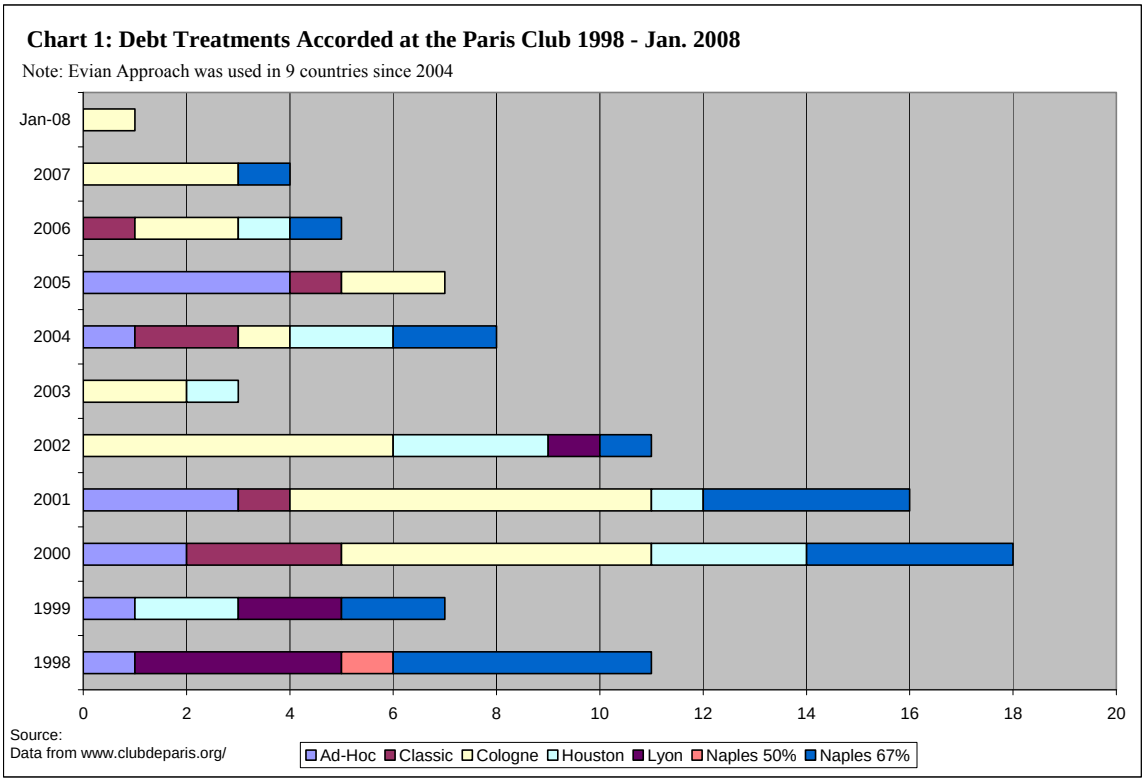
V. Issues in Paris Club debt restructuring

The assessment of the efficiency of the Paris club in dealing with debt repayment problems guided by debt sustainability considerations is now inseparable from the new overriding objective of financing development expenditure, the latter in many cases becoming a necessity because of the inadequate treatment of the former. Although debtors have often been blamed for irresponsible borrowing, the financial architecture for debt restructuring may itself have contributed to debt distress in countries through serial rescheduling, because very often an unsustainable debt problem was treated like a short-term liquidity constraint and contributed to the ensuing debt over-hang in some low-income and middle income countries. At the Paris Club, the negotiations and the terms of the agreement that were intended to keep countries on a short leash proved self-defeating, given the number of times several countries came back to the club for a rescheduling. In the case of low-income countries, recognition of this in some selected countries led to eligible debt stocks written-off under the HIPC initiative as high debt burdens was a serious impediment in poverty reduction in these countries. The relatively new Evian approach constitutes political acceptance by the members of the Paris Club that serial rescheduling is futile and that debt in deserving middle income countries needs to be written off too, although the approach is still in its infancy.[25] Other issues relate to the lack of transparency and the informal basis for comparable treatment with the private sector.

What criteria would one adopt to judge the success of the Paris Club? One option would be to assess if debt relief was followed by a permanent exit from the Paris Club.

[25] See the discussion on assessing debt sustainability for the difficulty in utilizing present approaches to the principles outlined in the Evian approach.

Chart 1 below captures the business activities of the Paris Club in the period 1998-Jan.2008 and the treatment



accorded in debt negotiations. The number of Cologne terms agreements show HIPC debt write-offs have been an important part of business activity at the Paris Club. Debt service forgiveness in the case of Naples terms and flow treatment of debt service to defer payments in the future under classic and Houston terms are also evident. Apart from debt reductions in a few prominent cases like Iraq and Nigeria, the implementation of he Evian approach to allow for debt write-offs still remains to be seen in many non-HIPC countries.[26]

[26] Nine countries have been treated under the Evian approach since its inception in 2003. According to the Paris Club the sustainable cases were Kenya (January 2004), Dominican Republic (April 2004 and October 2005) and Moldova (May 2006) and sustainable cases with goodwill clauses Gabon (June 2004), Georgia (July 2004) and Grenada (May 2006). The unsustainable cases were Iraq (November 2004), Kyrgyz Rep. (March 2005) and Nigeria (October 2005).

V.1 Serial Rescheduling

In recent years a favorable international environment and developments in domestic bond markets has led to agreements in 2007 for three countries, Peru, Jordan and Gabon, to pre-pay agreed amounts of their debt to their Paris Club creditors. These countries have undergone serial rescheduling at the Paris Club alongside many others as shown in table 1. In order to assess the success of Paris Club efforts, it is useful to understand how they got into serial rescheduling in the first place.

Serial rescheduling is a term applied to countries that come often to the Paris Club. The original objective of the Club to enter into debt rescheduling only in exceptional cases did not work in practice. Why did countries come frequently to the Paris Club? This section focuses on the structure of the restructuring machinery in order to provide an explanation for serial re-scheduling and the pile up in the stock of debt in some countries. The objective is to understand the factors behind serial rescheduling in order to design an improved framework for official debt restructuring. It is recognized that the external environment, commodity prices and growth performance amongst other factors play a role in determining a country's ability to service its debt, but the focus of analysis here is to bring forth another contributory factor - the structure of the restructuring machinery

An overview of the frequency with which countries have been to the Paris Club is given below in table 1. The first point to note is that both countries which are now covered under the HIPC initiative and non-HIPC countries have undergone serial rescheduling. The frequency ranges between four and fourteen times. Does serial rescheduling present a gap in International Financial Architecture?

Table 1: Serial Rescheduling 1980-2008

	Income Classification	1980-1990	1990-2000	2000-2003	2004-2008	Total
Africa						
Benin	lower-income	1	3	2	0	**6**
Cameroon	lower-middle	1	4	1	1	**7**
Central African Republic	lower-income	4	3	0	2	**9**
Democratic Republic of Congo	lower-income	6	0	1	2	**9**
Côte D'Ivoire	lower-income	5	3	1	0	**9**
Gabon	upper-middle	3	3	1	1	**8**
Guinea	lower-income	2	3	1	1	**7**
Madagascar	lower-income	6	2	3	1	**12**
Mali	lower-income	2	2	2	0	**6**
Mauritania	lower-income	4	2	2	0	**8**
Morocco	lower-middle	4	2	0	0	**6**
Mozambique	lower-income	2	5	2	0	**9**
Niger	lower-income	6	3	1	1	**11**
Senegal	lower-income	7	5	1	1	**14**
Sierra Leone	lower-income	3	3	2	1	**9**
Tanzania	lower-income	2	3	2	0	**7**
Togo	lower-income	6	3	0	0	**9**
Uganda	lower-income	4	3	1	0	**8**
Zambia	lower-income	3	4	1	1	**9**
Latin America						
Argentina	upper-middle	3	2	0	0	**5**
Bolivia	lower-middle	2	5	1	0	**8**
Brazil	upper-middle	3	1	0	0	**4**
Ecuador	lower-middle	4	2	2	0	**8**
Peru	lower-middle	1	3	0	0	**4**
Europe/Asia						
Indonesia	lower-middle	0	1	2	1	**4**
Pakistan	lower-income	1	1	2	0	**4**
Jordan	lower-middle	1	4	1	0	**6**
Poland	upper-middle	4	2	0	0	**6**

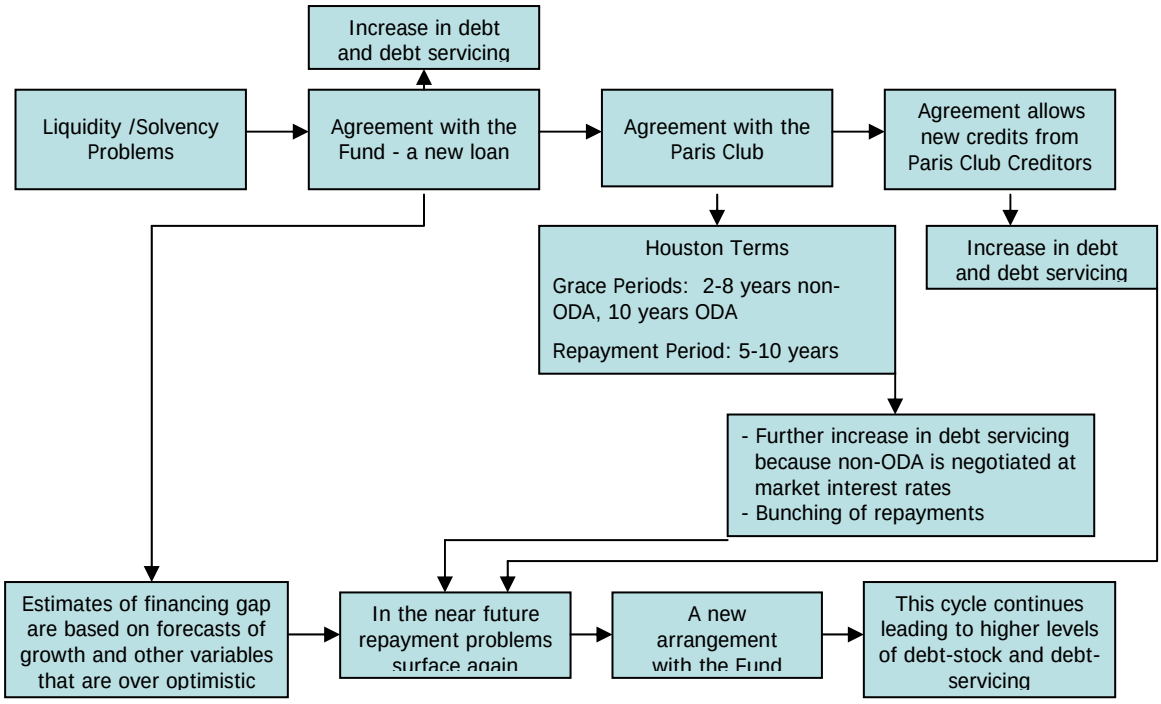
Source: Compiled from information on the Paris Club website (www.clubdeparis.org) and UNCTAD Secretariat

In what follows is an attempt is made to explain how the Paris Club contributed to this process in low-income and middle-income countries. Debt reductions were slow in coming in response to the build-up of debt in the 1980s. In the first 35 years of th paris

Club functioning, no distinction was made in the treatment of liquidity and solvency problems. In the early 1980s Paris Club creditors provided rescheduling for low-income countries on non-concessional terms and on market related interest rates. In the later 1980s Paris Club creditors were forced to shift their rescheduling strategy because of serial rescheduling and agreed to provide concessional rescheduling under the Toronto terms in 1988, Trinidad (1990), London (1991) and Naples (1994). Although the HIPC and now MDRI initiative for multilateral debt relief to countries enabled write-offs of eligible debt-stocks, other low income and some middle income countries are still caught in difficulties in meeting their debt payments.

Thus an understanding of how the system itself led to such serial rescheduling is useful. Chart 2 is an illustration of a typical rescheduling process.[27]

Chart 2: A typical representation of rescheduling under Houston terms



[27] For ease of explanation the example illustrates the process under Houston terms which accords flow rescheduling to a middle income country. Barring the difference in grace and repayment period, consolidation periods and whether a debt service reduction is awarded under different terms of treatment applied, the basic process remains the same while dealing with flow rescheduling.

A country either runs into liquidity or a solvency problem. In order to avert an external crisis it approaches the IMF and negotiates a new loan and signs up to an IMF program, typically a Stand-by Arrangement. Although the Stand-by Arrangement is for a year and can be extended, the conditions attached to the program deal with structural and institutional changes which are not feasible under the period of the IMF program.[28] The Paris club agrees to defer payments to the future depending on the size of financing gap that needs exceptional financing by the IMF. The consolidation period is usually very short. The agreements lead to the bunching of repayments in the future at a higher cost (negotiated in bi-lateral agreements). The problem is then compounded by the fact that the quantitative framework underlying the Fund program and negotiation at the Paris Club are based on optimistic scenarios which are not realised in practice, leading to renewed debt servicing problems and a new arrangement with the fund. This in turn leads to new cycle of rescheduling and higher levels of debt servicing. Debt stocks then rise because of new IMF credits and bi-lateral loans.[29]

The main causes of serial rescheduling are:

- Short consolidation periods to keep debtors on a short leash
- Mistakes in projections by the IMF and the difficulty of differentiating whether a problems is related to liquidity or solvency
- «Snowballing» debt because of bunching of repayments due to lower grace periods; market interest on non-ODA on new rescheduling; and new credits issued after rescheduling

Analyses provided to support debt negotiations do not include the terms of the first loan contract, and how much of the original principal and accrued interest have been repaid, and separate the cost of subsequent Paris Club rescheduling and their attendant bi-lateral agreements. A debt write-off for instance, may cover the high late fee, penalties and higher interest cost in bi-lateral agreements. The issue can be illustrated with the case

[28] The same is applicable to other IMF programs.
[29] It is ironic that developing country creditors are being called "free riders" riding free on the debt space created by debt relief when the OECD creditors themselves lent to countries they had given debt relief.

of the recent Nigerian negotiation. Odiadi (2008) reports that Nigeria borrowed $13.5 billion from an entity and has since then paid back $ 42 billion as interests and penalties, and owed the same entity $ 30 billion. The numbers cited are indicative of the cost of rescheduling to a country. Debt relief needs to separate the costs of rescheduling from the terms of the original contract. The write-offs are the creditors' share of the burden for their past mistakes in assessing the problem and the type of treatment granted which contributed to the debt build-up. But the signal that such agreements send out is that of the risk posed by the country ─ its incapacity to meet its obligations. Where private capital flows are significant it may even impact spreads and credit ratings adversely. Information is needed on all agreements and their attendant interest rates and debt stocks considered in bi-lateral agreements to evaluate the amount of the new relief granted is due to past mistakes made by the restructuring machinery.

Cases in which a country came for a rescheduling to finance a Fund Program with no apparent debt distress signals needs to be evaluated carefully. There has to be some de-linking of the intricate relationship between financing of Fund programs and debt relief. Further research and policy analysis is needed to understand the costs of rescheduling through the Paris Club and use it as one of the means to finance development expenditure. Alternative mechanisms need to be explored to keep down the costs of rescheduling in a non-transparent process.

V.2 Transparency

Until recently, Paris Club negotiations were shrouded in mystery and they were considered one of the most nontransparent pieces of machinery in the international financial system. The Press releases from the Paris Club at the conclusion of the negotiations did not carry the amount of debt restructured or the restructuring terms. In the late 1990s, as the international debate on transparency was stepped up by the Bretton Wood institutions after the Mexican and East Asian crises, the Paris Club made information available publicly for the first time by launching a website in April 2001 that explained basic concepts, principles and types of agreement concluded since 1956. Despite this improvement, bi-lateral negotiations and agreements continue to remain highly non-transparent. UNCTAD's role as observer has been restricted to the plenary

session and it is not an invitee to the actual negotiation for Paris Club agreements. Representatives from the Bretton Wood institutions[30] are, however, known to be in the negotiating room[31]. Moreover, the Paris Club negotiated agreement only covers the amount of debt treated and the period of rescheduling. The all too crucial agreement on interest rates on rescheduled debt[32] are agreed individually with each creditor in bi-lateral agreements which continues to remain a highly untransparent[33] and time-consuming process,[34] with reports of some bi-lateral agreements at variable and/or quasi-market interest rates which are likely to pose additional risks to developing countries and may endanger the previously concessional element of the debt treated. There is no system in place for observers to oversee the bi-lateral process. The list of loans covered and interest rates negotiated in bi-lateral agreements are not available publicly. The interest cost of the rescheduling is important in analyzing the implications for debt sustainability and the cost of negotiation to the debtor. Although a single standardized form can avoid time consuming bi-lateral negotiations, in fifty two years of its functioning the PC has not been able to resolve the different legal systems and institutional arrangements to make this possible.

---

[30] The BWIs play an important role in data reconciliation. Often discrepancies between the records of debt owed to official creditors in debt management offices in countries is at variance with the data furnished by Paris Club creditors. Data discrepancy between debtor and creditor data has also been picked up in the first DAC, OECD monitoring survey of the Paris Declaration on aid effectiveness.

[31] Representatives from Inter-American Development Bank, African and Asian Development Banks attend negotiations with countries from their region. An official from the European Commission also participates as an observer to most negotiations.

[32] There is considerable controversy surrounding the debt numbers as very often the debt numbers quoted by the country and those by the Paris club don't match up. The discrepancy in numbers has also been captured in the OECD survey monitoring the Paris Declaration on Aid Effectiveness.

[33] Until recently a lot of mystery surrounded the Paris Club negotiations and was considered one of the most nontransparent pieces of machinery in the international financial system. The Press releases from the Paris Club at the conclusion of the negotiations did not carry the amount of debt restructured or the restructuring terms. In the late 1990s as the international debate on transparency stepped up by the Bretton Woods institutions after the Mexican and East Asian crises, the Paris Club for the first time made information available publicly by launching a website in April 2001 that explained basic concepts, principles and types of agreement concluded since 1956. Information on bi-lateral agreements is still not available publicly.

[34] The entire process is reported to take 6 months to two and a half years with some creditors reaching agreement faster than the others. Time is lost in the interest rate negotiation and the list of debt covered. The interest rate negotiated can vary from one bi-lateral agreement to another. In the 1980s countries came up for a re-scheduling even when the agreed minutes of the last agreement had still not been completed in bi-lateral agreements.

V.3.1 Signals to the private sector

What signals does a Paris Club deal send out to market participants? Paris Club agreements with Russia in 1999 and Ecuador in June 2003 at the Paris Club received a negative reaction from the private sector. Both countries had a sizeable debt stock of bond debt. Although the issue needs to further researched, at a first glance it appears that spreads rose after the Russian deal on most bonds of short-term and long-term. In the case of Ecuador, spreads rose on short-term bond debt while falling slightly on its longer-term debt. The impact of a PC agreement on the cost of borrowing from the private sector has not been explored in the literature. The issue has great relevance for countries that are reliant on official borrowings that are now entering the market for capital from private sources and at the same time seek relief from debt distress at the Paris Club. The cost of borrowing and the maturity structure of bond debt and bank lending have implications for debt sustainability.

Assessment by credit rating agencies in assigning default risk varies. Chamberlin (2006) reports[35] that ratings agencies may apply quite different policies on how to treat sovereign debtors that are in, or emerging from, default scenarios, and in particular, they may have differing views on the relative importance of capacity and willingness to pay. The discrepancy in views reported between rating agencies is probably mirrored in a certain inconsistency of investor views regarding the significance of a debtor country's track record in servicing its debt. This inconsistency certainly can be seen in current investor attitudes toward countries that defaulted in the past. Argentina is a prime example.

V.3.2 Problems in comparability of treatment with private creditors

In the late 1990s the Paris Club was opposed to granting debt rescheduling to countries that had sizeable exposures to bond debt and enforced the principle of comparable treatment to restructure their bond debt. Although seeking comparable treatment had worked reasonably well in the case of bank debt in the past, private creditors have generally been unwilling to restructure their claims based on calls from the

[35] Based on presentations made by Standards & Poors' and Fitch Sovereign Ratings at EMTA in 2006.

public sector. This is due to the difficulty of differentiating between a debt problem and the use of these approaches to cut back public resources either for funding a Fund program or dealing with crisis prevention and resolution. Moreover, the principle cannot be legally enforced as the Paris club itself does not have a legal basis. This constitutes a problem for debtors as they get engaged in protracted negotiations with creditors. Thus a timely and speedy resolution to debt distress is problematic. The requirement, however, is that timeliness and speed are essential for crisis prevention to avoid a fully blown-out debt problem. Thus the informal relationship between official and private creditors and the lack of a rules-based system for their engagement is a deterrent to an efficient debt restructuring mechanism.

VI Lessons for the future

In a globalized world where emerging market economies are now contributing roughly half of the World's GDP and many other developing countries are on a growth trajectory, strengthening multi-literalism is the only way that one can deal with financially integrated economies. A gap in financial architecture for debt restructuring is becoming apparent as all official creditors are not members of the Paris Club and the dominance of private capital flows to the developing world make consideration of private debt restructuring imperative. The functioning of the Paris Club provides important lessons in what to do and what not to do in moving forward.

What are the lessons learnt?

1. A neutral body is needed to make assessments of the amount and type of relief required.
2. The technical work to support official debt restructuring needs to go beyond models based on those applied by the private sector that give exclusive priority to assessments of liquidity situations in countries affecting their debt servicing.
3. More transparency is needed in official debt restructuring operations to include information on interest rates, the list of debts covered and penalty costs.
4. There is a need to harmonize debtor and creditor reporting systems on bi-lateral debt to reconcile differences in the list of debt and amounts due.

5. A simplified process is needed so that the Paris Club negotiation and bi-lateral negotiation process can be merged into a single process.
6. Keeping countries on a short leash with burdening conditionality is self-defeating.
7. Debtor voice is needed both in the design of the machinery and in negotiations.
8. Serial-rescheduling leads to rising debt service requirements and makes debt sustainability targets an illusion.
9. A fair debt restructuring mechanism needs to look at repayments made on the original loan contract and amounts due from the costs of rescheduling.
10. The pros and cons of using Paris Club procedures for financing development expenditure in counties that do not have an existing debt problem need to be understood. A comparative cost-benefit analysis with other sources of finance is needed. The Paris Club rescheduling is seen as a signal of debt distress and impacts spreads and future costs of borrowing from the private sector.

What is the way forward?

The SDRM proposal of the IMF in 2002 considered incorporation of the Paris Club in an international permanent machinery, which in of itself, was an unspoken recognition of the drawbacks of the present framework. With growing financial integration and the need for strengthening multilateralism and improved transparency, transparency is also required in debt restructuring negotiations. A possible step is to set up a committee at the UN to examine the options for reforming the financial architecture for debt negotiations and re-examining the proposal the G-77 made in the late 1970s for an International Debt Commission along with other proposals that have been tabled by experts in the intervening years.

In addition, maintaining sustainable debts through a well worked-out borrowing strategy with adequate debt management policies in place is an objective which no country can afford to violate in a financially integrated world.

References:

Berg A. and Sachs J. (1988) The Debt Crisis, Structural Explanations of Country Performance, *Journal of Development Economics* Vol. 29: 271-306. North-Holland: Elsevier Science Publishers

Cizauskas A.C. (1979) International Debt Renegotiation: Lessons from the Past, *World Development* Vol. 7: 199-210. United Kingdom: Pergamon Press Ltd.

Cohen S.D. (1981) Forgiving Poverty: The Political Economy of the International Debt Relief Negotiations, *International Affairs* Vol. 58: 59-77. United Kingdom: Sirsi Corporation.

Cook P., Minogue M. And Mosley P. (1992) 'The IMF and Paris Club Debt Rescheduling: a Conflicting Role?' *Journal of International Development* (May-June). Manchester: John Wiley & Sons, Ltd.

Cosio-Pascal E. (2007), Paris Club: Intergovernmental Relations in Debt Restructuring, Paper presented to the IPD Task Force on Debt, Colombia University. (Draft).

Daseking C. And Powell R. (1999) From Toronto Terms to the HIPC Initiative: A Brief History of Debt Relief for Low-Income Countries. IMF Working Paper WP/99/142, October, Washington, D.C.: International Monetary Fund.

Ebenroth C.T. (1995) 'Rescheduling of the Sovereign Debt: A New Role for the Paris Club'. *Journal of International Banking Law* Vol. 10, No. 7: 280-292.

Goreux L.M. (1994) Paris Club Bilateral Agreements: A Study of Eight African Countries, UNCTAD/GID/DF/6. Geneva: UNCTAD.

International Monetary Fund (2000). Debt and reserve-related indicators of external vulnerability. Paper prepared by the Policy Development and Review Department in consultation with other Departments. Washington, D.C. 23 March.

_____ (2001). The challenge of maintaining long-term external debt sustainability. Paper prepared by the Staffs of the World Bank and the International Monetary Fund. Washington, D.C. 20 April.

_____ (2002a). Assessing sustainability. Paper prepared by the Policy Development and Review Department. Washington, D.C. 28 May.

_____ (2002b). Fund policy on lending into arrears to private creditors: further consideration of the good faith criterion. Paper prepared by the International Capital Markets, Policy Development and Review and Legal Departments. Washington D.C. 30 July.

_____ (2003a). Debt sustainability in low-income countries: towards a forward-looking strategy. Paper prepared by the Staff of the Policy Development and Review Department. Washington, D.C. 23 May.202 World Economic and Social Survey 2005

_____ (2003b). Sustainability assessments: review of application and methodological refinements. Paper prepared by the Policy Development and Review Department in collaboration with the Monetary and Financial Systems Department and in consultation with other Departments. Washington, D.C. 10 June.

_____ (2004a). Debt sustainability in low-income countries: proposal for an operational framework and policy implications. Prepared by the Staffs of the IMF and the World Bank. Washington, D.C. 3 February.

_____ (2004b). Sovereign debt structure for crisis prevention. Discussion paper prepared by the Research Department, pp. 59-60. 2 July.

_____, and International Development Association (2004). Debt sustainability in lowincome countries: further considerations on an operational framework and policy implications. Prepared by the Staffs of the IMF and the World Bank. Washington, D.C. 10 September

_____ (2005a). IMF Executive Board discusses balance sheet approach to analysis of debt-related vulnerabilities in emerging markets. *Public Information Notice (PIN)*, No. 05/36. 22 March. Availabe from www.imf.org.

._____ (2005b). Operational framework for debt sustainability assessments in low-income countries: further considerations. Prepared by the Staffs of the IMF and the World Bank, Washington, D.C. 28 March.

_____and World Bank (2006) Applying the Debt Sustainability framework for Low Income Countries: Post Debt Relief, November.

_____, Independent Evaluation Office (2006) Evaluation of the IMF's Multilateral Surveillance, Washington D.C.

Killik T. (1995) IMF Programmes in Developing Countries: Design and Impact. London and New York: Routledge.

Kuhn M. G. And Guzman J.P. (1990) 'Multilateral Official Debt Rescheduling, Recent Experience', *World Economic and Financial Survey*, November. Washington, D.C.: International Monetary Fund.

Lee S.H. (1991) Ability and Willingness to Service Debt as Explanation for Commercial and Official Rescheduling Cases, *Journal of Banking and Finance* Vol. 15: 5-27. North-Holland: Elsevier Science Publishers B.V.

Marchesi S. (1990) Adoption of an IMF Programme and Debt Rescheduling An Empirical Analysis, Warwick Economic Research Papers No. 542. Coventry, UK: University of Warwick.

Marchesi S. and J.P. Thomas (1999). IMF conditionality as a screening device, *Economic Journal*, Vol. 109, pp. 111-125.

Ministry of Foreign affairs, Policy and Evaluation Department, The Netherlands (2003) results of International Debt Relief 1990-1999, IOB Evaluation Nr. 292.

Mountfield P. (1990) The Paris Club and African Debt, *IDS Bulletin* Vol. 21, No. 2: 42-46. Sussex, UK: Institute of Development Studies at the University of Sussex.

Odiadi, A. (2008). Paris Club and the Nigerian debt available at http://ssrn.com/abstract=1082592

Powell R. (1991) International Debt and the Paris Club, *Treasury Bulletin,* Summer. London: HMSO.

Rieffel A. (1985) The Role of the Paris Club in Managing Debt Problems, *Essays in International Finance* No. 161 (December). Princetown, N.J.: Princetown University Press.

Riefel L. (2003) Restructuring Sovereign Debt: The Case for an Ad hoc Machinery, Brookings Institution Press, Washington D.C.

Sachs J.D. (2002) Resolving the Debt Crisis of Low-Income Countries*, Brookings Papers on Economic Activity*, 1. Harvard University.

Sevegny D. (1990) The Paris Club: An Inside View**.** Ottawa: The North South Institute.

Trichet J.-C. (1989) Official Debt Rescheduling: The Paris Club, in Bogdanowicz-Bindert Ch.A. (ed.), *Solving the Global Debt Crisis: Strategies and Controversies by Key Stakeholders.* New York: Harper & Row Publishers.

US General Accounting Office (GAO) 2003. International Financial Crisis: Challenges remain in IMF's Ability to Anticipate, Prevent, and Resolve Financial Crisis: Report to the Chairman on Financial services, and to the Vice-chairman, Joint Economic Committee

ANNEX I: List of Terminology used in Paris Club Agreements[36]

Active agreement: A Paris Club rescheduling agreement is said "active" until the date of the last repayment maturity expected by the agreement. Over this date, maturities expected by the agreement were, in theory, repaid.

Agreed Minutes: Participating creditor countries and the debtor country usually sign an Agreed Minute at the end of a negotiation session. This is not a legally binding document, but a recommendation by the heads of delegations of Participating creditors countries to their governments to sign a bilateral agreement implementing the debt treatment. When there are only a few creditors concerned, the Paris Club agreement is exchanged through mail between the Chair of the Paris Club and the government of the debtor country, and is called "terms of reference". In some cases, the multilateral debt agreement has also been called "memorandum of understanding".

Appropriate Market Rate: An interest rate defined in a bilateral agreement implementing the Paris Club Agreed Minutes, based upon standard interest rates of the currency considered, plus a management fee. This rate may be fixed or variable and does not include a country-risk premium.

Arrears: It is a debt due and not paid as of a given date. Arrears may be late payments as well as debt due a long time before.

Bilateral Agreements: Agreements reached bilaterally between the debtor country and agencies in each of the participating creditor countries; these establish the legal basis of the debt restructuring set forth in the Agreed Minute. Bilateral agreements specify the interest rate on amounts deferred or rescheduled (moratorium interest), which is agreed bilaterally between the debtor and each creditor.

Bilateral deadline: It is the date by which all bilateral agreements must be concluded. The period for concluding bilateral agreements is now generally six to seven months from the date of the Agreed Minute.

Commercial credits: (i) Credits granted by a bank or a supplier to a debtor country for importing goods and services. When these credits are guaranteed by an appropriate institution of a Paris Club creditor, they are included in the claims treated in the context of the Paris Club. (ii) Non-ODA credits are sometimes referred to as commercial credits.

Completion point: In the context of the Heavily Indebted Poor Countries Initiative (HIPC initiative), the international community commits to provide sufficient assistance by the completion point for the country to achieve debt sustainability.

[36] Information compiled and edited from the Paris Club Website (www.clubdeparis.org).

Concessional Treatment, Concessionality: Concessionality can occur either through a cancellation of part of the claims, or through a rescheduling of the claims over a long period of time with an interest rate that is lower than the appropriate market rate. When a debt treatment results in a reduction of the net present value of the claims rescheduled, it includes concessionality.

Consolidation: Change of the terms of debt payment obligations. This can be implemented either though a change of the terms of the existing debt ("rescheduling"), or through the exchange of the debt for a new instrument (notably, through "refinancing").

Consolidation Period: The period in which debt-service payments to be restructured (the "current maturities consolidated") have fallen or will fall due. The beginning of the consolidation period may precede, coincide with, or come after the date of the Agreed Minute. The standard consolidation period is one year, but sometimes debt payments over a two- or three-year period have been consolidated, corresponding with a multiyear arrangement with the IMF.

Current maturities: It is principal and interest payments falling due within the consolidation period.

Cutoff date: When a debtor country first meets with Paris Club creditors, the "cutoff date" is defined and is not changed in subsequent Paris Club treatments and credits granted after this cutoff date are not subject to future rescheduling. Thus, the cutoff date helps restore access to credit for debtor countries facing payment difficulties.

Cutoff interval: It is the number of months between the cutoff date and the beginning of the consolidation period.

De minimis provision: Paris Club agreements define a "de minimis" level : when the claims of a Paris Club creditor covered by the rescheduling agreement are less than this level, this creditor participates to the meeting as observer and does not reschedule its claims. This rule aims at preventing debt treatments that do not have a significant impact in terms of debt relief and would be costly to implement.

Debt reduction, DR: In the context of a concessional treatment, creditors may usually choose among a number of options to provide the required debt reduction in net present value. When the creditor chooses the "DR" option, the net present value reduction is achieved through a cancellation of part of the claims.

Debt service reduction, DSR: In the context of a concessional treatment, creditors may usually choose among a number of options to provide the required debt reduction in net present value. When the creditor chooses the "DSR" option, the net present value reduction is achieved through a rescheduling of the claims at an interest rate lower than the appropriate market rate.

Debt swaps: These operations may be debt for nature, debt for aid, debt for equity swaps or other local currency debt swaps. These swaps often involve the sale of the debt by the creditor government to an investor who in turn sells the debt to the debtor government in return for shares in a local company or for local currency to be used in projects in the country. Paris Club creditors and debtors regularly conduct a reporting to the Paris Club Secretariat of the debt swaps conducted.

Decision point: In the context of the Heavily Indebted Poor Countries (HIPC initiative), at the decision point, the Executive Boards of the IMF and World Bank formally decide on a country's eligibility, and the international community commits to provide sufficient assistance by the completion point for the country to achieve debt sustainability calculated at the decision point.

Deferral: A debt treatment may defer some debt due immediately or in the near future to a later date. When a new long-term payment profile is defined, the treatment applied is not a deferral, but a reprofiling or a rescheduling.

Effectively rescheduled portion: The portion of total payments covered by the rescheduling agreement that are rescheduled or otherwise deferred until after the end of the consolidation period.

Eligible debt : Debt that may be treated in the context of a Paris Club agreement.

Exit rescheduling : An exit treatment is the last rescheduling a country normally gets from the Paris Club. The aim is that the debtor country will not need any further rescheduling and will thus not come back for negotiation to the Paris Club.

Flow treatment: A standard Paris Club agreement provides a way of tiding a debtor country through temporary balance of payments difficulties during a given period of time. This is referred to as a flow treatment, as opposed to a stock treatment.

Goodwill clause: Refers to creditors' willingness as expressed in the Agreed Minute to meet to consider a further debt rescheduling in the future, subject to fulfillment t the debtor country of certain specified conditions.

Grace period and maturity: Paris Club Agreed Minutes specify the first and last payment dates, but do not refer to the length of the grace period or to the maturity, In this paper, grace periods and maturity on rescheduled current maturities are counted from the end of the consolidation period. In the case of the rescheduling of arrears and late interest on arrears, they are measured from the beginning of the consolidation period.

Initiative clause: The standard undertaking in the Agreed Minute that the debtor country will seek to restructure debts owed **to other creditors on terms comparable to those outlined in the Agreed Minute.** This clause appears as one of the general recommendations and reads:

In order to secure comparable treatment of public and private external creditors on their debts, the Delegation of (debtor country) stated that their Government will seek to secure from external creditors, including banks and suppliers, rescheduling or refinancing arrangements on terms comparable to those set forth in this Agreed Minute for credits of comparable maturity, making sure to avoid inequality between different categories of creditors.

Late interest: Interest that accrues on arrears. The late interest rate usually includes the original interest rate of the credits, plus a penalty.

Local currency clause: It refers to a provision in the Agreed Minute (normally in cases where private debt is rescheduled) whereby the debtor country undertakes to establish or extend the necessary mechanisms to ensure that debtors other than the Government can make into the central bank or other appropriate institutions the local currency counterpart payments corresponding on the due dates.

Moratorium interest, Interest on the consolidation: Interest rate applied on the rescheduling. The interest rate and the conditions applying to the claims of Paris Club creditor countries are defined in bilateral agreements.

Most-favored-nation clause: The standard undertaking in the Agreed Minute whereby the debtor country agrees not to accord to creditor countries that did not participate in the multilateral agreement repayment terms more favorable than those accorded to the participating creditor countries for the consolidation of debts of comparable term.

Multiyear rescheduling agreement (MYRA): Agreements that granted by official creditors, that cover consolidation periods of two or more years. They are implemented through a succession of shorter consolidations (serial reschedulings) that automatically come into effect after certain conditions are satisfied. To this effect, the Agreed Minute includes a “conditional further rescheduling” provision that sets forth the payments due in specified future periods, and the conditions for such a rescheduling to become effective without a further Paris Club meeting. The implementation of each stage requires only a decision by creditors that the relevant conditions have been met.

NPRD (Non previously rescheduled debt): Credits and loans with a maturity of more than one year, that have been concluded before the cutoff date and that have not been rescheduled pursuant to a previous Paris Club agreement.

Net Present Value: The net present value (NPV) of debt is a measure that takes into account the degree of concessionality. It is defined as the sum of all future debt-service obligations (interest and principal) on existing debt, discounted at the appropriate market rate. Whenever the interest rate on a loan is lower than the market rate, the resulting NPV of debt is smaller than its face value.

ODA credits, non ODA credits: "Official development assistance" ("ODA") credits are defined by the OECD as credits with a low interest rate and aimed at development.

Observers: Observers from international financial institutions or who are members of the Paris Club, but with no claims concerned by the debt treatment (de minimis creditors, creditors with only short term or post-cut off-date claims, etc.), may attend a negotiation session. They do not sign the Agreed Minutes, but are referred to in it.

Official creditor: This covers a) official bilateral creditors (governments or their appropriate institutions), including Paris Club members; b) multilateral creditors (international institutions such as the IMF, the World Bank or regional development banks).

PRD (Previously rescheduled debt): Credits and loans with a maturity of more than one year, that have been concluded before the cutoff date and that have been rescheduled pursuant to a previous Paris Club agreement.

Participating Creditor Countries: The creditor countries that sign an Agreed Minutes. They are members of the Paris Club or other official creditors.

Refinancing: Creditor countries may choose to apply the terms of a Paris Club agreement either through a refinancing (they make a new loan that is used to repay the existing debt) or though a change of the terms and conditions of the existing debt (rescheduling).

Reprofiling: In a Paris Club agreement, part of the debt may be reprofiled over a few years, instead of a long term period of time. The duration of a reprofiling is an intermediate between a deferral and a long term rescheduling.

Rescheduling: (i) Consolidation, change of the terms of debt payment obligations; (ii) when opposed to concessional treatment, non-concessional consolidation; (iii) when opposed to deferral or reprofiling, the part of a consolidation with the longer terms of repayment (iv) when opposed to refinancing, consolidation through a change of the terms and conditions of the existing debt.

Serial rescheduling: See “multiyear rescheduling agreement”

Special account: An account established under some Agreed Minutes by the debtor country with the central bank of a participating creditor country into which monthly deposits of an agreed amount are made. The total amount deposited usually approximates the amounts estimated to be payable to all participating creditors during the year; the debtor country draws on the account as bilateral implementing agreements are signed and specific payments under these agreements became due.

Stock: Sum of CRD (futures maturities of principal) and of arrears in principal and interest.

Stock treatment: As opposed to standard flow treatments, some Paris Club treatments apply not only to the payments falling due in a particular period of time, but to the whole stock of debt from which those payments fall due. The intention of any agreement which deals with the stock of debt in this way is to provide a country with a final treatment by the Paris Club called an exit rescheduling.

Terms of reference: When there are only a few creditors concerned in a debt treatment, the Paris Club agreement is not an Agreed Minute, but "terms of reference". The terms of the treatment are defined through an exchange of letters between the President of the Paris Club and the government of the debtor country.

Topping-up: In a subsequent debt reduction, granting more debt reduction on debt the Paris Club previously reduced to provide even further debt relief (e.g., when increasing the cancellation level from 33.33% of Toronto terms to 67% of Naples terms).

Transfer clause: A provision in the Agreed Minute that commits the debtor government to guarantee the immediate are unrestricted transfer of foreign exchange in all cases where the private sector pays the local currency counterpart for servicing its debt to Paris Club creditors.

ANNEX II: Standard Terms of Treatment[37]

Paris Club treatments are defined individually, by consensus of all creditor countries. Most treatments fall under the following pre-defined categories, listed below by increased degree of concessionality:

- "**Classic terms**" : standard treatment
- "**Houston terms**" : for highly-indebted lower-middle-income countries
- "**Naples terms**" : for highly-indebted poor countries
- "**Cologne terms**" : for countries eligible to the HIPC initiative.

Eligibility for the different terms is assessed on a case-by-case basis by Paris Club creditors, taking into account the track record of the debtor country with the Paris Club and the IMF and various criteria, notably per-capita income, level of indebtedness and of debt service. Any debtor country declared eligible for specific terms by Paris Club creditors may decline these terms in favour of a less concessional set of terms, notably if it considers them to have a negative impact for its creditworthiness.

Other terms had been defined in previous Paris Club treatments. Though they are no longer used, a part of the outstanding debt owed by debtor countries was treated according to these terms:

- "**Toronto terms**" (1988) 33% debt reduction for highly indebted poor countries. Replaced by "Naples terms." Flow deals only. ODA credits, were rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, with a 25-year repayment period including 14-year grace.
- "**London terms**"(1991) 50% debt reduction for highly indebted poor countries. Replaced by "Naples terms." Flow deals only. ODA credits, were rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, according to standard table "D" (30-year repayment period including 12-year grace and progressive repayment).
- "**Lyon terms**"(1996) 80% debt reduction for countries in the HIPC Initiative. Replaced by "Cologne terms." 2 stock deals. ODA credits were rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, according to standard table "D2" (40 years with 16-year grace and progressive repayment).

Classic Terms:

1. **History:** Classic terms are the standard terms applied to a debtor country coming to the Paris Club. As of today, 58 countries have benefited from the classic terms.
2. **Eligibility:** Any country which has an appropriate program with the IMF that shows the need for Paris Club debt relief may benefit from classic terms.

[37] Information compiled and edited from the Paris Club Website (www.clubdeparis.org) and from the World Economic and Social Survey 2005.

3. **Description:** Credits (whether ODA or non-ODA) are rescheduled at the appropriate market rate with a repayment profile negotiated on a case-by-case basis.

Cologne Terms:

1. **History:** In November 1999, the Paris Club creditor countries, accepted to raise the level of cancellation for the poorest countries up to 90% or more if necessary in the framework of the HIPC initiative. As of today, 28 countries have benefited from the Cologne terms.
2. **Eligibility:** To qualify for these terms, debtor countries must be eligible for Naples terms and: **(i)** have a sound track record with the Paris Club and continuing strong economic adjustment; **(ii)** have been declared eligible to the enhanced HIPC Initiative by the boards of the IMF and the World Bank.
   The level of debt cancellation required to achieve debt sustainability from each creditor is calculated by the international financial institutions based creditors' relative exposure in net present value terms of total external debt, as defined under the framework of the HIPC initiative. The Paris Club provides its share of the debt reduction needed to achieve debt sustainability on the understanding that all other creditors (public, private and multilateral) also make a consistent contribution to the common objective of debt sustainability.
3. **Description:**
   3.1. **Non-ODA** credits are cancelled up to a 90% level or more if necessary in the context of the HIPC initiative (including topping-up). The outstanding part is rescheduled at the appropriate market rate according to standard table "A1" (23 years with a 6-year grace and progressive repayment period).
   3.2. **ODA** credits are rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, according to standard table "D2" (40 years with 16-year grace and progressive repayment). This rescheduling results in a reduction of the net present value of the claims. The reduction in the NPV varies from one country to another, depending on the original interest rate of the claims. By contrast, the Paris Club rescheduling has a positive effect on the expected value of the ODA claims, as the creditors salvage value relative to the recovery of otherwise defaulted amounts.
   3.3. Cologne terms also include the possibility for creditor countries to conduct, on a bilateral and voluntary basis, **debt swaps** with the debtor country.
   These swap operations in principle may be carried out without limit on official development aid loans, and up to 20% of the outstanding stock of debt at a fixed date, or 15 up to 30 million SDR for non-ODA credits.
   3.4. Creditors may cancel their commercial claims up to a level higher than the one provided by the Paris Club agreements. Creditors will inform other creditors of an increased cancellation prior to such decision. It is understood that bilateral cancellations beyond multilateral treatment must benefit the debtor country.

Houston Terms:

1. **History:** In September 1990, Paris Club creditors agreed to implement a new treatment of the debt of the lower middle-income countries. This new treatment called " Houston terms " grant three substantial enhancements with respect to classic terms, that can be implemented on a case by case basis:
   - **Non-ODA** repayment periods are lengthened to or beyond 15 years and ODA repayment periods are lengthened up to 20 years with a maximum of 10-year grace;
   - **ODA** credits are rescheduled at a concessional rate;
   - **Debt swaps** can be conducted on a bilateral and voluntary basis.

   As of June 2007, 20 countries have benefited from the Houston terms.
2. **Eligibility: (i)** low level of income (GDP per capita smaller than $2995), **(ii)** high indebtedness (defined as reaching at least two of the following three criteria: debt to GDP higher than 50%, debt to exports higher than 275%, scheduled debt service over exports higher than 30%); **(iii)** have a stock of official bilateral debt of at least 150% of private debt.
3. **Description :**

   3.1. **Non-ODA** credits are rescheduled at the appropriate market rate over around 15 years with 2-3 years grace and progressive payments raising year by year. In the past, some Houston terms reschedulings were made over 15 years with 8 year grace and equal payments each year.

   3.2. **ODA** credits are rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, over 20 years with a maximum 10-year grace. This rescheduling usually results in a reduction of the net present value of the claims, as the original concessional rate is smaller than the appropriate market rate. The Paris Club rescheduling has a positive effect on the expected value of the ODA claims, as the creditors salvage value relative to the recovery of otherwise defaulted amounts.

   3.3. Houston terms also include the possibility for creditor countries to conduct, on a bilateral and voluntary basis, **debt swaps** with the debtor country. Debt swap operations may in principle be carried out without limit on official development assistance (ODA) loans, and up to 20% of the outstanding amount or 15-30 million SDR for non-ODA credits. Paris Club creditors and debtors regularly conduct a reporting to the Paris Club Secretariat of the debt swaps conducted.

Napples Terms:

1. **History:** In December, 1994, Paris Club creditors agreed to implement a new treatment on the debt of the poorest countries. These new terms, called "Naples terms", grant two substantial enhancements with respect to London terms, that can be implemented on a case by case basis, on the level of reduction and the conditions of treatment of the debt:
   - for the poorest and most indebted countries, the level of cancellation is at least 50% and can be raised to 67% of eligible non-ODA credits. Creditors

agreed in September 1999 that all Naples terms treatments would carry a 67% debt reduction;

- stock treatments may be implemented, on a case-by-case basis, for countries having established a satisfactory track record with both the Paris Club and IMF and for which there is sufficient confidence in their ability to respect the debt agreement.

As of today, 35 countries have benefited from Naples terms.

2. **Eligibility:** Eligibility for the Naples terms is assessed on a case-by-case basis, taking into account the track record of the debtor country with the Paris Club and the IMF and of various criteria, including having a high level of indebtedness, being only eligible for IDA financing from the World Bank, and having a low GDP-per-capita (755 $ or less).
3. **Description:**

3.1. **Non-ODA** credits are cancelled to a 67% level (after possible topping-up). Creditors may chose to implement the 67% debt reduction by one of the two following options:

- "**Debt Reduction Option**" ("DR"): 67% of the claims treated are cancelled (after possible topping-up), the outstanding part being rescheduled at the appropriate market rate according to standard table "A1" (23 years repayment period with a 6-year grace and progressive payments);
- "**Debt Service Reduction Option**" ("DSR"): the claims treated are rescheduled at a reduced interest rate according to standard table "A3" (33 years repayment period with progressive payments). In case of stock treatment, table A3 is replaced by standard table "A5".

Two other options were also designed, but have been very seldom used:

- the "**Capitalisation Of Moratorium Interest**" ("CMI") option, similar to the "DSR" option (with a reduction of 67% in net present value) but with slightly different repayment profiles;
- the "**Commercial Option**", with longer repayment profiles but no reduction of the claims in net present value. It was agreed that creditors would refrain from using this option to very exceptional circumstances.

3.2. **ODA credits**, are rescheduled at an interest rate at least as favourable as the original concessional interest rate applying to these loans, according to standard table "D2" (40 years with 16-year grace and progressive repayment). This rescheduling results in a reduction of the net present value of the claims, as the original concessional rate is smaller than the appropriate market rate. The reduction in the net present value varies from one country to another, depending on the original interest rate of the claims. By contrast, the Paris Club rescheduling has a positive effect on the expected value of the ODA claims, as the creditors salvage value relative to the recovery of otherwise defaulted amounts.

3.3. Naples terms also include the possibility for creditor countries to conduct, on a bilateral and voluntary basis, **debt swaps** with the debtor country.

These swap operations may in principle be carried out without limit on official development assistance loans (ODA), and up to 20% of the outstanding amount or 15 up to 30 million SDR for non-ODA credits.

Paris Club creditors and debtors regularly conduct a reporting to the Paris Club Secretariat of the debt swaps conducted.

The Evian Approach:

In October 2003, the G-7 finance ministers agreed to adopt a new initiative, termed the "Evian approach", providing more flexible debt restructuring through the Paris Club for non-HIPC and middle-income countries. The novelty of the approach was the introduction of a debt sustainability framework to provide an orderly, timely and predictable debt workout so as to reduce the occurrence and severity of financial crises. The negotiations are thus carried out on the basis of long-term debt sustainability analysis provided by IMF with specific attention being paid to evolution of debt ratios over time and the debtor's economic potential. The decision on sustainability rests ultimately with the creditors.

It is expected that the analysis will distinguish between liquidity problems and medium- and long-term debt problems. The former will be dealt with under existing arrangements with reductions in debt payments tailored to the debtors' financing requirements. When debtors have medium- and long-term problems that create questions of debt sustainability, a more comprehensive, country-specific treatment that encompasses coordination with private creditors and puts particular emphasis on comparability of treatment with private creditors will be applied. The treatment thus combines flow treatment and debt stock re-profiling or debt stock reduction. It is expected that the treatment will allow exit from the Paris Club and that comparability will be applied by private creditors. Where necessary, the cut-off date, which for many countries may be traced back to the early 1980s, will be moved forward to determine the debts eligible for restructuring. The approach retains the traditional links to IMF conditionality.

The comprehensive treatment of debt will consist of a three-stage negotiation procedure. In the first stage, a flow rescheduling will be provided under a Fund arrangement that could range from one to three years determined by the past performance of the debtor. The second stage will provide exit treatment, with exact terms and approach dependent upon the results of the debt sustainability analysis of the Fund. In the final stage, exit treatment could be provided in a phased manner over the span of a second Fund programme. The debtors progress and record of payment to the Paris Club would determine the final outcomes of these negotiations.

HIPC initiative and enhanced HIPC initiative:

The international financial community recognized in 1996 that the external debt situation for a number of low-income countries, mostly in Africa, had become extremely difficult and influenced the prospects for economic development. For these countries, even full use of traditional mechanisms of rescheduling and debt reduction (Naples terms) - together with continued provision of concessional financing and pursuit of sound economic policies - may not be sufficient to attain sustainable external debt levels within a reasonable period of time and without additional external support. A group of 41

countries in such a situation and potentially considered for the HIPC initiative was defined by the international financial institutions.

The HIPC Initiative entails coordinated action by the international financial community, including multilateral institutions, to reduce to sustainable levels the external debt burden of these countries. This assistance entails a reduction in the net present value (NPV) of the future claims on the indebted country. Such assistance helps to provide the incentive for investment and broaden domestic support for policy reforms. The HIPC Initiative was enhanced in September 1999.

Eligibility: A country must satisfy a set of criteria to be eligible for special assistance. Specifically, it must:

- be eligible only for concessional assistance from the IMF and World Bank ("IDA-only");
- face an unsustainable debt burden, beyond available debt-relief mechanisms such as Naples terms (where low-income countries can receive a reduction of eligible external debt of 67 percent in NPV terms);
- establish a track record of reform and sound policies through IMF- and World Bank-supported programs.

Participation of Paris Club creditors to the HIPC initiative:

- **Preleminary period.** To qualify for assistance, the country must adopt adjustment and reform programs supported by the IMF and the World Bank and pursue those programs for three years. During that time, it will continue to receive debt relief from Paris Club creditors and other official bilateral and private creditors, as well as traditional concessional assistance from all the relevant donors and multilateral institutions.
- **Decision point.** At the end of the first phase, a debt sustainability analysis is carried out to determine the current external debt situation of the country. In most cases if the external debt ratio for that country after traditional debt relief mechanisms is above 150 percent for the present value of debt to exports, it qualifies for assistance under the Initiative.
- **Completion point.** Remaining assistance, defined at the decision point, is provided at this point, through a reduction in the stock of eligible debt of up to 90 percent in present value terms by the Paris Club (or more if needed), subject to fair burden sharing, with at least comparable action by other creditors.

Many Paris Club creditors have announced that they will also provide debt forgiveness over and above HIPC Initiative assistance, particularly on ODA debt. HIPC Initiative - IMF and IDA annual report.

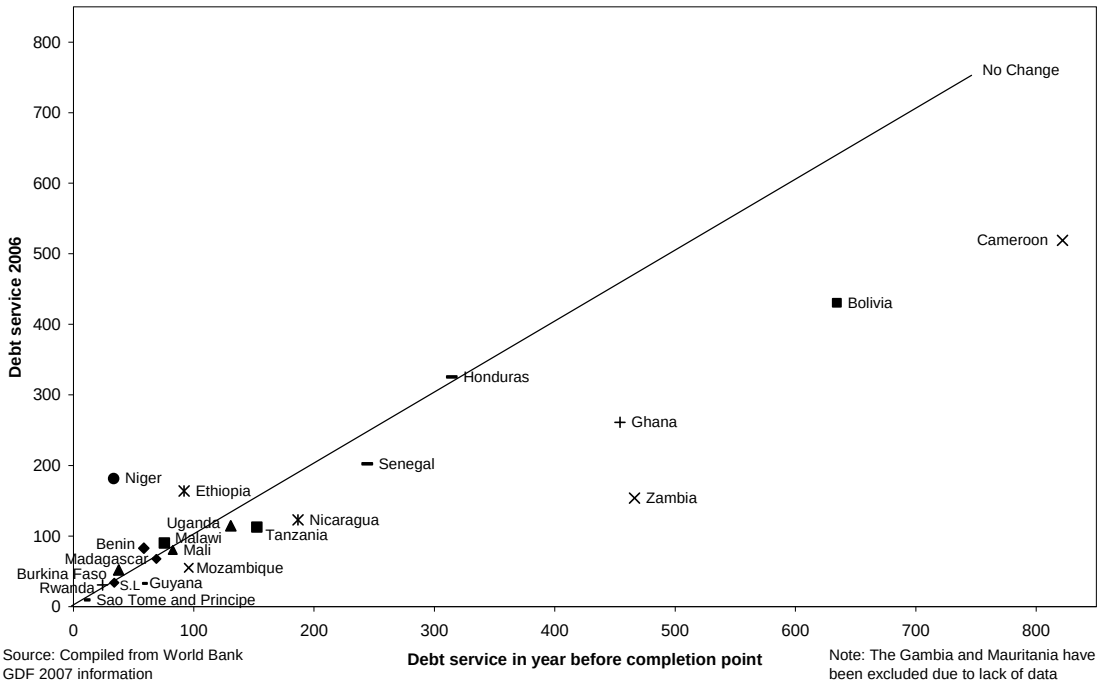
ANNEX III: Arrears and Nominal Debt Relief in the HIPC Countries

Arrears and Nominal Debt Relief in the HIPC Countries
(in US$ millions)

	Arrears in 1996 (HIPC Launch)	Completion Point	Nominal Debt Service Relief	Arrears in 2006
Benin	79.60	Apr-03	460	0.46
Bolivia	81.21	Jul-01	2060	…
Burkina Faso	47.97	Jun-02	930	78.90
Cameroon	1375.75	Jun-06	4917	647.09
Ethiopia	4782.99	May-04	3275	409.46
The Gambia	2.05	Jan-08	..	22.92
Ghana	33.53	Jul-04	3500	61.44
Guyana	179.96	Jan-04	1354	162.06
Honduras	245.09	May-05	1000	59.37
Madagascar	1758.53	Nov-04	1900	408.59
Malawi	20.19	Oct-06	1628	…
Mali	447.50	Mar-03	895	…
Mauritania	256.85	Jul-08	1100	352.88
Mozambique	1281.26	Nov-01	4300	1,276.32
Nicaragua	1470.88	Mar-04	4500	1,129.08
Niger	79.99	May-04	1190	102.23
Rwanda	74.12	May-05	1316	96.74
Sao Tome and Principe	28.79	May-07	263	80.36
Senegal	2.98	Jun-04	850	11.06
Sierra Leone	115.71	Jan-07	994	89.05
Tanzania	2515.72	Jan-02	3000	1,609.25
Uganda	279.73	Sep-00	1950	90.85
Rep. of Zambia	868.63	May-05	3900	488.23

ANNEX IV: Evolution of Debt Service for Countries that had reached completion point

Evolution of debt service for countries that had reached completion point (in US$ millions)



Source: Compiled from World Bank GDF 2007 information

Note: The Gambia and Mauritania have been excluded due to lack of data