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**THE EMERGING OF A MULTILATERAL FORUM
FOR DEBT RESTRUCTURING: THE PARIS CLUB**

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THE EMERGING OF A MULTILATERAL FORUM FOR DEBT RESTRUCTURING: THE PARIS CLUB

Enrique Cosio-Pascal

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THE EMERGING OF A MULTILATERAL FORUM FOR DEBT RESTRUCTURING: THE PARIS CLUB

Enrique Cosio-Pascal

Abstract

This paper describes the evolution of intergovernmental relationships on debt rescheduling. It starts describing some experiences that aroused in the 18th Century and which negotiations were carried out, in many occasions, with the help of gunboat diplomacy. The settlement of liabilities that were created at the aftermath of the two 20th Century World Wars, which were – at least for some countries – not exactly debt but war reparations, gave some insights in how to deal with these problems allowing the debtor country to find its own path to get out of the debt overhang. The settlement of these foreign liabilities may give some guidelines for dealing with debt restructuring in more general cases. The creation of the Paris Club – which is a very civilized way to settle debt defaults compared to gunboat diplomacy – is analyzed and described here: first its emergency as an ad hoc transitory institution and later its evolution toward its definitive establishment in the international financial system landscape. It is also suggested that for a combination of events, which included the launch in Evian of the G-8's so-called Evian Approach for the Paris Club, as well as the lack of support of some major industrialized countries to the implementation of a Sovereign Debt Restructuring Mechanism (SDRM), the Paris Club has become the only feasible international intergovernmental debt restructuring mechanism in spite of numerous shortcomings embodied in it. On this basis, some improvements of the actual mechanism are proposed, without precluding the possibility of the implementation of a more equilibrated SDRM in the future.

I. INTRODUCTION

Today, when the world's major government creditors seek to address the difficulties that individual governments of developing countries or economies in transition have in meeting their debt-servicing obligations to them, they usually work through the Paris Club. It is an informal forum, serviced by the French Treasury, at which the major creditors agree to take a common approach to restructuring the repayment schedules on each of the individual loans owed to each of the member countries' government agencies or offices, or sometimes they agree to reduce the amount of outstanding debt itself.

However, there are problems in this mechanism. Not all creditor governments are members of the Paris Club. It also excludes consideration of debts owed to the multilateral institutions, to commercial banks and other private creditors. Moreover, debtor countries express genuine concern about the effectiveness and lack of impartiality of the Paris Club, the heavy cost in terms of the time consumed in individual negotiations with many creditors, and the fact that

creditors can also apply pressure in bilateral reschedulings. Nevertheless, the Paris Club serves as the only specialized *intergovernmental* forum for debt restructuring of countries in debt crisis.

The major governments created the Paris Club in the 1950s at a time, which was marked by the post World War II environment, when most international lending was undertaken by or guaranteed by creditor governments or by official multilateral institutions. The International Monetary Fund (IMF) has played a central policy and financial oversight role in this structure, as well as major provider of additional financing, often coupled with new loans from the World Bank and regional development banks. IMF calculates the overall financing gap that debt relief needs to cover and the Paris Club establishes how to apportion among its member countries the relief it agrees to give. While informal, this is the first creditor-coordinated attempt to establish a comprehensive international framework for sovereign debt restructuring. Various ad hoc and selective measures had been used previously, including “gunboat diplomacy” in the nineteenth century. Compared to that, the Paris Club is a very civilized procedure!

As large-scale private lending resumed in the 1970s, Paris Club centrality could not last, although the Club has remained a crucial institution for those countries still heavily indebted to official bilateral creditors. However, with the introduction of the “Evian Approach” in 2003, the major creditor governments have sought to bring the Paris Club back towards the centre of international responsibility for sovereign debt workouts, including pressing for comparability of treatment by the private sector creditors.

This paper examines the emergence of the Paris Club and how its approach to debt workouts has evolved over time. It begins with a discussion of how sovereign debt crises were resolved beforehand and ends with recommendations to address certain outstanding issues involving the Paris Club in the twenty-first century.

II. THE EARLY DAYS OF SOVEREIGN DEBT RESTRUCTURING

Governments have raised funds by borrowing throughout history. Default on those obligations is also an ancient practice.¹ Mostly, the creditors were not other governments, although the governments of the creditors sometimes helped collect the debts for them. In particular, during the 19th and early 20th centuries, ad hoc associations of private holders of foreign government bonds customarily formed themselves for negotiating with debtor governments when payment difficulties arose. Occasionally the bondholders’ governments assisted, even employing “gunboat diplomacy” to enforce compliance with contractual obligations. The doctrine on which governments acted on behalf of private creditors in collecting payments on foreign sovereign debt was called “diplomatic protection”, the idea behind which is that governments may come to the aid of their citizens at their request, when they had not, or not

¹ The first known default is reported as taking place in the fourth century BC, “when 10 of 13 Greek city-states owing debts to the Delos Temple walked away from their contractual obligations” (see Birdsall and Williamson, 2002: 14). Through time, official obligors of varying origins defaulted. For example, in 1789 King Gustav III founded what later became the Swedish National Debt Office or Riksgäldskontoret, the oldest debt office in the world. He did so in order to circumvent the domestic rules, which did not allow him to borrow abroad. Its first task was to finance a war against Russia. By around 1810, 75 per cent of the central government debt had been borrowed abroad. As Sweden could not repay, in 1815 it decided unilaterally to write off most of its foreign currency debt.

fully, been paid.² The ultimate remedy was dispatching gunboats to collect on the debt, as by capturing and operating the debtor's customs house.³

Inefficiency and mismanagement of borrower governments were matched by the imprudent eagerness of private lenders. During the 19th century, such countries as Egypt, Greece, Mexico, Peru, Portugal and Turkey borrowed extremely large sums in the form of bond issues, leading to suspended payments and numerous defaults with corresponding settlements. Sometimes, litigation by the creditors ended in gunboat diplomacy, a primary example of which was the invasion and bombing of the Mexican harbour of Veracruz by gunboats of the United Kingdom, France and Spain on the 31st of October 1861, following the Mexican Government suspension of foreign debt service payments on the 17th of July 1861. The French carried the intervention in Mexico beyond the debt issue, imposing an Austrian prince, Maximilian of Hapsburg, as Mexican Emperor, followed this act of war. His reign was never uncontested and ended with his execution in 1867.

The treatment of the debts that triggered this punitive expedition and the French intervention is interesting. The defaulted Mexican bonds had been bought by foreign residents in Mexico and thus technically speaking these loans were domestic debt. However, when the Mexican Government was unable to repay, the foreign residents requested diplomatic protection from their embassies. The Mexican Congress acceded, as it delivered a special decree authorizing the Minister of Finance to negotiate with the diplomatic representatives to settle the foreign creditors' claims. The Congress by doing so implicitly delivered a "guarantee-of-repayment" to the creditors. Thus, the private claims were indirectly treated as though they were bilateral official debt. In this case, the request for diplomatic protection led to "gunboat diplomacy" which paved the road to the debt restructuring agreement (see De la Cruz, 2005).⁴ This notwithstanding, the debts – some £20 million – were never repaid (Suter and Stamm, 1992: 652n).

The precise content of debt rescheduling in the 19th century took various forms including: the consolidation and reduction of the face value of existing bond issues; refinancing at substantially lower rates of interest; and cancellation or capitalization of arrears. An interesting example of capitalization of interest in arrears took place after Mexico defaulted on a series of bonds on 1 October 1827, after a campaign that started in 1824 led to the expulsion of Spanish nationals who had been the owners of the majority of production and trade firms.⁵ This political expulsion decision led to a dramatic drop in government income that, in turn, led to the standstill in interest payments on the foreign currency bonds in 1827. In 1830, Mexico resumed servicing payments on the foreign debt, but there were £1.1 million

² See De la Cruz (2005: 319). However, some governments did not always give this policy an official status. For example, in January 1848, Great Britain's Chancellor, Lord Palmerston, issued an official communication stated that British diplomats would only be able to make "unofficial representations" on behalf of British investors in such cases, because British subjects that invested in lending to foreign governments instead in useful domestic British enterprises were imprudent and deserved the losses they were incurring (see Joaquín Casasús, 1885), "Historia de la Deuda Contraída en Londres con un Apéndice sobre el Estado Actual de la Hacienda Pública", México, Imprenta del Gobierno, as quoted by Bazant (1981: 69).

³ However, political pressure was not the usual practice. Suter and Stamm (1992: 656–657) count 20 cases of political and economic intervention to settle sovereign debt disputes from 1821 to 1975, out of 113 debt settlement cases; 15 of those interventions were in the period 1871–1925 and only one occurred after 1925.

⁴ See also Bazant (1981, chapter V). Other examples of the request for diplomatic protection, in particular, by French and British creditors of Turkey and Egypt, can be found in Buljevich (2005: 5–6).

⁵ See Bazant (1981, chapter III). It is worth recalling that Mexico obtained its independence from Spain in 1821, after a war that lasted 11 years.

in interest arrears outstanding. This amount was impossible to pay in one instalment. In order to overcome this problem, Mexico negotiated to issue bonds bearing a face value of £1.6 million, which were swapped against the claims on the interest in arrears outstanding.⁶ However, the agreement had a very unusual feature: an effective five-year grace period on interest. That is, the bonds were actually only issued on 1 April 1836, and did not accrue any interest in the meantime. Discounting five years of unpaid interest, the present value of the bonds in 1831 was actually about £1.2 million (see Bazant, 1981).⁷

Other interesting restructurings included the bonds that Portugal defaulted on in 1902. They were converted at half to three-quarters of their nominal value and were repayable in 99 years at an annual interest rate of 3 per cent. In 1947, a settlement involving Peru included the cancellation of interest arrears, creating a new maturity period of 50 years and a sliding scale of interest between 1 to 2.5 per cent (Wynne, 2002: 377–379).

The use of force for arriving at a workout from government debt crises also went through a certain questioning, as part of a more general rethinking of legitimate reasons for war. That is, as the 19th century ended, governments increasingly began to look for other ways than wars to settle disputes and thus in 1899 and 1907, two intergovernmental conferences took place at The Hague on the rules and regulations of war and on the pacific settlement of international disputes. During the second Conference in 1907, there was an agreement to limit the employment of force for the recovery of defaulted sovereign debts, although the eschewing of force was conditional on the debtor government participating in a cooperative way in an international arbitration process.⁸

Unfortunately, the efforts to settle international disputes non-violently were a total failure, as only seven years after this conference was held, World War I devastated Europe. And, from the moment when war ended on the various battlefronts in Europe in 1918, the reparation and inter-Allied debt question commanded the attention of the world. With the onset of the world economic depression in the late 1920s and early 1930s, coupled with the reparation payments by the vanquished and repayments of inter-Allied debts, the economic life alike of the debtor and creditor countries was profoundly affected.

Indeed, the global economic crisis radically changed the international approach to sovereign debt problems. The focus was on two fundamental questions. One was on whether a complete write-off of all reparation and inter-Allied war debt would retard or promote world economic recovery; the other question was on the benefit that the collection of these intergovernmental debts would bring to the creditor countries, if any.⁹ These were questions of the macroeconomic impact of debt servicing on the debtors and, by feedback, on the creditors. These questions were addressing the necessity to overcome a world debt overhang originated by reparations and war debts that came to impose unacceptable burdens especially by the 1920s–1930s when the depression set in. The questions, in other words, was at what point was

⁶ There were two bond issues involved. For the sake of simplicity, only the average outcome is presented here. For the details see Bazant (1981: 46–49). This was an excellent deal for the investors as other Mexican bond issues were trading at around 30 per cent of their face value in the London market at that time. See also a detailed exposition of these historical facts related to Mexico in Reyes Vayssade (2005).

⁷ The agreement was signed on 1 April 1831. As the average interest rate was 5.5 per cent, the present value of the bonds at the date of signature in 1831 was £1.22 million.

⁸ The text of the agreement may be found on the website of the Avalon Project at the Yale Law School: the Laws of War at <http://www.yale.edu/lawweb/avalon/lawofwar/hague072.htm>. See also the agreement on the arbitration process in the “Convention for the Pacific Settlement of International Disputes” at <http://www.yale.edu/lawweb/avalon/lawofwar/pacific.htm>.

⁹ See Moulton and Pasvolsky, (1932: chapter I, in particular page 5).

it more appropriate for the well-being of the international community to write-off the debts rather than collect them, or how long a breathing space did the debtors need before resuming total, partial, or any payments at all?

In this context, it is instructive to recall the war reparations imposed on Germany as a result of World War I. The reparations imposed financial payment obligations that, while not loan repayments, required financial transfers like loans. At first, difficulties in meeting the obligations were addressed through new international credit to Germany. Later attempts at settlement shifted the focus from what Germany should pay to what she could pay: reduction in scheduled payments by Germany, and even their temporary suspension, was provided for, in addition to the possibility of subsequently resuming payments.

The renegotiation of loans extended by the United States Government to its allies during World War I also deserves mention. The terms were adjusted when the initial conditions laid down by the US Congress were believed to be beyond the debtor countries' capacity to fulfil. That is, it was appreciated that if no debt relief was granted, international economic conditions would continue to deteriorate. Thus, for example, the settlement with the United Kingdom provided for repayment over a period of 62 years as opposed to 25, and an interest rate of 3 per cent per annum for the first 10 years and 3.5 per cent for the remaining 52 years, rather than original rate of 4.5 per cent over 25 years.

III. WORLD WAR II AFTERMATH AND SUBSEQUENT MAJOR DEVELOPMENTS

After the end of the Second World War, a number of sovereign debt restructuring agreements were reached that took account of the debtor government's perspective *and its ability to repay debt and still maintain economic growth*. First, the Anglo-American Financial Agreement of 1946 accorded the British options to postpone payments in response to given conditions. In 1956, certain conditions in the original repayment agreement were found to be ambiguous and likely unworkable due to changed conditions, so the agreement was amended to allow the United Kingdom, at her own option, to postpone payment of a number of principal and interest instalments. This amendment became known as the "bisque clause".

Another important milestone in the history of international debt agreements is the Multilateral London Conference on the German External Debt of 1953.¹⁰ This Conference resulted in an agreement to settle all the pre-war external debt owed by German public and private debtors and large sums owed for various forms of official post-war economic aid. The face value of the debt was decreased to around one third of its nominal value and was to be paid over 35 years with interest at a rate of 2.5 per cent per annum. This agreement took into account the repayment capacity of Germany's economy, which at the time still had uncertain prospects. The settlement concerned only West Germany.

1. Birth of the Paris Club

The economic rehabilitation of the major industrialized countries after the war was followed by the resumption of private foreign lending, albeit mainly as bank loans instead of bonds, as the depression and war had seriously disrupted the international securities markets. The loans were, moreover, primarily associated with export credits that were insured for risk of loss by the governments of the exporters. Also, as a result of the independence of a large number of

¹⁰ See Cizauscas (1979), and for a detailed analysis of the agreement and its implications (Hersel, 2002; Guinnane, 2004).

former colonies, the introduction of development aid targets and competition with the Soviet bloc during the Cold War, the governments of western developed economies directly extended large amounts of public credits to developing countries. In this environment and after applying expansionary policies and, to some extent, engaging in excessive commercial borrowing, several Latin American countries started to face debt payment problems by the mid-1950s.

In 1956, as a result, some European countries met in Paris, under the chairmanship of the French Treasury to restore orderly payments relations with Argentina.¹¹ This meeting dealt with the renegotiation of supplier and buyer credits, which had become creditor country government claims through the export credit insurance process, and bilateral government-to-government loans. This group came to be known as the “Paris Club” due to the meeting venue.

Rescheduling agreements, similar to the one for Argentina, took place between 1956 and 1966 for Brazil and Chile. It must be noted that the debt relief extended by the Paris Club in its early years could be characterized as the minimum short-term debt relief required. More favoured treatment was not considered because of what was viewed as mismanagement of the debtor countries’ economies. Long-term considerations were considered irrelevant. The point was to give the country enough time to be able to fully resume servicing the debt, the Paris Club being responsible to the member countries’ export-credit agencies and their treasuries, not the national development assistance agencies. As a result, two of the three countries, Argentina and Brazil attended the Paris Club five times altogether between 1956 and 1965.¹²

The short-term approach usually applied by the early Paris Club not only differed from the previous post-war settlements noted earlier, but also from certain politically sensitive cases treated in the 1960s. There were at least two of them: Turkey and Indonesia, the latter being a marked contrast to the simultaneous case of Ghana.

2. Early examples of politically sensitive cases: Turkey

Turkey experienced a rapid increase in external debt levels during the early post-war years due to expansionist policies. Severe debt servicing difficulties followed. However, since Turkey was a member of the Organization for European Economic Cooperation (OEEC), Western countries continued to extend, through their official export credit insurance agencies, large amounts of essentially short-term credits, even when serious foreign debt payment difficulties became apparent. The OEEC also convened a debt conference for Turkey where a rescheduling of the country’s commercial debt was obtained. In 1959, a multilateral agreement was reached that is notable because it included uninsured supplier and buyer credits, mostly involving United States firms,¹³ and terms more generous than those extended

¹¹ The countries were Austria, Belgium, Denmark, France, Italy, Norway, the Netherlands, Sweden, Switzerland and the United Kingdom. Austria, Belgium, Denmark, Norway, Sweden and Switzerland did not reschedule because of the minor amounts of their claims, thereby introducing the “*de minimis*” clause into what became the Paris Club. In August 1957, the original Paris Club countries, minus France plus Germany, met in Rome in order to agree on Germany’s admission to the Club. The condition for Germany to join was its acceptance of the debt funding arrangements for Argentina agreed to by the other members of the Paris Club in May 1956 (see *The Review of the River Plate*, 11 August 1982: 134). The United States and Japan joined the Club later. Presently, any interested creditor government might be part of the Club for specific meetings.

¹² Argentina: 1956, 1962 and 1965; Brazil: 1962 and 1964.

¹³ Rescheduling required complicated negotiations between the Government of the United States and over 100 private firms.

by the Paris Club up to that time. It also associated debt rescheduling with balance-of-payments loans by members of the OEEC and the United States.

In spite of this generous and unusual rescheduling agreement, Turkey continued to experience external debt payment difficulties. In 1962, the Organization for Economic Cooperation and Development (OECD), successor to OEEC, set up the Consortium for Turkey which, in 1965, arranged to extend relief on payments due to member countries, including some debt previously rescheduled under the 1959 agreement. Some of the members chose to extend balance-of-payments loans instead of direct debt relief.

Turkey's second multilateral debt rescheduling is notable because of several particularities: first, the rescheduling of previously rescheduled debt; second, the non-uniform terms extended by the creditors;¹⁴ and last but not least, the explicit recognition that balance-of-payments support loans are as efficient as debt relief in terms of the net resource transfer. All of the ingredients in Turkey's rescheduling exercise showed the association of debt rescheduling and official aid, which the Paris Club itself explicitly avoided until the mid-1990s when the Initiative for the Heavily Indebted Poor Countries (HIPC) was adopted, which we discuss later. Turkey's strategic military importance to NATO, without any doubt, was an important reason for those favourable treatments.

3. Indonesia versus Ghana

Indonesia and Ghana went into a debt rescheduling negotiation process that followed the overthrow of their two heads of State, Sukarno of Indonesia and Nkrumah of Ghana, at the same time. However, the origin of external indebtedness was different. In Indonesia's case it was military debt, and in Ghana's case it was the drop of the international price of cocoa, a principal export commodity, that triggered the external debt payments crisis.

The Indonesian case was complicated because more than half of her debt was owed to non-Paris Club official creditors, i.e. to the socialist bloc and in particular to the Soviet Union for military loans.¹⁵ An outsider, Dr. Hermann Abs, a prominent German banker who was the principal negotiator at the London Conference in 1953 on behalf of the Federal Republic of Germany, was called in to undertake a comprehensive study of Indonesia's balance-of-payments prospects with a view to developing a long-term solution to what was called the "Sukarno debt" and included loans owed to socialist countries. This assessment would be based on the Indonesian capacity to repay.

Dr. Abs' international reputation and objectivity allowed him to put forward a proposal that, with modifications by the creditors, was accepted by the Paris Club. The Indonesian debt, including concessional loans and previously rescheduled debt, was consolidated over 30 years. Bleak prospects for the Indonesian economy led to the addition of a *bisque* clause, similar to the one in the Anglo-American agreement, which allowed Indonesia to defer at her option up to one-half of the principal payments due during the early years of the rescheduling agreement. The deferred payments were to be repaid, at a 4 per cent rate of interest, during the

¹⁴ However, the different terms extended by the creditors were subject to review by the Consortium. This arrangement was unique and not repeated until approval of the Cologne Terms for the poorest countries in November 1999 (see below).

¹⁵ These debts were rescheduled on "essentially the same (and, indeed, in certain respects, slightly more liberal) terms" than the Paris Club debt (see Cizauskas, 1979: 204).

final years of the agreement. Indonesia availed herself fully of this arrangement, which has not since been granted to any other country.¹⁶

Ghana's case was quite different. The Paris Club provided only partial and short-term relief. Ghana could not understand nor accept the difference in treatment between her and Indonesia, since both reschedulings took place at practically the same time and involved the same creditors. Once irregularities were discovered in many supplier contracts, whose payments had been rescheduled at essentially commercial rates, Ghana complained and eventually repudiated all previous repayments arrangements. This situation created extremely long negotiations that finally ended in a settlement in 1974. The agreed terms were repayment over 18 years after a 10-year grace period at a 2.5 per cent interest rate.

Finally, the terms were reasonably consistent with Ghana's capacity to repay but, like most debt rescheduling negotiation processes, had a very high price in terms of the time, resources and good will of both creditors and debtor. This was due to the limited nature of the previous agreements. Possibly the main reason for the difference in treatment between Indonesia and Ghana, by the same creditors within virtually the same period, was the absence of any political motivation for the creditors to view the Ghanaian debt rescheduling as requiring anything more than the typical Paris Club arrangements. These experiences, including Turkey's, illustrate the importance of the political ingredient in the Paris Club rescheduling terms.

4. Involvement of international organizations

By 1961, the staffs of the World Bank and the IMF were being invited to attend the Paris Club meetings as observers and were increasingly being asked to supply information and technical advice. Much later, in 1978, the United Nations Conference on Trade and Development (UNCTAD) started to attend the Paris Club meetings as an observer and began to present the creditors with an analysis of the debtor situation taking into account medium and long-term economic development perspectives.¹⁷ The contributions of these three institutions often went beyond these services, as they would provide unofficial suggestions helpful for both debtors and creditors.

¹⁶ A *bisque* clause was included implicitly in the Mexican agreement of 1986. The Mexican Government was allowed to defer payments if the oil prices decreased below an agreed floor. The price-floor was negotiated and included in the Mexican agreement with the IMF, and was applicable to private as well as bilateral creditors. However, the price-floor was so low that the *bisque* clause was never triggered.

¹⁷ In 1975, UNCTAD's inter-sessional oversight body, the Trade and Development Board (TDB), endorsed a recommendation of an UNCTAD Ad hoc Group of Governmental Experts that UNCTAD "be invited to participate in the multilateral debt negotiations on the same basis as the representatives of other international organizations" (TDB resolution 132 (XV), paragraph 8). The intention was that UNCTAD – formally in the capacity of observer – help the debtor countries present their case to the creditors. However, the resolution did not specify which negotiations and the Paris Club did not volunteer to invite UNCTAD. Finally, in March 1978, the TDB adopted resolution 165 S-IX, which said that sovereign debt problems should be addressed in "an appropriate multilateral framework consisting of interested parties" (paragraph 10-b). This was understood to be an implicit reference to the Paris Club as the only "appropriate multilateral framework", and opened the door to UNCTAD participation based on TDB resolution 132 (XV). The first country to make use of this resolution was Peru in November 1978, although the Paris Club Secretariat was not aware of the resolution and the UNCTAD delegation was not allowed into the negotiation room. This misunderstanding was cleared up and since 1979, UNCTAD has attended practically all Paris Club meetings that involved developing countries or economies in transition.

The Paris Club normally requires the debtor country to adopt a stabilization programme approved and monitored by the IMF, typically in the form of a Stand-by Arrangement. This procedure relieves the creditors of the need to impose and monitor economic policies in debtor countries. In the Paris Club member countries' view, this requirement allows for impartial monitoring of the debtor country's economic performance, and thus the monitoring of progress in the recovery of its debt repayment capacity.¹⁸

5. More special cases

A few debtor countries have attended the Paris Club without a prior agreement with the IMF. One was Chile, in 1972, under the presidency of Salvador Allende and another was Cuba, which did not belong to the Bretton Woods institutions in 1982 and 1984. Other countries that did not belong to the Bretton Woods Institutions at the time also went before the Paris Club and reached an agreement, including Poland in 1981 and 1984, Mozambique in 1984, and Angola in 1989.

In the Chilean case, Chile's refusal to create a link between debt relief and an agreement with the IMF was resolved when she agreed to issue a unilateral declaration of intent with implications for economic policy comparable to those normally included in the IMF's Stand-by Arrangements. Another issue, subsequently resolved during the Pinochet regime, was the refusal of the Chilean Government to recognize the obligations arising from nationalizations as debt. The terms Chile obtained in the renegotiation were typical Paris Club arrangements, which were followed by two additional rounds of debt relief shortly thereafter. These latter renegotiations, in which some European members of the Paris Club refused to participate, had a highly political flavour because of the then-recent overthrow of the Allende regime.

In the Cuban case, the non-membership of Cuba in the Bretton Woods institutions and thus the absence of an agreement with the IMF, were solved by the creation of a task force composed of representatives of selected creditor countries that went to Havana in 1982 to assess the Cuban economic situation and its declaration of intent. For this occasion, UNCTAD was called on to draft an Economic Memorandum describing Cuban economic policies and prospects for the information of the international community in general and of the creditors in particular. UNCTAD was invited to Havana at the same time as the creditors in order to carry out this task. As in the case of Chile, the issue of compensation for nationalizations of property of nationals of the United States existed in the case of Cuba. However, the creditor countries managed for this country to stay away from the negotiations room in Paris.¹⁹ The debt concerned in this negotiation was the debt owed to Western

¹⁸ However, the debtors have challenged the impartiality of the World Bank and the IMF on many occasions by arguing that these two institutions are creditors themselves.

¹⁹ The Cuban rescheduling was diplomatically made "outside the Paris Club", because of the very sensitive issue of the US claim that the Castro regime expropriations created additional foreign debt. The meetings were thus held in Paris, if not at the Paris Club, and without the United States delegation, but they still followed the Paris Club principles, rules and procedures. One consequence is that the Cuban "Paris Club" meetings are not cited by the Paris Club Secretariat and are not included in the Paris Club website.

countries and Japan in convertible currency having its origin in export credits insured by the creditor countries.²⁰ The terms obtained were in line with standard Paris Club arrangements.

IV. PARIS CLUB MECHANISMS AND PARTICULARITIES

Frequently, as noted earlier, the rescheduling terms the Paris Club granted were deliberately extended on a “short leash” basis, with the aim of facilitating monitoring of the debtor’s economic performance and helping to determine whether additional debt relief might need to be provided in the future. The possibility of an extension, known as the “Good Will Clause”, came to be included in the Paris Club “Agreed Minute”, the negotiated outcome of a Paris Club meeting on a country’s debt problem (see below). In principle, the clause allowed the debtor country to request further debt relief in the future. Paradoxically, this “Good Will Clause” is implicit recognition by the creditors that the debt relief granted might prove inadequate.

Nevertheless, as was seen above, several debt reschedulings even before the widespread debt crises of the 1980s were ultimately concessional and took into account the capacity of the debtor to repay. In all cases, however, the agreements were reached after a lengthy and difficult negotiation process. It is important to point out that the cost in time, resources and effort, for both creditors and debtors, was higher than it needed to be in most cases.

1. A “Code of Conduct” for the 1980s

That the government creditors had become the sole decision makers over what kinds of debt relief treatments were accorded to different developing countries did not go unnoticed. In the mid-1970s at the “North-South Conference” in Paris that had been prompted by the 1974 call for a New International Economic Order (NIEO) at the United Nations, itself following the successful price increases of the Organization of the Petroleum Exporting Countries (OPEC), a proposal to create a set of international guidelines for handling external debt negotiations was discussed. No agreement was reached at this conference on this item (or virtually any other). Negotiations on prospective debt guidelines, however, continued under the aegis of UNCTAD.²¹

²⁰ The economic boycott established by the United States on Cuba precluded provision of any export credit by United States residents to this country. Thus, the United States had no export credits that needed to be covered by the negotiation, whereas the other Western countries and Japan did. This fact also explains why these creditor countries were eager to leave aside the United States and go ahead with the negotiation with Cuba. Chile and Cuba have not been the only countries that managed to leave aside the question of nationalization compensation: Peru in 1968 and 1970 did the same thing as well (see Cizauscas, 1979: 207).

²¹ UNCTAD’s Ad hoc Group of Governmental Experts, mentioned in an earlier footnote, had identified a set of “common elements” that the TDB recommended creditors should consider (TDB resolution 132 (XV), para. 2). Following up on that, the Fourth UNCTAD Conference in May 1976 requested the UNCTAD Secretary-General to convene a new Ad Hoc Intergovernmental Group of Experts on Debt and Development Problems of Interested Developing Countries, in particular to carry forward the incipient work on a code of conduct.

Developed and developing countries reached an agreement on the first draft of the guidelines in March 1978.²² The 1978 draft was refined and the guidelines were finally adopted in September 1980.²³ The UNCTAD Secretariat was requested to report to the Trade and Development Board (TDB) on their implementation, which the Secretariat does each time the TDB requests it.²⁴ It is noteworthy to say that these are the only guidelines on foreign debt rescheduling ever agreed upon by debtor and creditor governments in an international forum through consensus. Michel Camdessus, who at the time was Chairman of the Paris Club, interpreted the guidelines as establishing the international legitimacy of the Paris Club within the international financial architecture.²⁵

The guidelines were drafted in the spirit of a “Code of Conduct” for debtors and creditors. The guidelines are very broad as to the nature of debt and of economic symptoms that might lead to a request, which can only be on the initiative of the debtor country, to reschedule debt service payments. The OECD countries have claimed that the guidelines are applicable only for bilateral debt because there was no representative from the private financial sector in attendance at the TDB when it adopted Resolution 222 (XXI). Thus, the private financial sector would not be bound by the agreement. Nevertheless, the guidelines consider the external debt problem in general, and do not differentiate official from private debt sources.

2. Paris Club’s principles

Meanwhile, the Paris Club member governments agreed among themselves to operate under a set of principles to guide their consideration of country cases: **case-by-case** treatment of debtor countries; **consensus** decision-making by the members of the Paris Club; **conditionality** entailed in implementation of an economic adjustment programme put in place by each debtor country; **solidarity** among Paris Club members via the implementation of the Agreed Minute; and request that the debtor country seek **comparability** of treatment for similar debts by creditors that do not belong to the Paris Club.

The principles emerged from the practice in the Club, which became increasingly routine, as the Club met more and more frequently, especially once the 1980s debt crisis emerged. Today, the country representatives meet on a monthly basis in Paris, not only for scheduling negotiation sessions, but also for methodological matters including technical and political issues. Both the frequency of meetings and the diversity of subjects covered have created a

²² The Group met several times from 1976 to 1978, leading to an important consensus resolution of the UNCTAD Trade and Development Board in March 1978 (165 (S-IX)). OECD countries made substantial concessions on debt relief (Part A of the Resolution), but resisted the formal introduction of a debt restructuring mechanism (Part B of the Resolution). It also implicitly introduced the Paris Club as the “appropriate multilateral framework” for international consideration of debt problems of developing countries, as noted earlier. Part A of the resolution contained an agreement on “retroactive terms adjustment” on aid for a group of 30 least developed countries (i.e. repayment obligations on outstanding aid loans were changed to the easier terms that donors were now offering these countries). Some OECD countries that had decided to give aid exclusively as grants implemented this resolution by cancelling old debts, making this a precursor of the HIPC Initiative.

²³ The debate ended in September 1980 when TDB Resolution 222 (XXI) was adopted by consensus. Part B of the resolution contains the “Detailed Features for Future Operations Relating to the Debt Problems of Interested Developing Countries”. The Resolution was adopted without dissent, albeit with France abstaining to emphasize its strict neutrality, being host of the debt renegotiations, as this time the resolution made explicit reference to the Paris Club as the recognized multilateral forum for bilateral debt rescheduling. The text can be found in UNCTAD (1986: 139–140).

²⁴ See for instance UNCTAD (1989a).

²⁵ See Camdessus (1984).

kind of Paris Club *modus operandi* in which the country representatives know each other quite well.²⁶

Another particularity of the Paris Club is its **asymmetry**. In other words, the **solidarity** and **comparability** are among the creditors, but not among the debtors. This is because the Paris Club is a cartel of creditor countries. There is no cartel of debtor countries. The only attempt to create one was the “Consenso de Cartagena” in the late 1980s, under the initiative of 11 Latin American governments, in particular Uruguay and her Chancellor at the time, Enrique Iglesias. The whole effort was in vain because the larger countries of the group did not share their negotiation leverage with the rest. On the contrary, they behaved as “lone rangers”, on the expectation that they would obtain a better deal working alone than if they had participated in the negotiation as part of a cartel.

3. *The Paris Club Agreed Minute*

The term “Agreed Minute” can indicate either a written report of a discussion held at a conference or meeting, or the agreement reached by the parties attending the conference or the meeting. The Paris Club Agreed Minute indisputably belongs to the second category. It stipulates the overall terms that the creditors will accord, although it is only the first step for the debtor, who must then renegotiate the specific terms of all the loans covered by the agreement, country by country, in a series of bilateral negotiations.

The Agreed Minute might have been given the status of an international treaty subject to international laws in the Vienna Convention sense.²⁷ However, the Paris Club creditor countries themselves do not consider the Agreed Minute as legally binding. This position comes from a pragmatic approach taken by the creditor countries, i.e. it gives flexibility to each creditor to determine the technicalities of the rescheduling. Another reason is that it eliminates the risk of legal suits by the debtor countries as well as needing to have the Agreed Minute ratified by the creditor countries’ parliaments. The Agreed Minute is confidential in nature and is kept as such by the creditor countries’ governments.²⁸

The Agreed Minute is signed in a relatively short period of time usually after only 1 or 2 days of negotiations. The national delegations have full authority to sign the Agreed Minute as long as it is within the guidelines provided by their respective capitals. In general, the head of the delegation from a creditor country is a senior officer from the Ministry of Finance.²⁹

Debtor countries accord high importance to the Agreed Minute, as it guides the bilateral negotiations that follow that result in legal agreements to alter the debt contracts. The authority of the representatives that the debtor countries send to the meetings demonstrates

²⁶ There are 19 permanent members at the Paris Club: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, United Kingdom and United States. Other creditors that have participated in specific meetings include: Abu Dhabi, Argentina, Brazil, Israel, Republic of Korea, Kuwait, Mexico, Morocco, New Zealand, Portugal, South Africa, Trinidad and Tobago and Turkey.

²⁷ See Holmgren (1998: 217).

²⁸ There are certain exceptions, like the United States, which publishes the bilateral agreement once it is reached and thus the elements of the Agreed Minute. Presently, there is also a summary of the rescheduling outcome on the Paris Club web site, but not of the full Agreed Minute which continues to be considered as a confidential document.

²⁹ With some exceptions like the United States, whose delegation is headed by a State Department officer and seconded by Treasury Department and Eximbank officers.

how important they are regarded. In most of the cases, the head of the debtor country delegation is the Minister of Finance.

However, the drafting of the Agreed Minute is solely the creditor countries' responsibility. The debtor country is shown an already-drafted Agreed Minute as a first proposal and there is no possibility to change it in spirit or structure. Negotiations would concern the financial terms but not the structure, clauses or interpretation of the Agreed Minute. And finally, the creditor countries' interpretation prevails as long as the head of the debtor country's delegation signs, and thus ratifies, the Agreed Minute.

More precisely, during the negotiations at the Paris Club, the debtor country does not discuss the terms of relief directly with the creditors. After the initial plenary meeting in which the country and the international organizations deliver their statements, and the creditors' questions are answered by them, the debtor country and the observers, with the exception of the IMF, are asked to leave the plenary meeting room. The debtor country delegation is assigned a room within the building. The creditor countries negotiate among themselves their first proposal to the debtor, which should be obtained by consensus. At this point, the Chairman of the Paris Club goes alone to meet the debtor country's delegation at the room it has been assigned to present the proposal. The debtor country studies the proposal and discusses it with the Chairman and eventually proposes modifications. The Chairman conveys the debtor country's comments and proposals for modifications to the creditors. The debtor country's delegation never argues directly with the creditor countries' delegations. All the communications are made through the Chairman, who goes from one group in one room to the other group in the other room as long as the negotiation continues.

The binding nature of the Agreed Minute has more of a "moral" and "good faith" nature than a legal one. In this sense, it is a "gentlemen's agreement", because it is based on the honour, engagement and good faith of all parties concerned, especially the creditor parties. Not only do the creditor countries have a high degree of confidence in each other owing to the familiarity from frequent meetings, but they have a mutual interest in avoiding that some creditors receive disproportionately more repayment of loans than others. This causes them to fully respect the commitments taken through the Agreed Minute. In the same way, the creditor countries follow the agreed principles so as to avoid risking exclusion from the Club.

Creditor countries show less confidence in the debtor country. This is seen in the fact that the debtor country has to implement verifiable conditionality that shows that it will abide by its engagements. Indeed, the engagements in the Agreed Minute are sometimes of a difficult nature, such as stringent IMF adjustment measures or the application of the comparability clause to possibly recalcitrant private creditors. Delivering on these engagements is the debtor country's responsibility. Thus, mechanisms of monitoring and surveillance are important parts of the agreement. However, the agreement also contains elements of good faith between the creditors and the debtor country, such as in the "good will" clause, which as noted above leaves open the possibility of further debt relief in future assuming the debtor fulfils its engagements vis-à-vis the Paris Club and the international financial institutions in good faith. An element of good faith can also be found in the comparability clause, which trusts the debtor to negotiate relief with third-party creditors that do not belong to the Paris Club, so as not to accord them seniority to Paris Club creditors as regards repayment terms.

V. PARIS CLUB OPERATIONS IN THE 1980s AND 1990s

While the global financial threats that accompanied the 1980s debt crisis mainly had to do with the consequences for the international banks that had over lent, middle-income countries in debt crisis – including some in the socialist bloc as well as many developing countries – also sought relief from their official creditors, as did low-income borrowers without significant commercial bank debt. Until late in the decade, there was no write down of commercial bank debt or of Paris Club debt. Both types of creditors, working with the IMF, offered “short leash” reschedulings, which had to be regularly repeated. However, the crisis converted the Paris Club from an occasional forum that met on ad hoc cases into an unavoidable figure in the international financial landscape, impossible to circumvent by countries that, encountering debt service difficulties, tried to find their way to normalized payments. By the late 1980s, moreover, the financial terms of Paris Club debt operations became important enough for decision by the heads of State of the major industrialized countries at their annual summit meetings.

1. The 1980s debt crisis and its relevance for the Paris Club

The debt problems of the 1980s affected all types of developing countries and all types of debt. The amount of outstanding public medium- and long-term debt held by developing countries rose from about US\$270 billion in 1977 to US\$470 billion in 1981.³⁰ Short-term and non-guaranteed debts are believed to have grown even more rapidly. Countries borrowed heavily in this period as interest rates were low (even negative in real terms at some points), international private credit was readily available, and financing needs were substantial.

However, the borrowing became unsustainable as the 1980s arrived. The crisis was triggered by the following developments: first, the precipitous rise in interest rates to unprecedented levels after 1979 and the associated swings in exchange rates, as developed countries sought to roll back inflation; second, the sharp slackening of import demand in developed countries resulting from the steep and then prolonged recession that started in 1980; third, the collapse of primary commodity prices, *including oil*, beginning in 1980; fourth, the rapid increase in the relative prices of imported manufactured goods, which together with the fall in export prices entailed a deterioration of developing countries’ terms of trade; and last but not least, the growing wave of protectionism that characterized foreign economic policy in the 1980s in developed market economy countries.

In the difficult economic context of the 1980s, it became necessary for some debtor country governments to further enlarge their already swollen sovereign debt by taking over non-guaranteed private sector external debt. Sometimes that took them to the Paris Club. One example is given by the first time Mexico visited the Paris Club, which was in 1983. The debt dealt with at this Paris Club meeting was not the Mexican public debt but the non-guaranteed arrears that the Mexican private sector owed to foreign suppliers. This debt had been insured by the official insurance agencies in the exporting countries, and thus became claims of the export credit agencies after Mexico’s crisis erupted. However, the Mexican Government had not guaranteed them. Mexican industry was paralyzed by the crisis, because a large part of the imported intermediate goods needed for local production were cut off.³¹

To handle this case, the Mexican Government rescheduled debt payments in foreign currency while the private sector debtors continued to service their debts in local currency, following

³⁰ UNCTAD (1983). See paragraph 67 and table A.4.

³¹ As a result of this private-sector debt crisis, the insurance coverage by the official insurers in developed countries was suspended, triggering an interruption of imported supplies.

the original loan schedules and depositing their payments with the central bank, which created a sinking fund to honour the Paris Club rescheduling agreement.³² The standard Paris Club agreement terms were obtained in this rescheduling. The private sector arrears were thus put under public responsibility with the central bank assuming the exchange rate risk.

2. Making Paris Club policy at G-7 summits

At the Summit of the Group of 7 (G-7) in Venice in 1987, the major industrialized countries acknowledged the need for some additional effort to address the weakened development prospects of the poorer countries, including in the realm of external debt. Indeed, by 1987, rescheduling agreements for developing countries' official bilateral debt were already characterized by a dichotomy of treatment: the rescheduled maturities of sub-Saharan African countries averaged 18 years and the figure for the other developing countries was only 9.8 years. It was now agreed that the poorest countries undertaking adjustment efforts should also have the possibility of paying lower interest rates on their existing debt. It was further decided that an agreement should be reached to be implemented through the Paris Club on longer repayment periods to ease the debt service burden. As a result, the major developed countries agreed the next year at the Toronto Summit in June 1988 on the Toronto Options for Rescheduling Official Debt of Low-Income Countries. The "Toronto Terms" gave creditor countries the option to partially write-off a poor country's debt, and give it longer repayment periods or concessional interest rates on the remainder.³³ This would be the first in a series of gradual steps by the G-7, each of which acknowledged that they had previously demanded too much debt servicing by many of the poorest countries.

As was noted by UNCTAD in early 1989,

The pervasiveness of debt problems is such that debt rescheduling, once an isolated, one-off mechanism designed to overcome a temporary debt-servicing problem, has now become an established feature of the financial system (UNCTAD, 1989a, paragraph 57).

This also affected access to new funds, as most of the export credit insurers were only ready to restore official insurance coverage once the debtor had concluded the implementation of the bilateral agreements of the Paris Club rescheduling, and the export insurance cover would continue as long as obligations under the agreement were being met.³⁴

In addition to beginning to take account of the deep dichotomy between the poorest debtor countries and the emerging economies, the Paris Club also departed from its standard terms for some countries by offering "multi-year rescheduling agreements" (MYRAs). This was a relaxation of the "short-leash" approach noted earlier and an attempt to help countries plan over a longer horizon.

In 1989 and 1990, these policies began to be implemented. Bolivia was the first country outside sub-Saharan Africa to obtain Toronto terms in early 1990 and there were agreements on MYRAs for the Philippines, Mexico, Mali, Bolivia and Mozambique. In each case, an IMF programme covered the length of the period during which obligations were postponed, i.e. the length of the MYRA.

³² The sinking fund was known as FICORCA (Fideicomiso para la Cobertura de Riesgos Cambiarios) and was managed by the central bank (Banco de México).

³³ For an explanation and analysis of the Toronto terms see UNCTAD (1989b:35 box 7). The idea behind this was that whatever the choice of the creditor country for providing debt relief to the debtor, the present value of it would be equivalent to the other choices taken by the other creditor countries. The Toronto terms are now replaced by the Naples terms (see below).

³⁴ See K. B. Dillon, L. Duran-Downing and M. Xafa (1988).

3. Special cases and evolving policies in the early 1990s

Although the Paris Club was thus adopting policies meant to apply to all countries or all countries in a pre-defined class, it broke with this approach for politically important cases. An early sign of this was in 1990, as the rescheduling of the Polish debt marked a significant departure from standard Paris Club terms for middle-income countries. The so-called “consolidation period” (the time during which the debtor receives relief from repayment obligations) was 15 months, payable over 15 years, which was an unusually long maturity. However, this was not the final arrangement, as the creditor countries agreed to set up a working group with the Polish Government in order to further examine Poland’s financial obligations to Paris Club governments. Within this group, Poland would seek a long-term solution to its problem through debt reduction.

In early 1991, Egypt joined Poland in receiving exceptional treatment: for both countries, rather than the “Houston Terms” for which they would otherwise have qualified, a 50 per cent reduction was agreed in the entire eligible stock of official bilateral debt. For Poland debt reduction would occur in two stages: 30 per cent up front and 20 per cent after 3 years. For Egypt, the reduction would take place in three stages: 15 per cent up front, 15 per cent after 18 months and 20 per cent after 3 years. Debt reduction was implemented through a menu of options including partial interest capitalization on concessional terms, in addition to principal and interest reduction. In addition, creditor countries agreed to a voluntary debt swap facility, which could include up to an additional 10 per cent of outstanding claims. In both cases, the implementation of the stages following the upfront reduction was conditioned on the successful completion of an IMF arrangement.

In 1991, Peru’s treatment also diverged from standard Paris Club practices. In this case, the Club agreed to defer all “moratorium interest” payments falling due during the consolidation period,³⁵ and to reschedule arrears on “post-cut-off date” debt.³⁶ Peru rescheduled 70 per cent of its moratorium interest over 5 years, including 2 year’s of grace after the consolidation period, with the remaining 30 per cent to be paid over 18 months. Arrears on post-cut-off date debt were to be paid over six years after the consolidation period. The deferment was contingent on Peru’s performance under an IMF “rights accumulation” programme (a form of IMF adjustment programme for countries in arrears to IMF itself and seeking to return to normal IMF assistance), as agreed to in 1991. This special treatment may be explained by the change of regime in Peru, with Mr. Fujimori replacing as President Mr. Alan García, whose regime imposed a ceiling of 10 per cent on the debt service to exports ratio, making the country incur substantial arrears.

In April 1996, a five-day Paris Club meeting took place to reschedule the debt contracted or guaranteed by the former Soviet Union and for which the Russian Federation had assumed

³⁵ In the Paris Club jargon, repayments falling due to Paris Club members during the consolidation period are postponed and are treated, in effect, as though refinanced with new loans repayable according to a new repayment schedule; the debtor is usually required to pay the so-called “moratorium interest rate” on the outstanding balance of deferred payments.

³⁶ In its standard practice, the Paris Club only consolidates repayments on “eligible” loans, which will be those signed before some specified “cut-off date”. In a serial restructuring for a country, the initial cut-off date is kept from one Club restructuring to another. Creditors are reluctant to update the cut-off date once set, since it would add new loans (and more relief) in the succeeding renegotiations. Moreover, maintaining a fixed cut-off date says to government creditors that any post cut-off date loans they extend will not be subject to restructuring. This is to say that the new loans would have higher repayment priority than old ones, which is meant to encourage the creditors to renew their lending. As the Peruvian case showed, however, countries may not be able or willing to make payments on their post cut-off date debt and some restructuring of those obligations then becomes necessary.

responsibility. The Paris Club agreed to a comprehensive rescheduling in two stages, the first one a rescheduling of debt servicing payments falling due over a specified number of years, and the second a restructuring of all remaining obligations on the covered stock of debt. Besides the substantial amount involved in this agreement (around US\$40 billion), it was exceptional because it was a stock-of-debt rescheduling on non-concessional terms, the only one in the whole history of the Paris Club.

For a last set of special cases, the Paris Club repeatedly eased the terms of relief it made available to the poorest countries, on each occasion following decisions reached at meetings of heads of State of the G-7, the largest creditors in the Paris Club. Thus, in December 1991, the low-income countries were granted new concessional terms, referred to as the London terms.³⁷ Moreover, in most Paris Club agreements at that time, there were provisions for partial debt reduction through swaps of debt for social, environmental or investment activities.³⁸

The practice also kept evolving. In the case of Uganda, the Paris Club creditors agreed, in June 1992, to defer the payment of arrears on debt not covered by the Agreed Minute (mainly post-cut-off debt) by an average of one year. In the case of Zambia, 30 per cent of the moratorium interest and the service on post-cut-off date debt falling due during the consolidation period were deferred until its end (one and a half years). The remaining 70 per cent of moratorium interest was to be paid six months after the consolidation period.

Following the G-7 Summit in Naples, the Paris Club creditors agreed in December 1994 to a further easing of the terms for the poorest and most indebted countries. The Naples terms included an option to reduce debt flows or debt stock by up to 67 per cent.³⁹ Reducing the stock of non-concessional debt was reserved for exceptional cases and was called an “exit” option because the beneficiary would no longer need to request debt restructuring from the Paris Club. The countries eligible for Naples terms were those that had received Toronto or London terms.⁴⁰ To qualify for the 67 per cent reduction, the countries had to have either a GDP per capita of less than US\$500 or a ratio of debt to exports exceeding 350 per cent. Candidate countries for the stock treatment should have shown a satisfactory “track record” in

³⁷ Under the Toronto terms, mentioned earlier, creditors could select from different options that yielded at most a debt reduction of 33 per cent in present value (PV) terms. The London terms allowed for a 50 per cent debt reduction in PV terms (see below on “PV”).

³⁸ For example, in a “debt-for-nature” swap, a Paris Club creditor would cancel specific debts in exchange for a commitment of the debtor government to undertake specified public investments, as in a national forest, generally with the intention to apply foregone debt servicing payments to the new projects.

³⁹ In these Paris Club principles for treating low-income country debt (and in the HIPC Initiative to be described below) the stock of debt is said to be measured as “net present value.” In fact, the measure actually is a simple “present value” (PV) calculation. Creditors insist on measuring the stock of debt by calculating the PV of future debt service (principal and interest), discounted at a commercial rate. This is relevant for instruments that are tradable in the secondary market because the PV would reflect the instruments’ market value, but it is artificial for non-tradable official debt for which there is no secondary market. Notwithstanding, this kind of calculation is useful for creditor countries as it can measure the opportunity cost of concessional lending, on one hand, and on the other hand, it is also useful for a fair burden sharing of the rescheduling operations among the different creditors. However, what is relevant for debtor countries are the nominal value and the actual rate of interest applied to the loan, as this is what the debtor actually pays.

⁴⁰ These countries were: Benin, Bolivia, Burkina Faso, Cameroon, Central African Republic, Chad, Côte d’Ivoire, the Democratic Republic of the Congo, Equatorial Guinea, Ethiopia, Guinea, Guinea-Bissau, Guyana, Honduras, Madagascar, Mali, Mauritania, Mozambique, Nicaragua, Niger, Senegal, Sierra Leone, Togo, Uganda, United Republic of Tanzania, Viet Nam and Zambia.

economic policy and be able, on the creditors' view, to implement the debt agreement in order to exit once and for all from the rescheduling process.

VI. A CURRENT FOCUS: THE HEAVILY INDEBTED POOR COUNTRIES INITIATIVE

In September 1996, the two Bretton Woods policy-making committees, the IMF Interim Committee and the joint IMF and World Bank Development Committee, endorsed a programme of action proposed by the Managing Director of the IMF and the President of the World Bank to resolve the debt problems of a group of countries called the Heavily Indebted Poor Countries (HIPCs).⁴¹ The initiative aimed to commit the official international community to reduce to sustainable levels the debt service of countries that successfully completed a period of "strong policy performance" in regard to macroeconomic adjustment and structural and social policy. Aside from applying the deepest Paris Club relief yet on offer, the HIPC Initiative contemplated reducing the debt servicing obligations to IMF and the multilateral development banks, all of which had heretofore been regarded as senior creditors whose obligations had to be serviced no matter at what cost.⁴²

The Initiative was meant to ensure that a country's debt burden would not in future inhibit its capacity for sustained growth. The methodology chosen by the World Bank and the IMF in order to assess the sustainability of a country's debt involved making projections of macroeconomic variables and capital flows over a given time horizon, focusing on the implied evolution of two external debt indicators, debt to exports and debt service to exports. Initially, the upper limits for sustainability ranged from 20–25 per cent for the debt-service-to-exports ratio and 200–250 per cent for the ratio of PV of debt to exports. That is, debt relief for a country was meant to bring its ratios down to these ranges.

However, for some countries the fiscal burden of external debt service appeared more binding than the balance-of-payments constraint. The Boards of the World Bank and the IMF thus agreed in April 1997 to broaden eligibility to the HIPC Initiative (on a case-by-case basis) to countries that did not have such a severe debt burden relative to exports if they had a particularly severe fiscal burden indicator. From that point on, a PV of debt-to-exports ratio below 200 per cent would not disqualify a country provided that the country met two additional criteria: an export-to-GDP ratio of at least 40 per cent and a minimum ratio of fiscal revenue to GDP of at least 20 per cent. The target for relief in these cases would be to bring the ratio of the PV of debt to fiscal revenue down to 280 per cent.

While arguments could, and later would, be made about the analytical limitations of the threshold indicators, the difficulties that first rose were not about the choice or the interpretation of the indicators, but rather on the complexity of the calculations of the PV and estimations of exports involved. Uganda was the first country to come through the system:

During the months leading up to the presentation of the final HIPC document for Uganda at the Boards of the Fund and the Bank, we were engaged in a series of intense

⁴¹ Eligibility for the HIPC Initiative was limited to countries eligible to borrow from the World Bank's concessional facility, the International Development Association, and that faced an unsustainable debt situation. The preliminary classification of HIPCs included four categories of countries with regard to debt sustainability. For the details see Boote and Thugge (1997).

⁴² In fact, the institutions would still be repaid, if not by the debtors, as creditor governments covered the forgone debt servicing inflows of the relief-giving multilateral institutions (albeit with certain exceptions, principally, use of proceeds from revaluation of some of the IMF's gold and some of the profits of World Bank loans to middle-income countries).

discussions with the staff from the IMF and the World Bank, not over which indicators should be employed in the analysis of our debt sustainability, as this is largely a matter outside our control, but over how these apparently 'simple' indicators should be calculated...For example, there are different methods by which PV can be measured...we argued very strongly for the need to do some kind of averaging of exports figures in order to produce a realistic picture. The question then arises as to how this averaging is done, and again, the differences in cash terms are potentially very great.⁴³

By 1999, it was already clear that after all the calculations were made and resources committed according to those calculations, the amount of relief was still deeply inadequate. The World Bank and the IMF, under mounting pressure from the growing Jubilee Movement and facts on the ground, saw the need to undertake a full review of the HIPC Initiative. The external resource flows and debt reduction under the targets that were defined in the original framework seemed to fall short for low-income countries to achieve debt sustainability, owing both to how the Initiative was being applied and the principles governing it.⁴⁴ The review led to the so-called Enhanced HIPC Initiative. The innovations in the Enhanced HIPC Initiative started with lowering the debt-indicator thresholds to qualify for relief and to serve as targeted end points of relief. The consequence was that more countries might become eligible for the Initiative and those previously eligible might be able to seek larger debt relief.

In addition to agreeing to deepen relief, the major innovation of the Enhanced HIPC Initiative was that it sought to link debt relief to poverty reduction in an explicit way. However, the criteria governing the amount of debt relief did not pertain to poverty alleviation. The debt-relief target still aimed to remove the so-called "debt overhang" in order to reduce fiscal and payments constraints on domestic policy and allow countries to attain significant economic growth. These factors ought to result in a poverty reduction effect in the medium or long term, assuming the objectives of debt rescheduling are first achieved. The new connection that the Enhanced HIPC Initiative made to poverty alleviation was rather to require that resources freed up by debt relief should instead be applied to "pro-poor" government expenditures. In addition, HIPCs were now required to develop overall poverty reduction strategies, taking account of the views of non-governmental stakeholders.

One reason for keeping the amount of debt relief in the HIPC Initiative focused on eliminating the "debt overhang" was concerned that investors and other private agents might not be willing to invest for fear that their profits would be taxed away in order to pay for foreign debt. However, if the Initiative does not relieve fiscal pressure but transfers it from debt servicing to human and social investment expenditures, the effect will be similar to that of a debt overhang, generating a "poverty alleviation overhang". It is important to understand

⁴³ Rutakamagra (1997: 4–5).

⁴⁴ The debtor's perspective is given by Comboni (2000): "An issue that appears time and again in all DSAs [debt sustainability analyses] done with the participation of IMF staff is that macroeconomic assumptions tend to be overtly optimistic. The cases of Uganda and Bolivia are examples of that. To project that exports will grow by a two digit figure, while in reality they fall, seems to be a pervasive bias that needs to be corrected. The objective should be to perform a professional work aimed to help the country solve some of its most pressing problems, instead of trying to show that the country will be sustainable no matter what", p 33. "It was clear right from the onset, that the original HIPC initiative was not able to reduce the degree of indebtedness to a level of sustainability. In the first two countries to receive HIPC relief, debt sustainability analysis done right after completion point showed that neither country attained the HIPC I defined level of sustainability. For the case of Bolivia, the first completion point should have delivered a PV of debt to exports ratio of 225 per cent. Ex post analysis done for 1998 – the completion period year – shows that Bolivia had a level of sustainability of 232 per cent as measured by the above-mentioned indicator. This level is not very different from the pre-HIPC level of 252 per cent that the country showed on the official DSA done during 1997", p 8.

that the investment decisions of the private sector will indeed depend on issues such as profitability and the level of taxation, but what the taxes might be used for will not be crucial.

More precisely, consider the individual HIPC's obligations when it exits the programme and obtains its full relief. Assuming it needs the full Paris Club relief for HIPCs to reach its sustainability threshold, the debtor country obtains 90 per cent "external debt reduction" on its bilateral official debt. This means it must resume payments on the remaining 10 per cent of bilateral foreign debt that is not forgiven, and continue paying its remaining multilateral debt servicing. But the HIPCs are not freed from paying the forgiven 90 per cent: they instead re-allocate it to social and human development expenditures in domestic currency. This is, in effect, a "debt for poverty alleviation swap"; in consequence, the Enhanced HIPC Initiative is actually a swap mechanism to convert foreign currency liabilities into domestic liabilities linked to poverty alleviation⁴⁵.

There is a parallel swap on the creditor side, as debt relief is not absorbed but financed from the budget, indeed from the creditor's aid budget. An important reason for official creditors to want to swap out of the foreign loan repayment obligations of their poorest debtors is that by any realistic assessment, the "value" of the debt had substantially fallen due to the deterioration of the debtor's financial situation; i.e. the actual present value of the expected flow of debt servicing was less than the face value and reducing the stock of debt is the most realistic solution. This notwithstanding, when the debt is partially cancelled the accounting procedures in the creditor governments require that reduction in the value of the asset concerned be balanced by an offsetting item. That item is a transfer from the budget, in order to avoid recording a loss. The budget transfer, in these cases, is typically earmarked as "official development assistance" (ODA) or is effectively coming from the ODA budget. This is why creditor countries insist on counting debt relief as ODA. It is worthwhile to note that this mechanism absorbs ODA that could otherwise have been used for a real transfer of resources to HIPCs. It is also arbitrary to charge the ODA budget for the relief, as it mostly represents a failure of quasi-commercial lending policy.

The accounting is not better – but more drawn out – when Paris Club creditors give their relief in reduced annual flows instead of a reduction in the stock of debt; i.e. when the contractual value of the claims remain unchanged, but the rate of interest and annual principal repayments are substantially curtailed, as some creditor countries chose to do, the profitability of the official export credit insurance agency would be impaired in the absence of offsetting revenues. In order to implement a debt reduction, in this case, the missing revenue has to be allocated from the budget as well. ODA, once again, is used to make up the lost revenue with the equivalent effect on the deprivation of ODA for a real transfer of resources to HIPCs.

⁴⁵ Not all creditor countries are allowed by their domestic budget laws to provide a straight reduction on the stock of debt. The Paris Club, in order to overcome this problem, has calculated the equivalent flow reduction in PV to the stock reduction, so that these countries would provide debt relief with an equivalent burden sharing as the one by those countries granting the stock reduction. As far as creditors are concerned, so far so good! But on the debtor's side, if the stock reduction is granted, the resources are more predictable than for the flow reduction. In the former case, 10 per cent of the original loan has to be honoured as originally scheduled in foreign currency, and 90 per cent is converted into domestic currency anti-poverty expenditure following the original schedule too (here with an exchange rate risk borne by the debtor, because the amount of expenditure required is converted into domestic currency at the date the payment would otherwise fall due). However, if the option the creditor took is flow reduction, there is less predictability for the debtor because of an option given the creditor. It is allowed to alter the annual flow of debt servicing it wishes to receive in any year or years based on its own treasury needs as long as compensating changes are made in other years so as not to change the PV equivalence of the entire flow. This leaves the debtor no assured means to forecast the amount to be paid in foreign currency, let alone the amount to be expended for anti-poverty programmes in domestic currency in any given year.

In both cases, stock or flow reduction, donor resources are being utilized to cover the budget or the export agencies' losses originated by the loss of worth of the HIPC's debt, and the resources so allocated are earmarked ODA. Here, there is an astonishing paradox as far as the Enhanced HIPC Initiative is concerned: ODA is used, at least partially, to cover the creditor countries export credit agencies' losses, and then the pressure for poverty alleviation expenditures is put on the poor countries' domestic budget through the debt swap for poverty alleviation mechanism described above.

Moreover, while the intention in the Enhanced HIPC Initiative to bring about additional pro-poor expenditure may be appreciated, the resources required to implement poverty reduction are huge relative to poor country budgets. They also require expenditures over a long time span to have the desired effect. At this point, a very legitimate question arises: if HIPCs have been unable to generate resources to repay their debt, how can they manage the huge expenditures that poverty reduction requires? Moreover, additional social expenditures are only part of the solution. Even if practical problems of reaching the poor through social spending are overcome, long-term poverty reduction depends on the expansion of employment, productivity and economic growth. Channelling a relatively small amount of debt relief into social spending is a very incomplete step to long-term poverty reduction.

The creditors and donor countries should accept, as they do in principle if not necessarily in practice, that debt relief is not enough for a successful long-term poverty reduction policy. It will be necessary for creditors to continue to provide capital flows on concessional terms to HIPCs, to provide HIPCs' exports access to domestic markets without trade barriers, and to provide incentives to the private sector for investing in HIPCs. The HIPC Initiative requires, in other words, not only a coordinated official bilateral and multilateral creditor effort vis-à-vis the external debt of the poor countries, but coordination by essentially the same players over other financial and trade policies as well.⁴⁶

VII. ANOTHER CURRENT FOCUS: EVIAN AND “COMPARABLE TREATMENT”

An issue that became especially salient in the late 1990s is the “comparability” of treatment that official creditors asked the debtor government to obtain from its private sector lenders. The demand for comparable treatment followed from the same logic as the Paris Club itself, namely that creditors with comparable standing should share the burden of restructuring in a comparable way. However, comparable does not mean equal. While the seniority of loans of the IMF and the development banks was universally accepted, the Paris Club and non-Paris Club bilateral official lenders were seen as on a similar footing. This was a longstanding principle, although neither the debtor nor the Club members could do more than urge non-Club official lenders to cooperate. By the time of the 1980s debt restructurings, many countries had significant private as well as Paris Club debt. The IMF would guide the debtor countries to settle their rescheduling with the Paris Club and to settle with the “steering

⁴⁶ The 1953 Agreement for Germany is an example of the importance of trade development between creditors and debtors for success is “exiting” from cyclical rescheduling exercises. See Hersel (2002).

committees” of creditor banks, called London Clubs.⁴⁷ Although there were several rounds of short-term treatment by both Paris and London Clubs in the 1980s crises, it was clear that the banks would bear more of the remaining burden than the official creditors.

By the next cycle of debt crises in the late 1990s, most private loans to developing countries were bond issues, with potentially many thousands of bondholders and no coordinating mechanism of bondholders for negotiating restructurings that operated like London Clubs. Also, in the 1980s, the small number of developing country bond issues generally continued to be serviced even when bank loans were not. This would have to change. In 1999, Ecuador, Pakistan and Ukraine were facing bond-rescheduling problems. Governments in the Paris Club raised the question of burden-sharing comparability between private and official creditors. Very large-scale official bailout operations for some middle-income countries in the 1990s were being criticized by the end of the decade for risking public money to bail out private creditors (although all the loans were fully repaid). Suggestions were made that public assistance, including debt rescheduling, should not be provided unless some relief was also obtained from private creditors.

Pakistan had significant principal amounts falling due under its Eurobonds in December 1999. The Paris Club made it clear that Pakistan would need to implement comparable treatment between official and private creditors, in particular bondholders, if Pakistan wished to also have its bilateral debt rescheduled. Official creditors would not provide a bailout unless bondholders were “bailed in”. Subsequently, Pakistan negotiated to exchange the existing Eurobonds at par for 10 per cent bonds due in 2002/2005, which was accepted by more than 90 per cent of bondholders. This was, in essence, a concerted refinancing of the Pakistani bonds.

Ecuador also required debt restructuring in 1999, although it came about differently. It became the first country to default on “Brady Bonds”, the financial instrument into which the Brady Plan had finally transformed the reduced value of defaulted bank debt from the 1980s debt crisis. Ecuador asked the bondholders to draw upon the interest collateral provided under the Brady Plan to pay-off the interest payment default. Bondholders reacted adversely by voting to “accelerate” the bonds (demand repayment in full immediately, which was provided for in the bond contracts), thereby opening the doors to litigation. In so doing, bondholders created a “cross default” event affecting all of Ecuador’s other bonds. In essence, as all the bonds had equivalent seniority for repayment, payments could not be made to one bond without also addressing the others.

Ecuador finally resolved its problem in August 2000 by swapping old bonds for new ones at about a 40 per cent discount from original face value. It is important to note that the private creditors felt that the government of Ecuador had forced an excessive “haircut” on them with the backing of IMF. In this case, the private sector settled first and then the Paris Club rescheduled Ecuador’s official debt, first in September 2000 and then again in June 2003.

⁴⁷ The major banks created “steering committees”, which represented the largest creditor banks in order to negotiate with the debtor countries. Once a tentative agreement was reached between the steering committee and the debtor country, the banks represented by the committee had to ratify the agreement, which sometimes required a lot of pressure, sometimes even using the Central Banks of the creditor countries, in order to obtain what was called, “a critical mass” of creditors necessary for implementing the agreement. It is important to make some remarks about the “steering committees”. First, even though they are regularly referred to as the “London Club”, these committees do not necessarily meet in London. Second, the composition of the committee can be extremely different from one debtor country to another. Last but not least, the London Club does not have general guidelines or features like the Paris Club does, so their behaviour is really ad hoc including its composition, the distribution of the debt among the creditors and the debtor country’s particularities.

Final Paris Club treatment for Ecuador in this crisis, under the Houston Terms, rescheduled non-ODA credits over 18 years, including 3 years of grace, followed by progressively higher repayments until maturity, at the appropriate market interest rate; ODA credits were to be repaid over 20 years, including 10 years of grace, at a rate at least as favourable as the concessional rates applying to those loans. Amounts paid included notably post-cut-off date maturities and flows on the previous Paris Club agreement concluded in September 2000 as well as moratorium interest.⁴⁸ However, there was no debt reduction on the non-ODA debt and thus no comparability with the bondholders.

While the bondholders would deem this unfair, a more telling concern was the reason, namely that the forums and processes for dealing with different lenders to a country with a debt crisis operate independently of each other. Not only was there no assurance of inter-creditor equity, but it was not clear that the various separate processes would result in an appropriate overall amount of relief. Moreover, there was also concern that a minority of bondholders could prevent the now-standard way to restructure bonds – a swap of old bonds for new ones on easier terms – from taking place through actions in the courts of the countries in which the bonds were issued, usually New York or London. The lack of clearly established “rules of the game” for resolving crises in international lending as they apply to sovereign borrowers, in particular the absence of a process analogous to a bankruptcy court for sovereign nations, created many different proposals and much research.

It seems that three main schools of thought have emerged for how to address these concerns. The first one is very “market mechanism oriented” and claims that markets themselves will solve this problem if multilateral institutions do not bail out insolvent borrowers and imprudent lenders. This author’s view is that this approach has proven its inefficiency in practically all situations. The second one states that either the IMF or the G-7 central banks should act as last resort lenders; i.e. if central banks lend at a penalty interest rate with good collateral, debtor countries will find a way out.⁴⁹ The third one calls for a formal, mandatory process of debt restructuring similar to a domestic bankruptcy court, i.e. a Sovereign Debt Restructuring Mechanism (SDRM). According to this last mechanism, courts would enforce a temporary “standstill” on creditor claims for repayment while a restructuring was being worked out and a suitably defined majority of creditors would impose a debt-restructuring scheme on all other creditors.

The IMF’s proposal by Anne O. Kruger was to create an SDRM, which in its original formulation could have provided a means to bring together private and bilateral official creditors and provide a forum for obtaining “comparable” treatment as well as ensure that the total amount of relief was sufficient. However, major developed countries declined to participate as one of the creditor classes to be covered by an SDRM, and the private financial sector and the bond-issuing countries opposed the proposal. It was turned down in April 2003 during the IMF-World Bank Spring meeting.

Instead of a comprehensive mechanism with IMF at its centre, the Paris Club was pushed to take on a more central role. As a follow-up, in May 2003 during the meeting of the Ministers of Finance of the G-7 in Deauville, France, a new Paris Club approach for non-HIPCs was announced. In June 2003, at the heads of State Meeting of the Group of 8 in Evian, France, this new approach was welcomed and in October 2003, the Paris Club creditor countries reached an agreement on how to implement the new approach. Actually, the only piece of the

⁴⁸ In fact, Ecuador tried to settle first the bilateral debt by attending a Paris Club Meeting on 18 and 19 May 2000, but the creditors’ demands, as the Brady bonds question was unsettled, were so hard for Ecuador to accept that there was no agreement. The author attended this unsuccessful Paris Club meeting on behalf of UNCTAD.

⁴⁹ See UNCTAD (1990: 27) and Focerrada (2001: 81–86).

external debt rescheduling rules that the Paris Club was missing was precisely how to deal with non-HIPCs. This was to officially give a name to the Paris Club long-stand of giving ad-hoc case-by-case terms to specific LICs and middle-income countries. This event was, in some extent, not necessarily intended to replace an SDRM, however, the refusal of a large international financial community to support it and the now “comprehensive” rules of the game for the Paris Club made that, at least for the moment, no further intent to implement an SDRM was pursued.

The foundation for the “Evian Approach” is that the lack of comprehensive treatment of all categories of debt creates difficulties for debt sustainability achievement, making the debtor country come back to the Paris Club, as well as other creditors, in a cyclical manner. In this context, the Paris Club creditor countries decided to apply differentiated terms to restructuring their own credits and to press hard for comparable treatment by the other creditors, which if given would meet the debtor’s overall need for relief (at least as interpreted by the Paris Club). The Paris Club would be relying on the debt sustainability assessment carried out by the IMF, but reach its own conclusions. Here, the Paris Club would differentiate between a “liquidity” problem and an “unsustainable” debt problem, adapting the terms of its rescheduling to the financial situation of the debtor country.

A “liquidity problem” would continue to be treated with the standard terms. Thus, if the country is an “IDA country”, i.e. is eligible to borrow from the World Bank’s concessional window, the International Development Association, it will receive the Naples terms tailored to its financial situation. In the case where the debtor country is not an IDA country, it would get either the Houston terms or the Classic terms. In the Paris Club’s view, however, at times, the Houston terms appeared to be too generous for the debtor country needs, and thus a more detailed ad hoc consideration for different debtor country cases was needed. In other words, the Houston terms would be applied with more heterogeneity.

The Paris Club would apply different relief modalities if there is a finding of a “sustainability problem” and if the country is engaged with the IMF in an economic adjustment programme and is committed to policies that will secure its permanent exit from the Paris Club rescheduling cycle. In this case, there would be no “standard terms” and debt relief would be given in three stages. The debt relief could take various forms, include different flexible instruments, and push forward the cut-off date (i.e. make more recent and previously excluded loans subject to restructuring). Country programmes would be considered on case-by-case basis. The following table tries to summarize the Evian Approach.

EVIAN APPROACH FOR NON-HIPCs		
	<i>Liquidity problem</i>	<i>Unsustainable problem</i>
Non-IDA country	Classic Terms or ad hoc Houston Terms	No Standard Terms: on a case-by-case basis, the debt relief would be given in three stages
IDA country	Naples Terms tailored to the country's financial situation	

The process envisaged for applying the Evian approach begins with the IMF carrying out an assessment of the sustainability of the debt in the debtor country, which is in fact an official recognition of a long stand practice. If the debt were considered unsustainable, then the debtor country would commit to an IMF Adjustment Programme that aimed, in cooperation with the Paris Club, to become sustainable and thus avoid the need for a post-Evian return to the Paris Club. Then, the first stage of the Evian approach would be implemented with the Paris Club providing debt relief on one to three years of debt service flows. This debt relief flow would have to be comprehensive and include all types of creditors’ claims, including Paris Club and non-Paris Club. This first stage would be followed by an exit treatment over two stages,

which are not as yet well defined. The exit treatment might include reduction of the debt stock on an exceptional basis.

The first country treated under the Evian Approach was Kenya on 15 January 2004. Two outstanding points resulted from this experience: the debt was considered sustainable and the country was given Naples Terms without debt reduction. The payments due over three years were treated, with a decreasing percentage of amounts due consolidated each year: 82 per cent in 2004, 77 per cent in 2005 and 67 per cent in 2006, which was not generous for a country like Kenya. The Agreed Minute included a specific trigger clause that made the full implementation of the agreement contingent upon comparability of treatment that would be assessed regularly.

Iraq, under very special circumstances, attended a Paris Club meeting from 17–21 November 2004 under the Evian Approach. Iraq obtained a comprehensive debt treatment of its public external debt owed to the Paris Club creditor countries, which would reduce its debt by 80 per cent in three phases. First, part of the late interest payments, representing 30 per cent of the debt stock as at 1 January 2005, was immediately cancelled. Second, payment on the remaining debt stock was deferred up to the date of the approval of a standard IMF programme, which occurred on 23 December 2005. At that point, a reduction of 30 per cent of the debt stock was to be delivered. The remaining debt stock would be rescheduled over a period of 23 years including a 6-year grace period. This step would raise the rate of cancellation to 60 per cent. Third, the Paris Club agreed to grant an additional tranche of debt reduction representing 20 per cent of the initial stock upon successful completion of the last IMF Board review of three-years of implementation of Iraq's IMF programme. This debt reduction would bring the total debt stock from US\$38.9 billion to US\$7.8 billion, which is the 80 per cent reduction final goal. On a voluntary basis, each creditor country may also undertake debt swaps. A clause calling on Iraq to obtain comparable treatment from other external creditors was included in the agreement.

In 2005, Nigeria was declared eligible for "IDA-only" borrowing status, and subsequently attended the Paris Club from 18–20 October 2005. In lieu of negotiating a policy programme in the context of taking a loan from IMF under a Standby Arrangement (the usual prerequisite for a Paris Club deal), Nigeria issued a "policy support instrument" (PSI), which was approved by the board of the IMF. Nigeria then paid all its arrears owed to Paris Club creditors, received a measure of debt write down, and bought back much of its debt at a discount. On this basis, this debt treatment included debt reduction up to Naples terms on eligible debts and a buy back at a market-related discount on the remaining eligible debts after reduction. This agreement would be implemented in two phases in consonance with the implementation of the PSI. First, Nigeria undertook to pay arrears due on all categories of debts and Paris Club creditors granted a 33 per cent cancellation of eligible debts. Second, after the first review of the PSI by the Executive Board of the IMF in March 2006, the Nigerian Government paid amounts due on post-cut off date debt. Paris Club creditors then granted a further tranche of cancellation of 34 per cent on eligible debts, and Nigeria bought back the remaining eligible debts. In total, Nigeria obtained a debt cancellation estimated at US\$18 billion, including moratorium interest, representing an overall cancellation of about 60 per cent of its debt to the Paris Club, which was around US\$30 billion. Paris Club creditors requested to be paid an amount of US\$12.4 billion, representing regularization of arrears of US\$6.3 billion plus a balance of US\$6.1 billion to complete the exit strategy. The Paris Club creditors stated that this exceptional treatment of Nigeria's debt intended to provide a definitive solution to the problem of Nigeria's debt owed to them.

In neither the Nigerian nor Iraqi cases does the Paris Club report that it has applied its Evian Approach. These would rather seem to qualify as politically important cases, treated in ad hoc ways, as has been the Paris Club practice since the treatment of Turkey and Indonesia almost half a century ago. As of October 2007, only one country has been listed on the Paris Club

web site as having been accorded a comprehensive treatment under the Evian Approach, and this is the Kyrgyz Republic in March 2005. In at least two cases, Grenada in May 2006 and Georgia in 2004, the “good will” clause of the Paris Club agreement stipulates that the Club might address the country’s debt in future under the Evian Approach. Certainly, there is no evidence that the Evian Approach has guided negotiations of any major debtor country with its private creditors, especially its bondholders.⁵⁰ In sum, the Evian Approach has not solved the problem of developing an international mechanism for a comprehensive and equitable approach to resolving sovereign debt problems. It would thus be desirable to continue giving a further thought to how to deal with sovereign debt problems in a transparent, orderly, coordinated and timely manner.

VIII. CONCLUSION: A SELECTION OF OUTSTANDING POLICY ISSUES

While it is beyond the scope of this paper to discuss alternative comprehensive debt workout mechanisms, the experience of the Paris Club as reviewed here points to a minimal list of reforms that member countries of the Paris Club might themselves consider.

1. “Reverse comparability”

The major thrust of international policy regarding sovereign debt today is that governments need to pay close attention to achieving and maintaining “sustainability”. The Evian approach to debt workouts aims to put this policy thrust into practice through its effort to be comprehensive and bring about “comparability of treatment” of claims held by other government creditors and the private sector. However, the treatment of debt problems by the private sector has been, at least in some cases, more pragmatic and longer lasting than the Paris Club’s “short-leash” rescheduling. For example, the market-based private sector restructuring in Ecuador following its default included a write-down of debt, while the Paris Club’s restructuring shortly thereafter did not. Write-downs were also part of the private-sector workouts following the Argentine and Russian defaults, although they were not part of any of the other private sector ‘market-based swaps’ in the late 1990s and early 2000s. The Paris Club might thus consider applying, within the Evian framework, a “reverse comparability” in the sense that it considers from the start, in addition to flows, an approach to debt problems that directly addresses the stock of official debt, as private creditors do for bonds and bank loans.⁵¹

The Paris Club justifies addressing the flows and not the stocks even when the bilateral official debt is the largest share of the debtor’s outstanding debt and private creditors are pulling out, reducing their exposure. Moreover, in the cases in which bonds are the largest component of a debtor country’s external debt, uncertainty about the final Paris Club disposition has become an obstacle to reaching a swift solution. There are only two currently

⁵⁰ In its report on meeting with representatives of the international private financial sector on 9 June 2004, the Paris Club Secretariat noted, “Paris Club creditors presented their views on the treatment of Argentina’s debt under the Evian Approach while private creditors reported on the status of their relations with Argentina. This debate enabled both parties to better understand the positions of the different stakeholders involved in the process” (see Press release, 9 June 2004). Neither this nor subsequent events suggest any degree of coordination of bondholders and the Paris Club.

⁵¹ See Rieffel (2003) for the private creditor point of view on the same issue. Rieffel suggests modifications to the Paris Club practices as necessary changes for the present arrangements on sovereign debt rescheduling to prevail, and thus avoid the need for a formal implementation of an SDRM. In this paper, these modifications are presented as a necessity in order for the Paris Club to be on the same footing as the private creditors, without precluding the implementation of an SDRM that could indeed involve the Paris Club and private creditors sitting in the same meeting.

available techniques for rescheduling bonds and neither one lends itself to the partial approaches embodied in the Paris Club flow rescheduling. The first is through a vote of bondholders, if the pertinent collective action clauses (CACs) are in place,⁵² in order to extend the maturity and/or adjust the interest rate on a one-time only basis, and the second is to carry out a market exchange of old bonds for new bonds.

The Paris Club has already accepted stock-of-debt reduction, both for the HIPCs and middle-income countries (Poland, Egypt, the Russian Federation and Iraq). Yet, the strong presumption is against debt reduction in non-HIPC treatments of debt in the Paris Club for countries that are not politically sensitive cases for the creditors. If the Paris Club does not take broader steps toward debt reduction, an equity problem will emerge because the Paris Club creditors would be according themselves more favourable treatment than the private creditors.⁵³

2. Rescheduling and “new money”

In the early 1980s, commercial bank debt negotiations, the thrust was not to reduce the debt but to lend new funds in a concerted way to keep the debt servicing on old loans from becoming “non-performing”. From a cash-flow perspective, the Paris Club did the same thing with its rescheduling arrangements, in that repayments were in effect refinanced with new loans bearing commercial interest rates. There is thus a fundamental question when arranging a flow rescheduling: how much relief to accord as restructuring of debt servicing obligations and how much as new money. The private sector has addressed the debt problems in the past in a way that directly concerned debt stock reduction and committed new money in addition to debt relief. Aside from a signal of confidence for a country that new lending might give, the Paris Club would indeed benefit from a statement of intention for lending new-money in the Agreed Minute, without systematically leaving this matter to bilateral negotiations, and thus also bearing the new money burden sharing equitably, at least concerning official and officially insured export credits.

In the 1960s, in Turkish case, some of the “relief” was provided as rescheduling and some as new loans. The forum, however, was not the Paris Club but an OECD Consortium. Indeed, Paris Club representatives would not have the authority to grant new lending. Accordingly, the possibility might be considered for the Paris Club to merge traditional Paris Club tasks with a kind of consultative group, which should include the development agencies, export credit institutions and private sector creditor representatives.⁵⁴ This would allow additional

⁵² In simple terms, CACs grant a qualified majority of bondholders the ability to change the terms of the issuance and bind the rest of the holders to the new terms. CACs come into play when an issuer decides, or is forced, to restructure its debt and the holders are faced with the alternative to consent to the restructuring or to seek to enforce the original terms. See Repetto, Buljevitch and Rodríguez-Beltrán (2005) and Mathieson and Schinasi (2000) for more details on this matter.

⁵³ The Paris Club has actually applied in some extent “reverse comparability”: in April 1996, the Paris Club agreed to a comprehensive rescheduling of bilateral debt of the Russian Federation. Besides the substantial amount involved in this agreement (around US\$40 billion), it was exceptional because it was a stock-of-debt rescheduling on non-concessional terms. The commercial banks had reached their own comprehensive agreement with Russia in November 1995 paving the way for the agreement with the Paris Club.

⁵⁴ Presently, and on a regular basis, the Paris Club organizes meetings with representatives of the private sector creditors that have been qualified as frank and constructive. These are not negotiation sessions on individual countries but rather a sharing of views on the state of debt workouts. See websites of the Paris Club (www.clubdeparis.org) and the Institute of International Finance (www.iif.com) for reports and materials from these meetings.

external resource requirements for the debtor country to be seriously examined as a function of its overall debt relief and financing needs.⁵⁵

3. Revive the “Bisque” clause

Last but not least, this paper has shown that for the countries where debt relief was based on what the debtor country “could pay” and not what it “should pay”, long-term stable solutions for the debtor countries concerned were worked out, in the benefit of both debtor and creditor countries. In most of these cases, a bisque clause helped the debtor avoid lengthy and costly renegotiations arising from unforeseen external shocks. It would also be very important and legitimate to give a serious thought to the reintroduction, within specific circumstances, of a bisque clause within the Paris Club Agreed Minute.

Note that the inclusion of a bisque clause within the Paris Club Agreed Minute would trigger the “equitable burden sharing” issue among different types of creditors. Thus, coordination would also be necessary in order to work out a rescheduling process on an equal footing for all creditors. In other words, the bisque clause should affect all creditors equally.

The desirability of equitable comparable treatment of private and Paris Club debt when countries fall into crises calls for “lining up” the various rescheduling exercises. This means that if a bisque clause is included in the Paris Club Agreement, something similar, in terms and conditions, should be reflected, in one way or another, in treatments of private bond holders as well as non-Paris Club official creditors.

Regarding official creditors, including the bisque clause in the present “comparability clause” in the Agreed Minute would be a good starting point. Regarding the private sector, in particular bond holders, the new issues would have to bear specific clauses that would line up with the conditions triggering the bisque clause in the Agreed Minute.⁵⁶

The above discussion makes more necessary that during the rescheduling exercises, all kinds of creditors should be coordinated, as it was pointed out above: the possibility might be considered for the Paris Club to merge traditional Paris Club tasks with a kind of consultative group, which should include, *inter alia*, private sector creditors’ representatives, to allow additional external resources requirements for the debtor country to be seriously examined as a function of global debt relief and financing needs, including the possibility of including a bisque clause in the Paris Club Agreed Minute and the corresponding clauses of bond contracts.

⁵⁵ At the Paris Club, the link between rescheduling and new money is created by the fixing of the cut-off date: the willingness of export credit agencies to grant new credits depends, critically, on the expectation that these credits will be serviced on a timely basis. Thus, a fixed cut-off date is essential for insurance coverage to remain affordable for the debtor country. In some cases in the past, in order to preserve the cut-off date, the Paris Club has provided more comprehensive rescheduling than otherwise would have been the case. However, the additional resources to be obtained under these circumstances had absolutely no link to the Paris Club debt relief criteria. The Paris Club includes the export credit institutions of the member countries, but without a direct role on new-lending commitments.

⁵⁶ For example, the restructured bond or loan could include a “put option”, under which the debtor would have the right to issue additional debt to existing creditors at existing or pre-specified terms in lieu of making one or more scheduled repayments.

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