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THE PARIS CLUB AND THE MONTERREY CONSENSUS
(Chair's introductory statement for the session on the Paris Club at the DMFAS Conference)

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It is fitting to introduce a discussion of policy reforms in the Paris Club by setting it in the context of the "Monterrey Consensus", which was adopted by the Heads of State, Ministers and other Senior Officials present at the International Conference on Financing for Development in Monterrey, Mexico in March 2002.[1] The Monterrey conference was a special moment in the evolution of global oversight of the international monetary, financial and trading system in that it brought together for the first time governments of developed and developing countries and the key institutional stakeholders at leadership levels, as well as business leaders from different parts of the world and advocates from non-governmental organizations concerned about the global economic system and development. It was also a special moment in that by adopting the Monterrey Consensus, the world's governments set certain international reform processes in motion and gave a political impulse to many others. While it would be wrong to say that the recent Paris Club reforms originated in Monterrey, the international community committed itself there to a deeper review of the way it handles debt crises and I think one can fairly say that the

[1] See United Nations, *Report of the International Conference on Financing for Development, Monterrey, Mexico, 18-22 March 2002* (A/CONF.198/11), Chapter I, Resolution 1, Annex.

new Paris Club reforms are one outcome of that review.

The governments, international institutions, private creditors and civil society advocates that gathered in Monterrey did not see external debt only as a problem. Quite the contrary, the Monterrey Consensus argued that properly managed foreign borrowing should be "an important element for mobilizing resources for public and private investment" (para. 47). Indeed, the Consensus called for strengthening technical cooperation to aid countries in their debt management and debt tracking capabilities. The DMFAS programme, in which many of the countries at this conference participate, is a prime example of such cooperation.

The Consensus went further, however, in saying that "debtors and creditors must share the responsibility for preventing and resolving unsustainable debt situations" (para. 47). This requires, in turn, that all relevant information on the debt and its servicing obligations should not only be collected by the debtor authorities, but also be made publicly available on a timely basis. One could even argue that it would be desirable for a debtor and its domestic and foreign creditors to be in virtually "continuous conversation" on matters related to the management of its debt, which can be arranged at modest cost these days through the Internet.[2]

Unfortunately, the volatility inherent in the international financial and trading system is such that even countries with strong domestic policies and good government/creditor relations can and do slip into debt crises and require international

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[2] See Barry Herman, "Mechanisms for dialogue and debt-crisis workout that can strengthen sovereign lending to developing countries," in Ariel Buira, ed., *Challenges to the World Bank and IMF: Developing Country Perspectives* (London: Anthem Press, 2003), pp. 203-226. For a practical approach, a prototype of which can be found at www.globalclearinghouse.org, see Barbara Samuels, II, "Strengthening information and analysis in the global financial system: a concrete set of proposals," United Nations Department of Economic and Social Affairs, Discussion Paper No. 23 (June 2002).

assistance, including debt relief, to emerge from them. As the Paris Club is the central forum for restructuring debt owed to government creditors, it can look forward to having much work to do in future years.

The effort to reform the Paris Club is thus very important to the global financial system. This is especially the case as I believe it is no exaggeration to say that no one loves the Paris Club except its own member governments. The Club has been attacked by organizations representing private creditors, as well as by social critics. The private creditors say the Club has been far from transparent in how it operates and has been unfair in that it gives proportionately less relief on obligations to its own member governments than the international community expects of private foreign creditors. In particular, until the advent of the most recent reforms, a basic principle of the Club in addressing the situation of debt-distressed middle-income countries was that it would only agree to capitalize and reschedule repayment owed to governments, whereas private creditors would have to swap their non-performing loans or bonds for new claims with a lower face value or that paid less interest. The mood in the private financial markets only a few years ago was well captured by the editorial in the September 2000 issue of *Institutional Investor* magazine, which was titled, “Paris Club: reform or die.”[3]

The Paris Club has also been criticized regularly by non-governmental observers, both because of its closed deliberations on the amount of debtor country relief it would agree to accord in any specific case and the requirement that the governments of debt-crisis countries repeatedly return to the Paris Club for further rescheduling of debt service

[3] See also a feature article in that issue of the magazine by Brian Caplen, “Paris Club comes under attack” and the Policy Paper of EMTA (Trade Association for the Emerging Markets), “Burden-sharing in 2001: Now is the time to reform the Paris Club,” 13 February 2001 (on the Internet at www.emta.org).

as it falls due. The reason for giving only partial and temporary relief of debt servicing obligations has been to keep the debtor country in crisis "on a short leash" so as to maintain pressure on the government to implement its IMF and World Bank adjustment programmes. This requires almost annual visits to the Paris Club, each followed by a sequence of bilateral negotiations with each creditor in the Club to implement the "agreed minute". Also, while the Paris Club has generally followed pre-set guidelines on the relief it gives to the debt-servicing obligations of different groupings of countries, it departed from those guidelines in politically important cases, notably those of Poland and Egypt in 1991 and Yugoslavia in 2001.

Viewing this from the ground inside debtor countries in crisis, the non-governmental organizations that operate local development projects became profoundly frustrated at the huge gap they witnessed between the professed international official concern to reduce poverty in the world and the actual policies that the international community promoted in poor countries. This disappointment was effectively mobilized in what became the anti-debt Jubilee 2000 Campaign and that led the Group of Seven to sponsor the Heavily Indebted Poor Countries (HIPC) Initiative in 1996, to then enhance it in 1999, and to meet the pledge to qualify 20 countries for HIPC relief (reach the "decision point") by the end of the Millennium Year. Also, while the Paris Club treatment of HIPC debt went through a series of iterations that slowly acknowledged the depth of the insolvency of HIPCs, little was done for non-HIPCs. Certain of the latter countries are as insolvent as HIPCs, if not so poor in terms of average per capita income. Indeed, the current Paris Club reforms aim to address precisely the needs of insolvent non-HIPCs, as the presentations by the speakers to follow will explain.

Before beginning that discussion, it may be useful to recall what the Monterrey Consensus concluded about overall reform of the international debt-restructuring process. Noting, first of all, “the importance of re-establishing financial viability for those developing countries facing unsustainable debt burdens,” the governments at Monterrey welcomed the initiatives that had already been undertaken to reduce outstanding indebtedness and invited further national and international measures in that regard, including, as appropriate, debt cancellation and other arrangements (para. 48). The Consensus went on to comment upon and recommend ways to further strengthen the HIPC Initiative (para. 49), and stressed the broader need of the International Monetary Fund (IMF) and World Bank in making policy recommendations, including on debt relief, to respond to “fundamental changes in countries’ debt sustainability caused by natural catastrophes, severe terms of trade shocks or conflict” (para. 50).

The Consensus then addressed the directions in which further reform of the international machinery for debt restructuring might go:

> “While recognizing that a flexible mix of instruments is needed to respond appropriately to countries’ different economic circumstances and capacities, we emphasize the importance of putting in place a set of clear principles for the management and resolution of financial crises that provide for fair burden-sharing between public and private sectors and between debtors, creditors and investors… We also encourage exploring innovative mechanisms to comprehensively address debt problems of developing countries, including middle-income countries and countries with economies in transition (para. 51).”

A few months before the Monterrey Conference, the First Deputy Managing Director of IMF, Ms. Anne Krueger, proposed one such innovation, the “Sovereign Debt

Restructuring Mechanism" (SDRM), and that proposal became a focus of international discussion in 2002 and early 2003. The staff of the Fund developed and modified the proposal in a series of iterations following consultations with private creditors, legal experts, NGOs and governments, including in a public panel discussion on the margins of the Monterrey Conference itself. While the proposal did not win sufficient support to move to the stage of enactment, it was the first important effort to squarely address two central shortcomings in the way external debt crises of governments are handled by the international community.

The first and most important shortcoming was that there had been no clear means to ensure that when the debt restructuring negotiations with each group of eligible creditors was completed, the total relief would be enough to place the debtor country in a sustainable debt situation. The second key shortcoming was that there was no formal mechanism to ensure comparable and appropriate sacrifices by each class of creditors (or to define comparability and appropriateness). In short, the IMF Staff offered the SDRM proposal as a mechanism that would deliver a debt restructuring that was adequate and fair to all relevant parties (although critics did not believe it would actually do so).

The key feature in the SDRM that aimed to address comparability and appropriateness of overall relief was the proposal to cluster a debt-crisis government's creditors into different classes (bondholders, banks, etc.), facilitate negotiations of each class of creditors with the sovereign, and through a creditors joint committee see that the final set of agreements met the adequacy and fairness criteria. The IMF was ambivalent about whether official government-to-government debt would constitute one of the classes of creditors and in the final version of the proposal that question was left

unresolved.

Had the SDRM been adopted and official creditors included, the Paris Club would have become moot. It would have, in effect, been subsumed in the SDRM, although the Club itself might have continued to meet to discuss strategies to apply in the negotiations that their creditor class would undertake in the SDRM. Not surprisingly, Paris Club members preferred to keep restructuring of bilateral official debt outside the SDRM. Their representatives went so far as to argue at meetings on the SDRM organized by IMF that the Club functioned satisfactorily and that no new international debt workout mechanism was needed, certainly none that would treat bilateral official debt.

Nevertheless, soon after the SDRM was taken off the international negotiation table in April 2003, the finance ministers of the Group of 8 turned their attention precisely to reforming the Paris Club.[4] It was their proposed changes that were adopted in October 2003 and it is to these changes that our panellists today will now direct their attention.

[4] See Group of 8, "Finance Ministers' Statement," Deauville, France, 17 May 2003, Annex (www.g7.utoronto.ca/finance/fm030517_communique.htm).