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The evolving roles of the clubs in the management of international debt

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Abstract

Purpose – The regularity of default by countries on their sovereign debt has led to the establishment of a number of evolving institutions or "Clubs". These institutions' objective is to optimise the impact of imminent default or actual default on both international lending and borrowing. The purpose of this article is to discuss the informal institutions concerned with managing debt between national governments – the Paris Club, between governments and commercial banks – the London Club – and the currently *ad hoc* dealings with sovereign bonds.

Design/methodology/approach – The Clubs' changing approaches through the increasing depth and number of international financial crises from the Latin American debt crises of the 1980s, the Asian financial crisis of the late 1990s and the circumstances of the ex-Soviet economies, plus the ongoing debt sub-Saharan African debt crisis are discussed.

Findings – The shifts in the principles underlying the debt management system are manifest by the changing content of reschedulings, from simply deferring payments to actual reduction in their present value.

Practical implications – The functioning of principles of comparable treatment of all creditors are discussed with respect to the growing need for a body representing bondholders' interests.

Originality/value – The paper highlights the IMF's multiple and sometimes conflicting roles in the international financial system.

Keywords Foreign debt, International finance, Financial institutions

Paper type Research paper

1. Introduction

The imagery of the "international financial architecture" demands an analogy. The Clubs may be seen as gargoyles on a medieval cathedral, throwing clear the unclean waters of nations' defaulted debt and insolvency. Their form is obliquely ornate, and not entirely best adapted to the purpose; nevertheless, they perform their function of protecting the integrity of the greater structure.

The Clubs – Paris for credit between governments, London for lending by banks to governments, and possibly a future bondholders' club – are fora where a country's sovereign debt may be renegotiated to avoid the greater peril of default. Thus the integrity of *pacta sunt servanda*[1] can be maintained, while heeding the pragmatic limits of ability to pay. The devil lies in the detail, however, and the process for reaching agreements on the amount of debt rescheduled, the timing, and the terms of

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repayment (e.g. the maintenance of the debt's value or the acceptance that certain levels are unsustainable?) leads to potential conflict amongst the Clubs and with the international financial system's insurer, the IMF. These process and the conflicts involved can be explored through the changing crises to which the Clubs have responded since their inception.

1.1 Origins of Paris and London Clubs

Over the latter part of the twentieth century the London and Paris Clubs became the principal fora for the negotiation of debt rescheduling agreements between indebted governments and commercial and official creditors, respectively. The two Clubs represent sets of procedures for negotiating arrangements. Their procedures are broadly similar but there are some important differences discussed below. Neither club has a fixed membership nor charters[2]. Their meetings are usually quite brief and informal and are not always held in London or Paris. London Club negotiations tend to be much more protracted than Paris Club, simply because there are usually many more creditors involved. London Club negotiations are conducted by an advisory committee that, at each stage in the negotiation process, must consult with or at least keep informed all the other banks involved, whereas the Paris Club negotiators are also the indebted country's creditors. Traditional participants among Paris Club creditors are the OECD country governments, although in any single meeting any number, up to one-half of these, actually participate[3].

The two Clubs have been described as "mysteries" of the economic and financial world "artificially contrived by groups of players who find it convenient or advantageous to camouflage their activities from others" (Rieffel, 1985, pp. 1-3). Neither Club has formal rules or statutes and their *Agreed Minutes* are neither published nor legally binding. Participation in meetings varies on a case-by-case basis depending on which banks (London Club) or governments (Paris Club) are creditors of the indebted country in question. The London Club has no formal secretariat and, until 1974, nor did the Paris Club. It has been suggested that this was a deliberate decision in order not to appear too encouraging to governments wishing to apply for rescheduling (Martin, 1987). In response to increased demands placed on the Paris Club for rescheduling agreements a secretariat of staff from the French Treasury was established in 1974.

The practices and procedures of the Clubs have evolved in the context of the numerous and varied financial crises that the international financial system has endured over the last half of the twentieth century. The evolution of the Clubs practices and procedures reflects shifts in government, international institutions' and commercial lenders' responses to the evolving international financial system and the management of its crises. The first Paris Club rescheduling agreement took place in 1956 when Argentina agreed to meet in Paris to reschedule its publicly-guaranteed export credits totalling some US $350 million with a small group of European governments, while the first London Club meeting was not held until 1976 when commercial banks met to reschedule Zaire's debts. Despite the attempt to create the impression that debt rescheduling agreements constituted absolute exceptions in the workings of the international financial system, the number of London and Paris Club reschedulings increased dramatically from 1978 onwards. In the 7-year period from 1978 to 1984 the number of Paris Club reschedulings increased to 56; more than double the number during the first 22 years of the Club's existence (Rieffel, 1985). It took only

3 years (1985-1987) for another 56 Paris Club reschedulings to be negotiated (Brown, 1992a). The 1990s witnessed a further surge in London and Paris Club reschedulings, totalling 63 in number through the decade. These were predominately associated with the disintegration and associated indebtedness of the former Soviet bloc, the Asian financial crises of 1997-1999 and the increasingly concessional treatment of unsustainable poor country debt.

The London Club, by virtue of its responsibility for the rescheduling of commercial bank debt, has been involved primarily with the heavily indebted commercial borrowers concentrated mainly in Latin America and Asia, while the lower income sub-Saharan African countries became the Paris Club's principal clients. Of the two clubs, it is the Paris Club that has been the more proactive in initiating changes to debt rescheduling practices and principles. To a large extent, the evolution of Paris Club rescheduling terms over the last 20 years reflect the development of official OECD government and multilateral financial institutions' policy towards the management of the debt crises of the 1980s and 1990s. New OECD initiatives in debt management became a regular item on the agenda of the G-N Summits[4], from London in 1984 to Cologne in 1999. The evolution of debt rescheduling principles and terms, including the relationships between the various creditor groupings, both Club and non-Club, can thus best be traced through the development of official, Summit initiatives and responses to the financial crises over the years. These developments are traced in some detail in Section 3.

1.2 Rescheduling principles

Paris Club rescheduling is based on four basic principles. These are:

(1) imminent default, which implies that creditor governments will not consider a request for debt relief unless the debtor has already fallen into arrears on debt service payments due, or they are satisfied that without it the country will default;

(2) conditionality, which implies that rescheduling is conditional upon a credit agreement with the IMF;

(3) burden sharing, implying that all creditors must provide relief that is commensurate with their exposure to the debtor country; and

(4) consensus, implying that *all* Paris Club creditors must unanimously approve each element of a rescheduling agreement.

The two issues that have dominated much of the discussion on debt rescheduling and on which this paper focuses are the related questions of IMF conditionality and burden sharing.

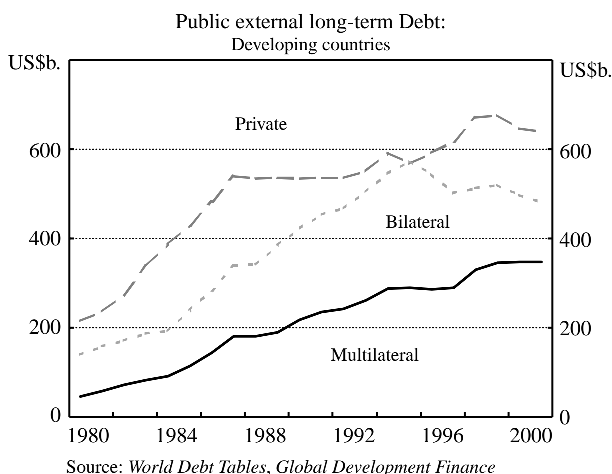
In relation to burden sharing, what has evolved is a situation in which multilateral lenders, including the IMF, World Bank, and regional development banks acquired *preferred status*. They are exempted from participating in rescheduling agreements, implying that their non-reschedulable loans continue to be serviced thanks to the relief granted by the other less preferred creditors. It could thus be argued that by accepting that principle of preferred creditor status for the multilateral institutions, bilateral Paris Club creditors have accepted responsibility for bailing them out when an indebted country is in risk of defaulting on multilateral debt repayments.

As far as participating bilateral creditors are concerned, the guiding rule for sharing the burden of debt relief is a simple one. All loans extended prior to a particular date (the *cut-off date*), irrespective of their original terms, are rescheduled with the identical grace and repayment periods. The interest rates charged on the rescheduled part of the original loan can vary from one Paris Club creditor to another, but the understanding is that penalty rates will not be charged and that concessional loans will remain concessional. Non-participating creditors, consist primarily of governments of other less-developed countries or, prior to the break-up of the Soviet bloc in early 1990s, governments of centrally-planned economies. To achieve equitable burden sharing with these creditors, the Paris Club introduced a *non-discrimination clause* in its standard agreements; the debtor undertakes to negotiate with non-Paris Club official creditors on terms that are not more stringent than Paris Club terms.

The concept of burden sharing or *comparable treatment* requires that the indebted country must agree to seek relief from banks that is as generous as the relief offered by the Paris Club. On the whole Paris and London Club terms have been sufficiently close to avoid the accusation that official creditors were bailing-out the private banks. In addition, to avoid free-riding by non-participating banks, London Club agreements usually include a non-discriminatory clause, in terms of which the debtor country agrees not to offer more favourable rescheduling terms to any other non-London Club creditor.

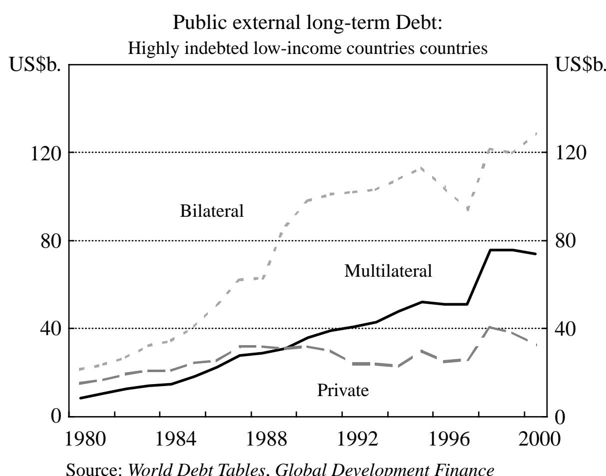
From the earliest stages in the development of the Clubs, the IMF was seen as the international organisation best equipped to coordinate among the various parties involved. Since 1966, a precondition for Paris Club rescheduling has been that the debtor country must have concluded a credit agreement with the IMF. Prior to the existence of the London Club, banks had been sceptical of the IMF's place in debt management processes. But when, in 1976, commercial banks failed in an attempt to negotiate a rescheduling agreement with the Peruvian government, the centrality of the IMF's role was firmly established (Gisselquist, 1981)[5]. However, the IMF has not always enjoyed the same degree of leverage in relation either to creditors or to debtors. The inability of private banks to monitor the policy conduct of indebted governments and their weak financial position in the early stages of the 1980s debt crisis allowed the IMF significant leverage. The IMF exercised significant leverage in, what has become known as, "bailing-in" the commercial banks (Eichengreen and Portes, 1995). It did this by holding up disbursement of its credits until the debtor's commercial bank creditors had reached agreements on both debt rescheduling and fresh finance. As the 1980s crisis unfolded, the banks significantly reduced their exposure to default through restructuring their debts and making provisions for losses. As a result the banks' bargaining position strengthened, and from the late 1980s the IMF began approving credit agreements with debtor countries where no agreement with the banks had been reached. This also meant that the exposure to less developed country (LDC) debt shifted quite markedly from commercial banks to official lenders (see Figures 1 and 2). By taking on a larger share of LDC debt, the official lenders and the IMF had contributed to the bailing-out of private banks.

Another dimension to the official versus private lender burden sharing issue emerged during the 1990s. The increasing use by some of the former Soviet bloc countries and some of the larger less-developed economies of bond markets has witnessed growing concern by the banks and official lenders that bondholders are not



Source: *World Debt Tables*, *Global Development Finance*

Figure 1.



Source: *World Debt Tables*, *Global Development Finance*

Figure 2.

bearing an equitable burden of debt rescheduling (Eichengreen and Portes, 1995). This issue is taken up in more detail in Section 5.

1.3 Processes and protocols

Paris Club rescheduling agreements themselves are reached extraordinarily quickly, and usually do not exceed 1 or 2 days (Rieffel, 1985). In practice, the negotiations begin much earlier when the French government first receives a formal request from a debtor country to arrange a rescheduling meeting with its official, bilateral creditors. If the debtor does not have an IMF credit agreement covering the period over which relief is to be negotiated, it will have to begin negotiations with the IMF in order to have such a credit facility in place. Once an IMF agreement is in place, a date is set for a meeting. Before the meeting there will be a period of intensive data gathering and preparations

by the creditors. During this period, of about 2 weeks to 2 months, most of the terms are agreed in outline form at a number of preliminary discussions (Martin, 1987).

In the Paris Club meeting itself, the representatives of the debtor government are required to leave the room while the creditors discuss among themselves proposals for the terms of the relief to be granted (Griffith-Jones, 1984). These are then presented informally to the debtor's representatives. Once an informal agreement has been reached the general terms are formally announced and *Agreed Minutes* are signed. These are not published nor are the agreements they contain legally binding (Griffith-Jones, 1984).

To implement a Paris Club rescheduling agreement, the payment terms specified in the original bilateral loan agreements between each individual creditor government and the debtor have to be revised. This requires the conclusion of separate bilateral agreements with every Paris Club creditor, and, in the case of the United States and some other countries, a separate rescheduling agreement has to be concluded between the debtor government and each individual lending agency in the creditor country (Rieffel, 1985). These stages of the process can take a long time to be concluded. UNCTAD estimated that one round of Paris Club debt rescheduling may take from 12 to 18 months (Griffith-Jones, 1984). If, as is often the case with many of the most heavily indebted countries, successive reschedulings become necessary, the process becomes continuous. It can also place a heavy burden on the often limited human resource capacities of the indebted country's key economic and financial institutions.

2. Implications for the IMF's role

With the breakdown of the Bretton Woods fixed exchange rate system in the early 1970s and the subsequent LDC debt crisis that had already inflicted a number of poorer sub-Saharan African countries by the second part of the 1970s, the IMF's role in the functioning of the international financial system and the function of IMF conditionality underwent significant changes (Brown, 1992a). As both the Paris and London Clubs had come to require an IMF arrangement as a precondition for debt rescheduling, the IMF took on central role in LDC debt management. Where debt is owed to official lenders the IMF coordinates between the indebted government and the creditor governments. In practice, it is often the IMF that encourages the debtor to seek Paris Club debt relief in the first instance, and will advise it on what level of relief to apply for (Martin, 1987). For the IMF to conclude a credit agreement with a country in (imminent-) default it will need to know how much debt relief will be forthcoming to be satisfied that the country's projected external financing gap is likely to be covered. In such instances the IMF reaches a *provisional* agreement that only becomes operative after the successful conclusion of a Paris Club rescheduling agreement[6].

The IMF plays a decisive role in the negotiations themselves, and often advises the debtor on the details of procedure in the negotiations. The terms of the rescheduling agreement are in effect pre-arranged by the IMF in the course of preparing its balance of payments analysis and projections. This does not always work to the country's advantage. It has been found that debtor governments relying on the IMF to prepare their submissions to the Paris Club on their behalf have generally requested and received less debt relief than those that have acted more independently (Martin, 1987).

The IMF also plays an important role in the implementation of a Paris Club rescheduling agreement. It is usually assigned responsibility for keeping creditor

governments informed about the economic situation in the debtor country, especially concerning its debt, the servicing of this to other creditors, and about any other rescheduling agreements that the debtor may enter into with other creditors. In situations in which the anticipated Paris Club debt relief is still insufficient to close the IMF-projected balance of payments gap, the IMF has taken the initiative to call a donors' consortium meeting (made up very often of the same Paris Club creditor governments meeting under the aegis of a Consultative Group) to pledge additional balance of payments support in the form of new aid loans or grants. This enables the IMF's Executive Board to conclude the necessary credit arrangement that, in turn, enables the Paris Club to meet (Griffith-Jones, 1984; Rieffel, 1985).

As the debt crisis of the 1980s unfolded it became evident that an IMF credit arrangement with a member country performed two functions:

(1) ensuring that debtor countries adopted the policies it considered necessary for longer-term balance of payments recovery; and

(2) providing the catalyst for the provision of immediate balance of payments support in the form of new credits, additional concessional financial flows and debt relief.

It was the IMF's role as "honest broker" to determine the appropriate balance between the adjustment effort required by the indebted government, and the commitment of new external financial flows from its creditors and donors (Hudes, 1986).

However, the IMF's ability to perform this honest broker role came into question in the latter part of the 1980s. In the words of an ex-Deputy Director of the IMF's Africa Department:

> The close linkage between Fund-supported programs and debt rescheduling has given a prominent role to the Fund, but it has also on occasion placed the Fund in an uncomfortable position. In some cases, strong pressures have been exerted on the Fund to conclude a program in the absence of adequate finance. . . [to cover the projected foreign exchange gap] (Goreux, 1989, pp. 152-3).

Where creditor governments were also major "shareholders" of the IMF and are in a position to wield influence on the Executive Board, it became apparent that the IMF was prepared to relax the conditions and performance criteria normally applied in some situations, while in others it allowed functional agreements to be reached which its staff knew would not be adhered to, for the purpose of allowing a rescheduling arrangement to be struck (Sachs, 1989a, b; Edwards, 1989). This would often be for the purpose of bailing-out a particular government that the IMF's major shareholders wished to support. The experience of Egypt and Sudan under a succession of IMF credit agreements between 1978 and 1984 provides good illustrations of this (Brown, 1992a, b; Finch, 1988).

Cases of arm-twisting by the IMF's major shareholders also occurred with heavily indebted commercial debtors in Latin America. In the case of Mexico in the first half of the 1980s, an upper tranche credit agreement had to be "foisted upon a reluctant IMF. . . by the combined pressure of the US Treasury and Federal Reserve Board and the threat of Mexican repudiation" (Buiter and Strinivasan, 1987, p. 411)[7]. Sachs refers to the case of Argentina during 1987-1988:

> . . . in which the IMF and a debtor country signed a series of agreements in which almost no observers had any confidence, and in which the IMF simply relaxed the conditionality terms . . . throughout the course of the agreement. . . [because] the US government was fearful that Argentina would default to commercial banks in the absence of new IMF money. The US therefore pressured the IMF to maintain a program with Argentina despite the failure of the Argentine government to live up to earlier agreements (1989b, p. 265).

This dual and sometimes conflicting role led to a weakening of the IMF's leverage with respect to both London Club commercial creditors and in relation to its capacity to enforce conditionality on the indebted country (Eichengreen and Portes, 1995; Brown, 1992a; Finch, 1988; Sachs, 1989a). The prospects for compliance with IMF conditionality were significantly weakened as a result. As Sachs pointed out, to comply with the IMF's stringent policy conditions:

> The country bears the cost of reforms . . . while the foreign creditors appropriate much of the benefits. This overhang acts not only as a disincentive to a government to carry out a program of economic reform, but also as a political barrier to the election of reformist candidates, who seem to offer more years of austerity for the sake of continued debt servicing . . . (1992a, p. 107).

These conflicting interests were an inevitable consequence of Paris Club terms prior to 1988, as the next section elucidates. At that point, the unsustainability of the axiom of repayability underlying international debt management caused a shift in fundamental philosophy towards an easing of the pressures on client-country domestic policy makers.

3. The evolution of Paris Club terms

3.1 Immediacy over capacity: the terms to 1988

Not all debts owed to Paris Club members are reschedulable. *Eligible debt* has been traditionally restricted to official, public and publicly-guaranteed, medium-term loans having an original maturity of more than 1 year. Also excluded from most Paris Club agreements were arrears on previous Paris Club rescheduling agreements, although the rescheduling of already rescheduled debts became necessary as the debt crisis worsened in the early 1980s. Between 1983 and 1986 in 16 of the 29 follow-up reschedulings, previously rescheduled debts were included among the *eligible debt* for rescheduling (Klein, 1987).

In the Paris Club negotiations both interest and principal payments are eligible for rescheduling. The payments eligible for rescheduling are then divided into two parts: the *consolidated* and the *non-consolidated* payments. The *non-consolidated* part represents that percentage of the debt service payments due on a loan that, in principle, the creditor will not reschedule; it is expected to be serviced according to the original terms of the loan agreement. The *consolidated* share, traditionally around 85-90 per cent of the eligible debt service payments due over the whole stipulated period, is what is subject to the rescheduling agreement.

Unlike at the London Club, Paris Club negotiations throughout the pre-1988 period *never* rescheduled the entire stock of debt on which the debtor has defaulted (or may imminently default). It is only part of the existing arrears on debt service payments, as well as those obligations falling due over a specified period of time in the near future, that are *consolidated* into a "new" loan. In effect, a second layer of debt is added to that

already existing. A country's debt service-obligations are not therefore reduced, but *increased* when they are rescheduled because interest is charged on the outstanding obligations (of principal and interest) being rescheduled (Rieffel, 1985). This was described by the Ghanaian Minister of Finance, Mensah, in 1970 as "the principle of relieving debts by increasing them"[8].

Earlier, only in very exceptional circumstances would creditors agree to consolidate 100 per cent of debt service payments due, but by 1987 nearly all agreements consolidated 100 per cent of eligible maturities (World Bank, 1988). Klein (1987) found that between September 1986 and July 1987, 11 out of the 13 agreements reached consolidated 100 per cent of eligible debt service payments. Furthermore, as Rieffel (1985) points out, the distinction between *consolidated* and *non-consolidated* maturities was never very clear. In most Paris Club reschedulings since 1978, the so-called *non-consolidated* payments were also rescheduled, albeit on different, less favourable terms, with only a small part of the *non-consolidated* payments still scheduled on the original terms.

The number of months of debt service payments included under a rescheduling agreement is thus termed the *consolidation period*. This was traditionally limited to debt service payments due over a 12-month to two- and one-third-year period, although the average *consolidation period* during the early 1980s was little more than 1 year; the usual duration of an IMF Stand-By Loan Agreement (SBLA) (Griffith-Jones, 1984)[9]. In most agreements, however, there is a *goodwill clause* in terms of which, creditors agree, in principle, to consider a request from the debtor for further relief in a follow-up meeting on expiry of the *consolidation period* of the current agreement[10]. In more recent years creditors have agreed to *multi-year rescheduling agreements* (*MYRAs*), which allow for a *consolidation period* spanning a 2- to 3-year period, through the implementation of a succession of shorter consolidations which are negotiated in advance and which come into effect automatically provided certain conditions have been fulfilled (Keller, 1988). *MYRAs* were first accepted in principle by Paris Club creditors at the *London Summit* in 1984, but were explicitly not meant for chronic debtors, "that were locked in a pattern of serial rescheduling" (Rieffel, 1985, p. 36). It was only on the eve of the 1985 *Bonn Summit*, however, that the first *MYRA* was concluded at the Paris Club, with Ecuador. The first sub-Sahara African debtor to benefit from a Paris Club *MYRA* was Ivory Coast, in June 1986 (Klein, 1987)[11].

The grace period[12] attached to most rescheduling agreements was 4-5 years, with an average repayment period of around 5 years, giving a total maturity of 10 years (Griffith-Jones, 1984). In recent years, for countries considered to be facing especially difficult situations, the low-income countries of sub-Sahara African particular, a period of grace of 10 years followed by a 10-year repayment period was sometimes offered (Klein, 1987; World Bank, 1988)[13]. Nevertheless, even these latter, more generous terms were predicated on repayment crises being founded on (temporary) liquidity difficulties, not on any fundamental issue of economic solvency. Thus only the immediate cash flow burden was reduced, not the net present value (NPV) amounts due.

3.2 A shift to sustainability: the terms post-1988

That these terms operated with a fundamental misconception of the nature of the debt being renegotiated was evidenced by the rapid accumulation of further debt, as

repayment and interest rescheduling arrangements snowballed. In response, a shift in the philosophy underlying the applied terms emerged from the 1988 *Toronto Summit* of the heads of the seven leading western industrial nations. Agreement was reached on a significant departure from prevailing Paris Club principles: in rescheduling the non-concessional bilateral debt of the poorest debtor countries, Paris Club creditors would no longer be obliged to apply market terms. Instead a "menu approach" could be adopted. Creditor governments could choose among three alternative sets of rescheduling terms when negotiating with debtors at the Paris Club (World Bank, 1989). These sets were designed to cater for the variety of debt crises, and, where necessary, to ultimately reduce the NPV of outstanding debt by up to a predetermined percentage:

(1) *Lower interest rates*. All debt service due over the *consolidation period* would be rescheduled at reduced interest rates. Under *Toronto terms*' *Debt Stock Reduction* (DSR) option, this was at 3.5 percentage points below the commercial rates or one-half of the commercial rate whichever of the two gives the *smallest* reduction, over a 14-year period with 8 years of grace under.

(2) *Partial writeoffs*: Under *Toronto terms*, one third of the debt service due during the *consolidation period* could be written off, while the remainder would be rescheduled at market interest rates over 14 years with a grace period of 8 years on principal repayments. This was incorporated in both the DSR and *Debt Reduction* (DR) options.

(3) *Longer repayment terms* (*Long Maturity* or LM option): All debt service due during the *consolidation period* would be rescheduled at market interest rates, but with a 25-year maturity and a grace period of 14 years under Toronto terms. This does not affect the debt's present value.After 28 agreements with 20 countries covering about $6 billion of due payments (Daseking and Powell, 1999, p. 7), these *Toronto terms* were expanded on and superseded by *London' terms*[14] (December 1991-December 1994) that further extended the maturity period to 23 years and deepened the present value debt reduction to 50 per cent. Grace periods were removed for the DSR option. An additional option was incorporated into the menu:

(4) *Capitalisation of moratorium interest (CMI)*: While this option achieves similar ends as the DSR option, it caters more for liquidity crises by capitalising the interest accrued during a 5-year grace period into the stock of debt.

With the adoption of *Naples terms* in January 1995, the emphasis further shifted to reducing low-income countries' indebtedness. Most countries, other than less-indebted lower-middle-income countries[15], became eligible for a NPV debt reduction of two-thirds. This is achieved through below-market interest rates over extended maturity periods of 33 years for DSR and CMI terms and 23 years for the DR options. Additionally, a distinction was drawn between stocks and maturing flows under the DSR option, with a 3-year grace period applied to the former. The long maturity option continued to maintain the present value of debt by applying market interest rates, while the grace and maturity periods were further extended to 20 and 40 years, respectively. The eligibility of pre-cut-off date debt to *Naples terms* agreements is decided on a case-by-case basis depending on the perceived balance-of-payments situation. Previously rescheduled debt could be included, with NPV reduction being

"topped up" from the 33 or 50 per cent of Toronto or London terms to the 67 per cent of *Naples terms* (Boote and Thugge, 1997). The debtor country's track record with the IMF and Paris Club and internal economic adjustment policies are also important determinates in Paris Club deliberations on applying these highly concessional terms targeted at medium-term debt sustainability. The terms came into immediate use, with 13 agreements reached in the first year.

The two most recent sets of terms are associated with the institutionalisation of the low-income debt reduction process into the *Highly Indebted Poor Country* (*HIPC*) *Initiative* (see Appendix 1). Under *Lyons terms*[16], maturity periods lengthened to 40 years, grace periods to 8 years for DSR and CMI options and 6 years for DR terms, and applicable interest rates were further reduced to achieve an 80 per cent reduction in NPV. Twenty-six Paris Club debt-rescheduling agreements were concluded under *Naples* and *Lyon terms* to mid-2000. Finally, *Cologne terms* (agreed by Paris Club members in November 1999 following the G8 summit of that year) approach the maximum possible debt concessionality, with three options achieving a present value reduction of 90 per cent. Under the DR option, the remaining 10 per cent is to be paid over a 23, including a 6-year grace period. A 125-year repayment period (including 65 years grace) is applied to the DSR option; alternatively, a "bullet" option[17] was created, requiring the 10 per cent be paid over 23 years with 6 years grace, and the remainder due at the end of this period after applying an interest rate of 0.0001 and a final overall interest calculated to achieve a 99.9 per cent NPV reduction (World Bank, 2000). The potential moral hazard of flow agreements under these enhanced terms is reduced by inclusion of a clause indicating the creditors' willingness to provide a stock-of-debt operation at the end of the consolidation period if the debtor had abided by the agreement and remained in an IMF program.

4. The changing clients

4.1 Through the Asian crisis

After the 1980s experience of bank-based debt of Latin American Countries and the sovereign debt of the sub-Sahara African countries, a significant characteristic of the 1990s debt management crises is the predominate role of private rather than government indebtedness. This was particularly so during the 1997-1999 Asian crisis, where "private sector financial decisions were the main source of difficulties. Public sector borrowing played only a small role" (World Bank, 1998, p. 28). Indonesia was unique in the Asian crisis context of establishing a centralised body to coordinate the restructuring of corporate and bank debts (INDRA[18]). Given these circumstances, the Paris Club could not follow its standard meeting procedure as no institutions of the debtor state were concerned. For these reasons, in the case of Indonesia, it met in a separate forum as "Creditors of Indonesia" in September 1998, to restructure $4.3 billion of principal payments owed to Paris Club creditors as a group[19].

This event is indicative of a further trend in the Paris Club through the 1990s; namely, the decreasing number of agreements with middle-income countries. Indonesia was the only middle-income country that met with the Paris Club in 1998; Jordan was alone in 1997. In 1995, four middle-income countries reached agreements with the Paris Club.

4.2 Indebtedness issues of the former Soviet Bloc

The collapse of the Soviet Union and its network of satellite states during the 1990s significantly impacted on the logistics of international debt management. The complications were principally founded in the oblique nature of COMECON transactions, characterised by significant levels of cross-lending.

Poland's protracted negotiations formed the first significant Paris Club agreement with a former centrally-planned economy. In mid-1993, the landmark, phased-restructuring of Poland's debt was concluded. The agreement entailed a 50 per cent cancellation of the debt stock or a 50 per cent present value reduction in scheduled debt service. Conclusion of this agreement gave impetus to the even more extended London Club negotiations, as 30 per cent of the present reduction was effective immediately, while the remaining 20 per cent only came in effect after a successful program review by the IMF and a comparable restructuring of commercial bank debt. Nevertheless, the agreement exceeded the standard middle-income *Houston terms* by including an explicit debt stock reduction[20].

Within the former Soviet Union, difficulties arose from the sudden shift in trading relationships. As prices increased to world levels during 1991-1993, energy importers found their terms of terms rapidly deteriorating while there was no longer a central bank to provide finance. Russia (with Turkmenistan, the main energy exporters) introduced interest-free technical credits to finance the trade, but trade deficit states rapidly went into arrears. In consequence, the program was suspended in mid-1993, and the technical credits were consolidated into long-term loans at market interest rates and – to maintain their real value – linked to the US dollar. Again, some countries ran up arrears as the total debt owed amongst the CIS members escalated from $928 million in 1992 to $15 billion in 1994 (World Bank, 1996, p. 63). Following the Paris Club precedent of *Houston terms*, debt-for-equity swaps have also been employed as a means of resolving difficulties with indebted energy importers (see Appendix 2). In a similar vein, and indicative of concurrent movements throughout the transition economies, debt payments between the former Soviet republics were often satisfied through exchange of goods rather than currency.

Russia assumed responsibility of the former Soviet Union's liabilities along with selected assets, such as the embassies, by accepting the "zero option"[21]. In seeking to honour these obligations, Russia entered a series of distinctive Paris Club agreements. Late in 1992, negotiations commenced on an agreement (signed April 1993) to reschedule the arrears and maturities (though not interest) falling due through 1993. The unprecedented treatment of post-cut-off date debt and arrears brought debt service relief of $14.5 billion. A further agreement was concluded 4 June 1994 with respect to the principal and payments due during 1994. Its conditions entailed a 15-year payment period, including a 3-year grace, and a graduated amortization schedule to reduce immediate cash-flow pressures while still applying market interest rates. The third annual rescheduling of maturities of debts incurred prior to 1 January 1991 was concluded on 3 June 1995, applying the same terms as the previous agreement. At this agreement's conclusion, the need for a MYRA was apparent. This became the Paris Club's largest ever debt-rescheduling agreement, signed 29 April 1996. The total pre-1991 debt of $38.7 billion (excluding that previously rescheduled plus the amount owed to over former Soviet states) was rescheduled over 25 years with 6 years grace. A multi-year $10.2 billion IMF facility depended on the ongoing fulfilment of these

obligations. Reminiscent of the politicisation of Paris Club agreements with Egypt and Sudan over a decade earlier (Brown, 1992a; Finch, 1988), the deal's timing was "nakedly designed" (The Economist, 1996) to assist there-election of incumbent President Yeltsin. However, the deepening of Russia's economic crisis associated with the August 1998 default on Soviet-era bonds brought a more demanding approach by Russia to its bilateral creditors, including a substantial reduction in the present value of inherited debt[22].

Russia's payment difficulties are placed in context by Christian Noyer, chairman of the Paris Club during the mid-1990s, ranking Russia "among the world's major creditors" (The Economist, 1996). Simultaneous with its own approaches to the Paris Club for highly favourable treatment, Russia was becoming increasingly involved within the Club as a creditor. In 1997, Russia graduated from simply attending Paris Club meetings[23] on an *ad hoc* basis to eligibility to participate on the same basis as established Paris Club participants. The dues payable were a reduced stock of claims. Those from the Soviet period are reduced by an up-front discount, which – given the debtor's financial and economic situation – is implemented when Russia first treats these claims in a Paris Club framework. Additionally, Russia will be bound by the Paris Club agreement, including those that reduce the present value of claims. Russian involvement is expected to reduce the immediate bilateral nature of many previous reschedulings and to increase the comparability of treatment, hence integrity of debt forgiveness in the *HIPC initiative*.

5. Emerging economies and bond finance

5.1 Bondholders and the question of comparable treatment

In previous sections, it was noted that the principle of comparable treatment of creditors and the potential for one creditor group to end up bailing-out another have been central issues in the evolution of the Club's principles and practices. Throughout the post-WWII crises there were almost no sovereign-bond defaults, given that bonds were an insignificant source of LDC borrowing[24]. During the 1990s a number of emerging, market economies, especially former Soviet-bloc countries, came to rely more heavily on bond finance. An important factor explaining why emerging-market bond issues grew so rapidly and by the end of the century had become the main source of private credit for emerging market economies is that they were thought to carry hardly any risk of default (The Economist, 1999a). As bond creditors were not included under the Paris and London Club debt restructurings that a number of these countries negotiated in the 1990s, the issue of comparable treatment and burden sharing raised had resurfaced as a major issue for the IMF and OECD governments. The recent episode of such a conflict emerging between private bondholders and the Paris Club began with Venezuela, in 1994. The government introduced comprehensive exchange controls and ran up arrears to the Paris Club and other creditors, but rationed its foreign exchange reserves to enable full continuing service of its sovereign bonds. At the peak of the Asian crisis, Korean eurobonds were treated as senior to bank claims *ex post*, while the markets questioned the security of their seniority *ex ante* and credit spreads on the secondary market widened dramatically. Eichengreen (1999) argues that this course of action was essential for these countries' quick return to credit markets.

Some mechanism had to be found to bail-in bondholders. The IMF responded by reportedly encouraging a number of highly indebted, emerging-market borrowers to

default on their bond service payments, so as to force the bond market to share in the burden of the required debt restructuring. In 1999, Paris Club creditors insisted that Pakistan renegotiated its private-sector debt, including bonds, as a precondition for official debt relief. In the same year, the IMF required Ukraine renegotiate its bonds as a precondition for the extension of official assistance. The background was Ukrainian balance of payments difficulties, coinciding with political resistance within the US Congress to an increase in the IMF quotas given concerns that IMF resources were to be used – in effect – to bail-out private creditors. Further, international debt markets had closed with the concurrent Russian default, making a roll-over of the $90 million of maturing Ukrainian treasury bonds impossible. To resolve the conflict between Ukraine's liquidity requirements and the IMF's resource constraints, the IMF made $257 million available immediately. The bond restructuring condition was made implicit by the inclusion of minimum foreign reserve requirements that could not be met if the bonds were paid. In response, the Ukrainian government pressured bondholders to restructure voluntarily to longer-maturity eurobonds; recalcitrant bondholders were paid out with non-repatriable domestic currency. Bondholders' litigious tendencies were negated – in this instance – by Ukrainian law being the applicable jurisdiction.

The first nation to formally default on its international bonds was Ecuador, failing to pay interest after negotiations with the IMF broke down. Financial markets had expected the IMF to require a rescheduling be negotiated with bondholders, pursuant to the bond contracts' attendance conditions. However, the IMF indicated that it would only require *negotiations* in good faith for its approval of a package. Thus, the IMF apparently did not encourage Ecuador's default on its debt. Consequently, the "inept" (The Economist, 1999b) act hurt Ecuador's credit worthiness as the seniority structure was destroyed by the concentration of defaults on *Brady bonds*[25].

Like Ukraine and other former socialist economies, Romania's external obligations are characterised by relatively low indebtedness (less than 30 per cent of GDP) but sharp repayment periods implying high cash-flow demands. In mid-1999, two sets of bonds matured simultaneously and IMF assistance was sought. Elements of the standby agreement required Romania to roll over 80 per cent of the bond debt, but this was prohibited by the debt's location on secondary markets. As a secondary recourse, a further bond sale (to effectively raise an equivalent amount as the rollover) also failed to raise sufficient funds. Thus private creditors had successfully called the bluff of the IMF's resources (Eichengreen, 1999).

While bailing-in the bond market might seem a perfectly sensible reaction by the IMF to this development, it is not a straightforward matter. By the end of 1999 it had become clear that there was little agreement among OECD countries on how the IMF could or should best achieve a bailing-in, making it unlikely that a quick solution will be found. Bond-market borrowings raise some awkward questions. The legal structure of bonds makes it difficult for them to be rescheduled; bondholders are widely scattered and often anonymous; and, creditors can often sue in the event of default (The Economist, 1999a).

The G-10 countries and particularly the US, have argued that bond contracts should be changed to include clauses that allow for orderly restructuring in the event of default. However, while most OECD countries are in favour of such measures being applied to emerging countries' bond contracts, they do not favour their inclusion in

their own bonds. Creating a two-tier bond market has historically been opposed by the emerging economies on the grounds that this would be tantamount to relegating theirs' to the status of junk bond (The Economist, 1999a)[26].

Pakistan has been widely cited as the most significant Paris Club agreement over the 1990s, an importance flowing from its potentially precedent-setting inclusion of bondholders in comparability-of-treatment clauses. The background to the agreement was an increasing balance-of-payments deficit following many years of economic mismanagement by Prime Minister Sharif, and a subsequent military coup and consequent international isolation. By early 1999, $700 million of bonds were outstanding, loomed over by $3 billion of debt to Paris Club creditors and $26 billion to other official sources. Despite Pakistan's protests during negotiations, the Paris Club agreement extended the non-discrimination clause to sovereign bonds falling due during the consolidation period. Such treatment was also explicit in the approval of the second instalment on an IMF arrangement, made immediately prior to the conclusion of the Paris Club agreement. One difficulty with such arrangements is their apparent arbitrary nature: unlike most Paris and London Club debt, bonds generally have long maturity periods, without a representative spread of bondholders forced (in the bond market vernacular) to "take a haircut."

However, this incident (like the others discussed here) can be distinguished from other debtors: the bonds were only a small portion of the total external liabilities; and, the instruments were British-style, requiring only a majority agreement on restructuring rather than the greater legal difficulty of unanimous-consent American bonds.

The first 6 months of 2003 brought a substantial shift in parties' positions on sovereign debt restructuring mechanisms. IMF-sponsored proposals to introduce a bankruptcy court-styled sovereign debt restructuring mechanism (SDRM) were allowed to slip in favour of the US government's and bond markets' preferred option of inserting collective action clauses into bonds. Mexico, a long-standing critic of such clauses, led a wave of emerging markets to issues bonds that included them. Brazil and, it was rumoured, South Africa quickly followed. Further evidence that collective action clauses had become a standard feature of sovereign bond issues (including "American-rules" bonds) was provided by the Uruguayan government when it sought to swap much of its existing debt for new bonds incorporating the clause (The Economist, 2003).

5.2 The need for a new club?

One possibility, as recommended by Macmillan (1995) and supported by Eichengreen and Portes (1995), is the formation of another creditors' club: a Bondholders' Council that would be responsible for restructuring bond debts in times of crisis and which would rely on a "specially constituted conciliation and mediation service designed to minimize the danger of an extended deadlock ... [and] [C]hanges in bond covenants to permit a majority of creditors to alter the terms of payment [and] prevent dissident investors from holding up the settlement" (Eichengreen and Portes, 1995, p. xvii). The important question arises as to whether bondholders' club would need to be created from above, through interventions by a multilateral international institution such as the IMF, or whether such a club (or council) is likely to emerge spontaneously within the international financial markets as it moves into the new millennium.

Eichengreen and Portes argue that the experience of the nineteenth century through to the 1930s shows that "[S]ignificant institutional innovations sprang up in response to . . . difficulties . . .[where] Bondholders represented themselves in negotiations with sovereign debtors by forming committees" (p. 19). Such committees proliferated in the UK and USA and in both countries their status became regularized through the establishment of formal bondholders' organizations; the Corporation of Foreign Bondholders in the UK, in 1868, and the Committee on Foreign Securities in the USA, in 1918, succeeded by the Foreign Bondholders Protective Council in the mid-1930s. However, the spontaneous emergence of such councils did not obviate the need for official, government recognition, upon which their authority ultimately depended. Nor, as they point out, were these councils ever successful in averting default. Negotiations of bond debt restructuring only occurred once the indebted government had resorted to a unilateral standstill on debt service obligations, for the probable reason that if bondholders' councils announced the need for such negotiations, this would send signals to the markets likely to cause bond prices to collapse[27].

Eichengreen and Portes (1995) have recommended that in the event of a number of competing bondholders' committees emerging, as in the nineteenth century, it would be necessary for the IMF and OECD governments (or, G-N) to formally recognize the right of one such committee (a "Bondholders' Council"?) to represent the bondholders in negotiations with indebted government, in the expectation that these would ultimately evolve into organizations similar to the London and Paris Clubs. It still needs to recognized that:

(1) countries that in the past were reluctant to suspend debt service payments on bonds for fear of how this would affect their perceived creditworthiness in financial markets would not necessarily be enticed nor could be compelled to negotiate with a bondholders' council; and

(2) restructuring negotiations would still take a long time to complete unless some instrument can be found to exert leverage to compel indebted governments to reach a quick conclusion. One suggestion is that some formal agreement on coordination among the IMF, London and Paris Clubs and the Bondholders' Council be established that would in effect make the final restructuring agreement with each organization dependent on successful negotiation with the others.

6. Concluding remarks

The sustainability of the international financial architecture depends on the strengths of its constituents. The key institution underlying the performance of the Clubs has been the IMF. The contortionism required for its supporting act grows, as the Fund's multiple conflicting interests seek dominance. The Fund's founding *raison d'être* was to act as prudential supervisor to the Bretton Woods arrangement and the financial relations amongst its members. Thus it gains privileged information about its members' financial and economic status. Simultaneously, it shares some characteristics of a private company, in which shareholders seek to maximise their returns – or, for the IMF, minimise their required contributions. Dominant shareholders may be inclined to exercise their influence for their perceived benefit. And international concern increases for the perpetually destitute. Thus, the Fund's involvement in mediating the exposure of the various parties to the recurrent financial

storms is inevitably contentious, and the existing arrangements may be far from optimal. Its transformation in response to these conflicts, and the consequential changes within the Clubs, will remain part and parcel of the international financial architecture's ongoing evolution for the coming century.

Notes

1. The ancient and universally accepted doctrine that contracts must be performed.
2. The term "membership" has come to be applied rather loosely in the literature on the Clubs, referring to a creditor country's eligibility to participate fully in Club rescheduling negotiations; e.g. Russia has recently been admitted as a Paris Club "member".
3. Other non-OECD creditor countries, including Argentina, Israel, Mexico, South Africa, Brazil and Russia have participated in Paris Club meetings.
4. Used by Eichengreen (1999, p. 2) amongst others to describe the variety of (predominately) rich-country summits, where $N = 7, 8, 10, 22$.
5. In September 1988, however, Argentina's creditors including the World Bank, broke with this principle and pushed ahead with a rescheduling agreement without the IMF's involvement (The Economist, 1988).
6. Rieffel (1985) cites three instances in which IMF conditionality was not possible because the debtor countries were not IMF members at the time; namely, Poland, Cuba and Mozambique. In these cases the creditors had to negotiate policy reforms directly with the debtors, without formal IMF involvement.
7. See also Edwards (1988) on the same point in the context of his analysis of the threat of default by one or more of the HICs.
8. Quoted from the *Financial Times*, 21 August 1971 by Korner *et al.* (1986, p. 120).
9. There was a slight lengthening of the average consolidation period to 15 months, between 1985 and 1987 (Keller, 1988).
10. There is also an improved goodwill clause which represents a stronger degree of commitment by the creditors in the sense that it also specifies some of the rescheduling terms and the exact length of the consolidation period to be applied at the next rescheduling (Keller, 1988).
11. Apart from these two cases, Yugoslavia was the only other debtor to enjoy a MYRA. In 1988, it was reported that there had been no further MYRAs or other forms of Paris Club rescheduling agreements after the first half of 1986 (Keller, 1988); however, the requirements of Russia's debt and the Highly Indebted Poor Country (HIPC) Initiative would later demand the reemployment of these terms.
12. A period during which only interest falling due need be paid, not principle.
13. In 1987 a "working group" of Paris Club creditors agreed more formally to the principle of preferential debt consolidation for the poorest, heavily indebted countries, particularly those in sub-Sahara Africa, that "were pursuing far-reaching economic reforms" (Keller, 1988, p. 6). By the end of that year seven countries, six of which were from sub-Sahara Africa had been accorded extended repayment periods under this arrangement (Keller, 1988). For all other countries, a maturity of 10 years with 5 years' grace remains the norm.
14. Also called "enhanced Toronto" and "enhanced concessions" terms.
15. Countries with per capita incomes exceeding US $500 and indebtedness of less than 350 per cent of exports. The conditionality applied to these countries allowed only a 50 per cent reduction in NPV.
16. Applied from December 1996, these terms are actually a product of the 1997 G7 Lyons Summit.

17. The objective was to achieve the substance of debt reduction, while maintaining the legal form required by some creditors.
18. Indonesian Debt Restructuring Agency, which consolidated the private sector's external liabilities.
19. The ongoing nature of Indonesia's economic difficulties did force it to eventually (early 2000) seek a Paris Club agreement in the conventional manner.
20. Albania is another, less usual case. An agreement was entered in December 1993; however, as the applicable debt was all short-term, the usual format of Agreed Minutes was not appropriate. Instead, a Terms of Reference for Rescheduling Public External Debt set uniform terms: arrears to be paid on 7-year maturity with 2-years grace.
21. So-called as it entailed the other republics giving up all claims to assets and responsibility for all Soviet-era liabilities.
22. At the time of writing (September 2000), Russia was in negotiations with the Paris Club on $42 billion of debt. It was officially seeking a halving of present value.
23. This follows in the precedent of Brazil, which came to the Paris Club as both creditor and debtor during the late 1980s.
24. Exceptions are Panama and Nigeria during the 1980s.
25. Named after Nicholas Brady, a US Treasury Secretary during the late 1980s who helped supervise the Latin America debt restructuring. Defaulted commercial bank loans undergo a debt reduction operation and are reissued as "Brady bonds" backed by 30-year American Treasury bonds (and thus tend to follow an exaggerated variation in the US bond market). A Brady bond program is usually associated with an IMF structural adjustment program.
26. Some may argue that, by the early 2000s, there existed some instances where this was the case.
27. It should be noted that comparisons with nineteenth century international debt management are problematic. The situation moving into the twenty-first century is best characterised as one of increasing disparateness amongst bondholders, in terms both of geography and institution.

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Appendix 1. The HIPC initiative process

The process of receiving reduction in debt-stock under the HIPC initiative is a multi-stage process, characterised by repeated determination of a country's eligibility.

Pre-conditions for HIPC

- *Before requesting consideration for eligibility for HIPC initiative assistance, countries must have prepared and adopted a detailed Poverty Reduction Strategy Paper (PRSP)*. This can be subject to stringent requirements from the International Financial Institutions (IFIs), although there is some flexibility in this process – e.g. Uganda's application was accelerated after it introduced an independently administered Poverty Fund.
- *Countries must be eligible for assistance*:Ie: International Development Association (IDA) loans, and the IMF's Enhanced Structural Adjustment Facility (ESAF).
- *Countries must have a strong track records of performance under IMF and World Bank programs*.
- *The applicant country would not be expected to achieve a sustainable external debt situation otherwise*.

The definition of sustainability is a function of the prevailing HIPC initiative – i.e. a lower level of debt is considered as "sustainable" under the 1999 Enhanced HIPC initiative (the initiative was expanded to be "deeper, broader, faster" following the 1999 Cologne G8 Summit).

As of April 2000, 41 countries met these criteria. 32 of these qualified through the low-income requirements, and a further nine were otherwise eligible for concessional rescheduling by the Paris Club. At end-1997, these countries' debt stood at $201 billion. 26 had reached their decision points in 1999-2000, and a further eight were expected to do so from 2001. The cost of the enhanced HIPC initiative has been estimated at $27.4 billion for the 33 countries expected to qualify (Andrews *et al.*, 1999).

Phases of the HIPC initiative

- *First phase*:Applicant countries must adopt and pursue for 3 years an IMF/World Bank program. During this period, they continue to receive usual concessional assistance (e.g. Paris Club agreements on *Naples terms*).

- *Decision point*:A Debt Sustainability Analysis (DSA) is performed. If the NPV of external debt exceeds 150 per cent of exports, then the country qualifies for assistance.

  The debt burden of very open economies (defined as those with exports exceeding 30 per cent of GDP) is determined with respect to fiscal revenues (revenues must exceed 15 per cent of GDP); "sustainable" debt being a NPV less than 250 per cent of fiscal revenue (which is also, *ipso facto*, below the 150 per cent of exports criterion).

  At this point, the Executive Boards of the IMF and the World Bank decide on a country's eligibility. The Boards must be sufficiently assured that bilateral creditors will also embark on debt relief programs.

- *Second phase*:The applicant country must continue its good performance: there must be satisfactory implementation of structural adjustment programs agreed at the decision point, the maintenance of macroeconomic stability, and the implementation "of a poverty reduction strategy developed through a broad-based participatory process" – i.e. incorporating *civil society* organisations, such as Oxfam.

  This phase does not explicitly envisage any time frame; rather, "floating" completion points are used, so countries such as Uganda can be accelerated towards debt relief.

  The funds needed to satisfy all three of these conditions are obtained through bilateral and commercial creditors rescheduling obligations falling due. *Lyons* or *Cologne terms* are applied in Paris Club agreements to achieve a 90 per cent reduction in NPV. IDA and the IMF also provide "interim relief" between the decision and completion points.

- Completion point:At this point, the remaining debt assistance is provided.

  Bilateral, commercial creditors: Provide up to 90 per cent reduction in the present value of the remaining stock of debt (subject to burden sharing). This will be exceeded by some bilateral creditors, such as the United Kingdom, which has led the debt relief initiatives.

  Multilaterals: Further reduce the NPV of their claims, given all creditors act to achieve sustainable future debt obligations. These commitments are funded through sale of the IMF's gold stocks and a Trust funded by the World Bank's and regional banks' shareholders (Andrews *et al.*, 1999).

Appendix 2. Debt swaps

After being much discussed through the 1980s, in 1990 the Paris Club creditors commenced including clauses in their agreements allowing debtors to swap part of their external obligations for equity, nature, development or other domestic currency obligations. The full value of Overseas Development Assistance (ODA) debt and 10 per cent or $10 million (whichever larger) of non-ODA obligations were swappable under Houston terms. These ceilings were doubled following the 1999 *Cologne G8 Summit*. The rationale falls on swaps achieving an outcome closer to the optimum than would a more constrained bargaining process: the creditor accepts less than the debt's face value in the form of, e.g. a humanitarian outcome and given the probability of expected future repayment, while the debtor may pay a higher price for cancellation as it retains some benefit and demands are reduced on scarce foreign exchange reserves. Thus, those countries failing to qualify for consideration under the (enhanced) *HIPC initiative* remain eligible for debt swaps.

Since 1987, when the first debt-for-nature swap occurred between Bolivia and Conservation International (establishing the precedent of NGOs' involvement in debt rescheduling as a [profitable] arbitrageur between the debtor government and the obligation's seller-profit is made from the difference between the debt's *purchase price* and its local currency *redemption price*), over $1 billion of swaps were organised involving in excess of 30 troubled debtors, although

swaps involving France and its former colonies constitute the bulk of these totals. The targeted programs include forest protection, desertification reversal, low-income housing, primary education and other analogous issues considered important by creditor governments (see UNDP, 1998; for a generalist introduction to debt-for-environment swaps, and Zagonari, 1998; for a technical contrast of the logistics of debt-for-environment and debt-for-development swaps).

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