



CRS Report for Congress

The Paris Club and International Debt Relief

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Summary

The Paris Club is a voluntary, informal group of creditor nations who meet approximately 10 times per year, to provide debt relief to developing countries. Members of the Paris Club agree to renegotiate and/or reduce official debt owed to them on a case-by-case basis. The United States is a key member and Congress has an active role in both Paris Club operations and U.S. policy regarding debt relief overall. The Federal Credit Reform Act of 1990 stipulates that Congress must be involved in any official foreign country debt relief and notified of any debt reduction and debt renegotiation. This report will be updated as events require.

The Paris Club is the major forum where creditor countries renegotiate official sector debts. Official sector debts are those that have been either issued, insured, or guaranteed by creditor governments. A Paris Club ‘treatment’ refers to either a reduction and/or renegotiation of a developing country’s Paris Club debts. The Paris Club includes the United States and 18 other permanent members, the major international creditor governments. Besides the United States, the permanent membership is composed of Austria, Australia, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Italy, Japan, Netherlands, Norway, Russia, Spain, Sweden, Switzerland, and the United Kingdom. Other creditors are allowed to participate in negotiations on an ad-hoc basis.

By contrast, the London Club, a parallel, informal group of private firms, meets in London to renegotiate commercial bank debt. Unlike the Paris Club, there is no permanent London Club membership. At a debtor nation’s request, a London Club meeting of its creditors may be formed, and the Club is subsequently dissolved after a restructuring is in place.

The Paris Club does not exist as a formal institution. It is rather a set of rules and principles for debt relief that have been agreed on by its members. To facilitate Paris Club operations, the French Treasury provides a small secretariat, and a senior official of the French Treasury is appointed chairman. The current Paris Club chairman is Jean-Pierre Jouyet, Under-Secretary of the French Treasury. In addition to representatives from the creditor and debtor nations, officials from the international financial institutions (IFIs) and the regional development banks are represented at Paris Club discussions. The IFIs

present their assessment of the debtor country's economic situation to the Paris Club. To date, the Paris Club has reached 405 agreements with 84 debtor countries. Since 1983, the total amount of debt covered in Paris Club agreements — rescheduled or reduced — is approximately \$505 billion.

Paris Club Operations

Since the first debt restructuring took place in 1956, the terms, rules, and principles of the Paris Club have evolved to their current shape. This evolution occurred primarily through the G7/8 Summits.¹ Five 'principles' and four 'rules' currently govern Paris Club treatments. Any country that accepts the rules and principles may, in principle, become a member of the Paris Club. Yet since the Paris Club permanent members are the major international creditor countries, they determine its practices.

The five Paris Club 'principles' stipulate the general terms of all Paris Club treatments. They are: (1) Paris Club decisions are made on a *case-by-case* basis; (2) all decisions are reached by full *consensus* among creditor nations; (3) debt renegotiations are applied only for countries that clearly need debt relief, as evidenced by implementing an International Monetary Fund (IMF) program and its requisite economic policy *conditionality*; (4) *solidarity* is required in that all creditors will implement the terms agreed in the context of the renegotiations; and (5) the Paris Club preserves the *comparability of treatment* between different creditors. This means that a creditor country cannot grant more favorable terms to a debtor country a treatment on more favorable terms than the consensus reached by Paris Club members.²

While Paris Club 'principles' are general in nature, its 'rules' specify the technical details of Paris Club treatments. The 'rules' detail (1) the types of debt covered - Paris Club arrangements cover only medium and long-term public sector debt and credits issued prior to a specified "cut-off" date; (2) the flow and stock treatment;³ (3) the payment terms resulting from Paris Club agreements; and (4) provisions for debt swaps.⁴

Since the Paris Club is an informal institution, the outcome of a Paris Club meeting is not a legal agreement between the debtor and the individual creditor countries. Creditor countries that participate in the negotiation sign a so-called 'Agreed Minute.' The Agreed Minute recommends that creditor nations collectively sign bilateral agreements with the debtor nation, giving effect to the multilateral Paris Club agreement. By recommending that the United States renegotiate or reduce debts owed to it, congressional involvement is necessary to implement any Paris Club agreement.

¹ The G8 Summit brings together the leaders of Canada, France, Germany, Italy, Japan, Russia, the United Kingdom, and the United States, annually, to discuss a wide range of political, social, and economic issues.

² For more information on Paris Club principles and rules, see [<http://www.clubdeparis.org>].

³ The flow treatment provides a method for the debtor country to progress through temporary balance of payments difficulties. Stock treatment specifies what portion of a country's 'stock' of debt is covered by the Paris Club agreement.

⁴ A debt swap is a transaction in which a company, or in the case of the Paris Club, a country, exchanges debt for other assets, such as foreign aid, equity, or local currency debt.

Paris Club Terms

There are four type of Paris Club treatments depending on the economic circumstances of the distressed country. They are, in increasing degree of concessionality: **Classic Terms**, the standard terms available to any country eligible for Paris Club relief; **Houston Terms**, for highly-indebted lower to middle-income countries; **Naples Terms**, for highly-indebted poor countries; and **Cologne Terms**, for countries eligible for the IMF and World Bank's Highly Indebted Poor Countries Initiative (HIPC). Classic and Houston terms offer debt rescheduling while Naples and Cologne terms provide debt reduction.

Classic Terms. Classic terms are the standard terms for countries seeking Paris Club assistance. They are the least concessional of all Paris Club terms. Debts are rescheduled at an appropriate market rate.

Houston Terms. Houston terms were created at the 1990 G-7 meeting in Houston, Texas so the Paris Club could better accommodate the needs of lower middle-income countries. Houston terms offer longer grace and repayment periods on development assistance than do Classic terms.

Naples Terms. Naples Terms, designed at the December 1994 G-7 meeting in Naples, Italy, are the Paris Club's terms for cancelling and rescheduling the debts of very poor countries. Countries may receive Naples terms treatment if they are eligible to receive loans from the World Bank's concessional facility, the International Development Agency (IDA). A country is eligible for IDA loans if it has a per-capita GDP of less than \$755. According to Naples Terms, between 50% and 67% of eligible debt may be cancelled. The Paris Club offers two methods for countries to implement the debt reduction. Countries can either completely cancel the eligible amount, and reschedule the remaining debts at appropriate market rates (with up to 23-year repayment period and a six-year grace period); or they can reschedule their total eligible debt at a reduced interest rate and with longer repayment terms (33 years).

Cologne Terms. Cologne terms were created at the June 1999, G-8 Summit in Cologne, Germany.⁵ Cologne terms were created for countries that are eligible for the World Bank and IMF 1996 Highly Indebted Poor Countries Initiative (HIPC).⁶ They allow for higher levels of debt cancellation than Naples Terms. Under Cologne terms, 90% of eligible debts can be cancelled.

⁵ A list of all Paris Club debt reductions under Cologne Terms can be found online at [http://www.clubdeparis.org/en/countries/countries.php?TYPE_TRT=CO].

⁶ CRS Report RL33073, *Debt Relief for Heavily Indebted Poor Countries*, by Martin A. Weiss; and CRS Report RS22534, *The Multilateral Debt Relief Initiative*, by Martin A. Weiss.

The Evian Approach

On October 8, 2003, Paris Club members announced a new approach that would allow the Paris Club to provide debt cancellation to a broader group of countries. The new approach, named the “Evian Approach” introduces a new strategy for determining Paris Club debt relief levels that is more flexible and can provide debt cancellation to a greater number of countries than was available under prior Paris Club rules. Prior to the Evian Approach’s introduction, debt cancellation was restricted to countries eligible for IDA loans from the World Bank under Naples Terms or HIPC countries under Cologne terms. Many observers believe that strong U.S. support for Iraq debt relief was an impetus for the creation of the new approach.

Instead of using economic indicators to determine eligibility for debt relief, all potential debt relief cases are now divided into two groups: HIPC and non-HIPC countries. HIPC countries will continue to receive assistance under Cologne terms, which sanction up to 90% debt cancellation. (The United States and several other countries routinely provide 100% bilateral debt cancellation.) Non-HIPC countries are assessed on a case-by-case basis.

Non-HIPC countries seeking debt relief first undergo an IMF debt sustainability analysis. This analysis determines whether the country suffers from a liquidity problem, a debt sustainability problem, or both. If the IMF determines that the country suffers from a temporary liquidity problem, its debts are rescheduled until a later date. If the country is also determined to suffer from debt sustainability problems, where it lacks the long-term resources to meet its debt obligations and the amount of debt adversely affects its future ability to pay, the country is eligible for debt cancellation.

The Role of Congress

Congress has an active role in shaping United States debt relief policy. Title V of the Omnibus Budget Reconciliation Act of 1990, The Federal Credit Reform Act of 1990 (P.L. 101-508; 2 U.S.C. 661 et. seq) set new guidelines for the cost accounting of credit and loan programs in the U.S. budget. Following the passage of the act, when a new loan program is created, Congress must make a specific appropriation to cover the cost of the program. These rules also apply to changing the terms or reducing the amount of existing loans. Thus, Congress must appropriate in advance the anticipated cost of any U.S. debt relief. Typically, the appropriated amount is included in the annual Foreign Operations spending measure.

The method that the U.S. Government uses to value foreign loans is also based on the Federal Credit Reform Act of 1990. The act requires that U.S. loans be valued at the net present value and not their face value. Determining the net present value is a complex calculation involving several factors including the terms of loan (whether it is concessional or at market rates) and the financial solvency of the debtor and their likelihood of repayment. In effect, this means that the U.S. government can forgive large amounts of foreign debt with very little budgetary implication. For example, on December 17, 2004, the United States forgave 100% of the debt that Iraq owed to the United States, worth \$4.1 billion, with a budgeted \$360 million, the determined net present value of the outstanding debt.

The United States began participating in Paris Club debt forgiveness in 1994, under authority granted by Congress in 1993 (Foreign Operations Appropriations , section 570, P.L. 103-87). Annually re-enacted since 1993, this authority allows the Administration to cancel various loans made by the United States. These can include U.S. Agency for International Development (USAID) loans, military aid loans, Export-Import Bank loans and guarantees, and agricultural credits guaranteed by the Commodity Credit Corporation.

Issues for Congress

The second session of the 110th Congress may address several issues related to Paris Club debt relief. Members of the private sector frequently raise concerns about the procedure for providing debt relief and a perceived lack of input into debt relief negotiations, especially considering that foreign investment is the largest source of external finance for low and middle income countries, significantly higher than foreign assistance. In addition, many observers are concerned that in the wake of substantial Paris Club and multilateral poor country debt relief several emerging creditors are extending large loans to poor countries, potentially prompting a new round of debt crises among developing countries.

The Paris Club and Private Sector Activity. The private sector financial community has frequently expressed concerns about Paris Club operations. When the Paris Club was created in 1956, official capital flows (government finance) dominated total capital flows to developing countries. This situation has since changed dramatically. The bulk of developing country debt is now held by the private sector and private capital flows account for more than five times official borrowing worldwide.⁷

One private sector concern is a perceived lack of input in Paris Club negotiations. While Paris Club only reschedules ‘official sector’ debt, the outcome of their negotiations greatly affects the private sector’s ability to renegotiate debts owed to the them by sovereign creditor nations. Private sector officials are also concerned that official Paris Club debt is not written down to its appropriate market value, as private debt often is during a restructuring. This could possibly distort the value of a country’s debt and lead to an increase in the private sector’s share of the debt relief burden. Since 2001, the Paris Club has held annual meetings with the private sector to discuss these concerns.

Emerging Creditors. Paris Club member countries and the multilateral development institutions are increasingly providing foreign assistance in the form of grants rather than loans. In 2002, the United States introduced a new grant-making foreign assistance program, the Millennium Challenge Account.⁸ At the World Bank, 30% of assistance to the poorest countries is now provided as grants.⁹ At the same time as traditional creditors are switching to grant-based assistance, several new creditors have begun providing large-scale loans to low-income countries. Some argue that these emerging creditors are taking advantage of low debt levels in poor countries (because of

⁷ Tirole, Jean. *Financial Crisis, Liquidity, and the International Monetary System*. Princeton University Press, 2002.

⁸ CRS Report RL32427, *Millennium Challenge Account*, by Curt Tarnoff.

⁹ CRS Report RL31136, *World Bank: IDA Loans or IDA Grants?*, by Jonathan E. Sanford.

recent Paris Club and multilateral poor country debt relief) and are engaging in “opportunistic lending.”¹⁰ Among non-Paris Club lenders, China is by far the largest international creditor with \$5 billion in foreign claims as of year-end 2004.¹¹ Africa has been of special interest to Chinese investors.¹² Recent investments include a \$1.9 billion deal between the Angolan government and a consortium of Chinese companies to upgrade its railroad infrastructure and an \$8.3 billion investment to build an 1,800 mile railroad in Nigeria. Besides China, other large emerging creditors are Brazil, India, Korea, Kuwait, and Saudi Arabia.

While Paris Club creditors have established clear and transparent rules for their foreign assistance, little is known about the terms of this new lending. Many Western donors are concerned that new accumulated debt will create a new cycle of poor-country indebtedness and will erase any potential gains from recent debt relief efforts by Paris Club creditors and the international financial institutions. According to the IMF, many emerging creditors loans “have nontraditional financial structures (including implicit or explicit collateralization, foreign exchange clauses, and variable fees).”¹³ If this debt is non-concessional, short-term, and at rates that poor countries cannot afford over the long-term, a potential debt crisis may be looming. This presents a significant challenge to the international community and the members of the Paris Club. The Paris Club will likely have to reach out to emerging creditors over the next several years and try to harmonize their lending with the existing norms. According to one analyst, “either it will include new members such as China, or it will close.”¹⁴

¹⁰ Leo, Ben and Seth Searls, and Lukas Kohler. “Achieving Debt Sustainability in Low-Income Countries: Past Practices, Outstanding Risks, and Possible Approaches,” Department of the Treasury Office of International Affairs.

¹¹ “Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief,” World Bank and International Monetary Fund, November 6, 2006. p. 8.

¹² See Traub, James. “China’s African Adventure” *New York Times*, November 19, 2006; Beattie, Alan and Eoin Callan, “China loans create ‘new wave of Africa debt,’” *Financial Times*, December 7, 2006; Lombard, Louisa. “Africa’s China Card” *Foreign Policy: Web Exclusive*, April, 2006; Moss, Todd and Sarah Rose. “China’s Export-Import Bank and Africa: New Lending, New Challenges” *Center for Global Development*, November 11, 2006.

¹³ World Bank and International Monetary Fund, *op. cit.*, p. 8.

¹⁴ Cohen, Daniel. “The Paris Club at Fifty” Paper prepared for the 50th anniversary of the Paris Club. Paris Club International Policy Forum. June 14, 2006. Available at [http://www.clubdeparis.org/en/anniversary/pdf/articlecohen_english.pdf].