Club de Paris
Paris Club

19 SEPTEMBER 2008

## *PARIS CLUB CONTRIBUTION TO THE DOHA CONFERENCE ON FINANCING FOR DEVELOPMENT (29th November-2nd December 2008)*

The Financing for Development Review Conference will take place in Doha (Qatar) from 29 November to 2 December 2008 under the aegis of the United Nations. Its main purpose is to draw up a shared assessment of the implementation of the Consensus reached in Monterrey (Mexico) in 2002 and to sketch out renewed priorities in response to new challenges.

Chapter II.E of the Monterrey Consensus, which is now mirrored by Chapter V in the Doha Outcome drafted by the UN co-facilitators at the end of July 2008, specifically deals with external debt.

As a group of major sovereign creditors that has been involved in restructuring operations for countries facing debt problems over more than 50 years, the Paris Club is particularly well placed to provide substantive inputs in debt related discussions within the frame of the Doha Conference, both as an expert and as a stakeholder.

The Paris Club submission first comprises an assessment of the implementation of the Monterrey provisions on external debt (I). It then articulates policy recommendations on critical issues that are key to advance the agenda on debt in the coming years (II).

### I. Since Monterrey, international debt relief initiatives have made significant progress, leading to a sharp decline of debt burdens in low-income countries

**1.** The Monterrey Consensus called for swift and effective progress under the enhanced HIPC (Heavily Indebted Poor Countries) initiative, in order for eligible countries to reap full benefits associated with debt relief, i.e. improved indebtedness outlooks, increased resources available for poverty eradication and enhanced access to private financing sources.

To date, 23 countries (19 since Monterrey) have benefited from full and irrevocable debt relief after reaching the HIPC completion point, with a total reduction of US$ 35 billion (in end-2007 net present value terms). Ten more countries have gone through decision point and have been granted an additional US$ 16 billion in interim debt relief. Debt relief for the remaining 8 pre-decision point countries is estimated at US$ 20 billion.

Once completed for the 41 eligible countries, the HIPC initiative is expected to provide a total of US$ 71 billion, with an additional US$ 33 billion delivered under the MDRI (Multilateral Debt Relief Initiative).

**2**. Debt relief, along with other factors (improved macroeconomic performance, strengthened debt management…), has led to a sharp decrease in indebtedness ratios in beneficiary countries, thus freeing up resources for additional public spending on development and poverty reduction.

As a result of HIPC debt relief, the 23 post-completion point countries' external debt stock fell by more than 90% (in end-2007 NPV terms) compared to their pre-HIPC situation. At end-2007, the NPV of the debt-to-export ratio for post-completion point HIPCs averaged 63%, compared to 200% for pre-completion point countries. Debt service has also declined as a percentage of GDP in the 33 post-decision point HIPCs, from a peak of nearly 5% on average in 2000 to 1,5% in 2006 and less than 1% projected through 2010.

At the same time, poverty-reducing expenditures have risen by about 2% of GDP (from 7% of GDP in 1999 to 9% in 2006). Although no unequivocal correlation can be derived of those figures, there is no doubt that debt relief has significantly contributed to enlarge fiscal space in beneficiary countries and help them mobilize more public revenue for development purposes.

**3**. The Paris Club contribution to HIPC debt relief amounts to US$ 25,5 billion in end-2007 NPV terms for the 33 post-decision point HIPCs (50% of the overall assistance), of which:

- US$ 18,8 billion granted to the 23 post-completion point HIPCs, with US$ 11,5 billion corresponding to 100% of the debt relief effort committed by the Paris Club within HIPC and an additional US$ 7,4 billion provided within bilateral efforts by Paris Club members beyond HIPC ;

- US$ 7,1 billion committed in the end as part of HIPC assistance to all 10 interim HIPCs. The Paris Club has already provided preliminary and interim HIPC debt relief to those countries and some Paris Club members extend additional debt relief beyond usual HIPC assistance once decision point has been reached.

For countries outside the HIPC scope, the Paris Club has developed since October 2003 a tailor-made approach (called the "Evian approach") to address debt repayment problems on an ad hoc basis, taking into account the very nature of the difficulties faced by the country (temporary liquidity shortages, long-term insolvency risks,…). In the period from 2004 to 2006, nine countries had their external debt treated under the Evian approach, to the amount of US$ 69,3 billion, out of which US$ 47,8 billion were cancelled.

**4**. The Monterrey Consensus, now echoed by the Draft Doha Outcome, emphasized "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".

As an informal group of official creditors whose role for over 50 years has been to find coordinated and sustainable solutions to the payment difficulties experienced by debtor countries, the Paris Club has developed a consistent, transparent and predictable set of principles and terms governing debt restructuring operations. The comparability of treatment principle specifically provides for a clear and balanced framework for burden sharing amongst creditors, based on efforts by all creditors that are proportionate to their respective claims on the debtor country. Paris Club debt treatments have proven effective over time in striking a balance between creditors, as well as between creditors' interests and debtors' needs. In this respect Paris Club members have indeed not refrained from granting exceptional debt treatments, beyond usual terms, to countries with a very low payment capacity and subject to severe external macroeconomic shocks.

The Paris Club recognizes efforts by other creditors to build up mechanisms for orderly debt workouts, such as those implemented by private creditors, including bondholders (collective action clauses, “creditors committees”), providing debt reductions granted are effectively comparable to those provided by the Paris Club.

The Paris Club expresses its openness to discuss proposals for forms of sovereign debt restructuring mechanisms with a broad creditors’ participation and to achieve greater inter-creditor equity, providing they comply with the Paris Club’s core principles, and recalls that the IMF worked out a comprehensive statutory sovereign debt restructuring mechanism (SDRM) in 2002.

The Paris Club has significantly improved the transparency and accountability of its procedures, including through a website upgrade with detailed country-specific data on debt reschedulings, release of annual reports, and continued outreach efforts towards non-Paris Club sovereign and commercial creditors.

**5.** The Monterrey Consensus stressed that preventing unsustainable debt situations should be a shared responsibility of debtors and creditors.

Considering that debt sustainability in low-income countries not only requires full completion of debt relief under the HIPC initiative but also hinges upon increased vigilance on new borrowing, Paris Club members use the IMF and World Bank Debt Sustainability Framework (DSF) as a reference both to assess the risk of debt distress and to guide new lending policy decisions in light of risk analysis. Paris Club members supported the January 2008 OECD “Principles and Guidelines to promote sustainable lending practices in the provision of official export credits in low-income countries”, which commit them to meeting minimum applicable concessionality requirements established by the IMF and IDA.

The Monterrey Consensus emphasized the need to keep debt sustainability analyses under review, inter alia in order to appropriately address sudden changes in growth prospects and terms of trade that might be adversely affected by exogenous shocks. The two successive DSF reviews conducted in 2006 allowed for further improvements in debt sustainability analyses, including through a greater consideration for monitoring private and domestic public debt in low-income countries.

The Paris Club welcomes recent moves by the Bretton Woods Institutions to adapt the DSF and would deem helpful further attempts by them to update the DSF in light of rapidly evolving debt patterns in low-income countries.

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**II. The fulfilment of the Monterrey commitments crucially depend on completion of ongoing international debt relief efforts and on all creditors factoring debt sustainability in their new lending to post-debt relief low-income countries.**

**1**. Full participation of all creditors to HIPC debt relief is essential to bring debt ratios in HIPCs back to sustainable levels, in accordance with the level of debt reduction computed for each country.

Insufficient participation would cause excessive debt burdens to persist, undermine the effectiveness of the HIPC initiative and prevent eligible countries from realizing the full benefits linked to debt relief, in terms of increased spending capacity for poverty eradication and improved prospects for credit market access. Debt relief would only come at the expense of creditors who contribute their full share to HIPC and therefore "subsidize" the other creditors unwilling to undertake comparable efforts.

According to the latest available data from the IMF/World Bank, non-Paris Club official bilateral HIPC creditors as a whole have so far delivered around 40% of their expected contribution to debt relief, while commercial creditors are estimated to have delivered 33% of their commitments (up from 5% in 2007).

The Paris Club members call on those HIPC creditors who are still not in line with their debt relief commitments to upgrade their participation in the HIPC initiative. Such a move is key to ensure that the HIPC initiative delivers the amount required for beneficiary countries to bring their external debt back down to levels compatible with their projected repayment capacity.

In addition to the measures already implemented to deter aggressive litigation against HIPCs (enhancement of the Debt Reduction Facility by the World Bank, creation of a new Legal Support Facility by the African Development Bank, technical assistance offered to HIPCs by the Paris Club in their efforts to seek comparable treatment from their other creditors…), the Paris Club members encourage all creditors to take up a similar commitment to the one they made in May 2007, i.e. to avoid selling claims against HIPCs to creditors who do not intend to provide debt relief within the HIPC initiative.

**2**. Preserving long-term sustainability remains a challenge, even after provision of debt relief.

Only nine post-completion point HIPCs (out of 23) have a low risk of debt distress. Risk distribution even worsened from mid-2007 to mid-2008, while the number of countries at high risk of debt distress has increased fourfold (from one to four).

Debt sustainability in low-income countries is sensitive to a number of external factors, including export shocks and volumes and terms of new financing. In about 60 percent of debt sustainability analyses for post-completion point HIPCs, less favourable terms for new borrowing (i.e. 2% increase in the interest rate charged on new loans) cause the NPV of external debt to exports ratio to rise beyond the corresponding threshold, compared to 30% for non-HIPCs.

In this respect, Paris Club members highlight the need for a cooperative approach by all major sovereign and private low-income countries' creditors to ensure that new financing to LICs is provided in accordance with the country's long-term repayment capacity. The Paris Club members invite all creditors to respect the minimum concessionnality requirements set in the IMF and World Bank Debt sustainability analyses and derived from the DSF, with a view to preventing and limiting unsustainable borrowing.

**3**. Joint efforts by all creditors to safeguard debt sustainability in low-income countries need to be accompanied by appropriate reporting mechanisms to ensure that information on outstanding claims and new financing flows by Government and public entities (volumes allocated, concessionnality levels…) are shared amongst creditors and debtors. The Group of

24, which comprises emerging creditors as well as sub-saharan African countries, is also pushing for a better disclosure by all lenders in order to “avoid misperceptions” and “provide the basis for more informed discussions and decisions on debt sustainability”.

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| As a first contribution to increased debt transparency, Paris Club members consider releasing aggregate data on their overall claims (commercial and ODA) by the end of 2008 and encourage other major sovereign creditors to follow suit. |

Furthermore, new financing towards low-income countries needs to be tracked on a regular and homogenous basis, with all creditors to disclose amounts and conditions of new loans for a preselected sample of debtor countries. Indeed existing reporting frameworks (such as the World Bank Reporting System) mostly rely on data supplied by debtors and need to be complemented with a creditor-based information system, so as to improve reliability of collected figures. The 2008 aforementioned OECD Guidelines already commit Export Credit Group members to providing data on transactions with IDA-only countries on an annual basis.

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| Paris Club members support a framework for reporting and information sharing to ensure all major sovereign creditors align themselves with existing best practices and standards regarding disclosure on new lending flows to low-income countries. |

**4**. Paris Club members strongly favour deepening ties amongst creditors. Cooperative action lies at the heart of the Paris Club rationale and is a prerequisite for an efficient international response to debt difficulties.

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| The Paris Club therefore fully supports those provisions of the Draft Doha outcome that call for enhanced creditor coordination. The Paris Club is in fact committed to strengthening its outreach policy towards major developing countries’ sovereign creditors. |

For the first time since the Paris Club began annual meetings with commercial creditors in 2001, representatives of sovereign emerging creditors took part on June 11th, 2008. Building on this first achievement, the Paris Club proposed to convene a series of informal working sessions with major sovereign emerging creditors in Paris with a view to exchanging views and sharing practices on a broad set of issues related to debt, including approaches to debt restructuring and burden sharing among creditors, and implications of new lending to low-income countries.

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| Without prejudice to the outcome of those discussions, Paris Club members would be open to propose as a starting point some flexible arrangements to allow non-Paris Club sovereign creditors participate in Paris Club negotiations and/or ordinary sessions.<br><br>Given the primary importance it attaches to having a substantive and sustained dialogue with all creditors, the Paris Club welcomes interactions with all creditors as opportunities to learn from alternative approaches and revisit its own principles and methods, where appropriate. |