Jean-Claude Trichet: Celebrating the 50th anniversary of the Paris Club

Speech by Mr Jean-Claude Trichet, President of the European Central Bank, at the celebration of the 50th anniversary of the Paris Club, Paris, 14 June 2006.

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It is a great pleasure to be here in Paris on the occasion of the 50th anniversary of the Paris Club. This is not only because the Paris Club is an important forum that has made a major contribution in the area of orderly debt restructuring, but also because I have of course a lot of personal memories of the long time – from 1982 until 1993 – that I spent actively participating in its activities, together with a lot of close friends from all over the world.

The Paris Club, which is responsible for the rescheduling of official bilateral credits to developing and emerging market economies, has played a remarkable role as a forum for crisis management and resolution. Embedded in the international financial system, the Paris Club has responded to the changing international financial landscape and the various financial crises over the last few decades by systematically adapting its modus operandi to the varying needs of the different groups of indebted countries. In particular, once it was recognised that traditional mechanisms were not sufficient to attain sustainable external debt levels, the Paris Club introduced increasingly concessional debt restructuring terms and, as of the late 1980s, debt reduction mechanisms as well to address the rising debt burdens of certain countries. During that time, the Paris Club reached its peak level of activity. More recently, the number of countries rescheduling with Paris Club creditors has been declining, reflecting enhanced access by middle-income countries to market financing and more comprehensive debt stock treatment of low income countries. Since its first debt rescheduling meeting in 1956, the Paris Club has been highly effective and has reached some 400 agreements with 81 debtor countries, covering a total of USD 523 billion in nominal value. The success of the Paris Club is understandable and, considering that these accomplishments were attained by what we could term a “non-institution” (there was no international treaty or written charter to set up the Paris Club), may therefore appear to be a paradox at first sight.

The operations of the Paris Club over the last five decades reflect both the way in which developing and emerging market economies have benefited from economic and financial globalisation and the challenges that they have been faced with during this process. Let me be more specific on the substantial benefits of economic and financial globalisation and the inevitable challenges that this poses to policy-makers and market participants.

Among the benefits of globalisation, I would mention one which appears particularly relevant for the activities of the Paris Club. Emerging countries are becoming more and more integrated into the world economy. They are increasingly involved in the exchange of goods and capital, and can benefit from the transfer of know-how and technologies. The scrutiny by international investors enhances the quality of their economic policy, thus contributing to better fundamentals. In most recent years, several emerging countries have been providing the rest of the world with net resources in the form of current account surpluses – a trend that would have been unthinkable just a few years ago in the midst of the Asian crisis. Given these developments, an increasing number of emerging countries have significantly decreased their external debt or have even turned into net creditors vis-à-vis the rest of the world.

That said, economic success does not come without risks. Globalisation and capital mobility have made the international system more vulnerable to changes in investor sentiment. We all remember the severe financial crises that have occurred over the last 25 years, including the debt crises during the 1980s, starting with Poland and Mexico and spreading to Latin America, Africa, the Middle East and the Soviet Union; the Mexican crisis in 1994; the Asian crisis starting in 1997; the Russian crisis in 1998; and the Argentinian crisis in 2001-02. All these events, irrespective of their origin or magnitude, posed major threats to the international financial system. While the international community has always managed to resolve such crises, they highlighted the potential vulnerabilities of the global economy, the resilience of which cannot be taken for granted. This is true even in a period characterised by high growth, low inflation and stability of financial markets such as the one we have been experiencing since 2003. Past financial crises or, in a more benign way, recent increases in risk awareness as reflected in higher asset price volatility, remind us of the relentless need to improve the functioning of mechanisms that deal with the prevention and resolution of such events.

I will focus on two issues today. First, I would like to take this opportunity to review the important contribution of the Paris Club to orderly sovereign debt restructuring over the last 50 years. Second, I will make some observations on recent international developments related to crisis prevention and resolution.

History and achievements of the Paris Club

The fact that the Paris Club has enjoyed the trust of the international financial community for half a century now is due to its efficient way of dealing with sovereign debt restructuring by combining pragmatism with a strict set of principles to be implemented when working out agreements on debt restructuring.

First, making decisions on a case-by-case basis allows Paris Club creditors to tailor their actions to the individual situation in each debtor country. Such an approach reflects a spirit of permanent adaptation to new financial problems and difficulties faced by rescheduling countries. Second, Paris Club treatments are agreed by consensus by all participating creditor countries. Third, creditor countries apply the principle of conditionality, whereby debt treatments are granted to countries only if they need debt relief and implement appropriate reforms to resolve their payment difficulties in the context of an IMF programme. Fourth, the principle of solidarity commits every Paris Club creditor, in its conclusion of individual bilateral agreements, to respect the terms agreed upon in the joint negotiation. Last but not least, the Paris Club attaches great value to comparability of treatment of all creditors. By insisting that a debtor country should not accept less favourable terms from another creditor than those agreed by consensus within the Paris Club, it is ensured that its taxpayers' claims are not subordinated to those of other creditors and that their financial interests are preserved. Moreover, applying such a clause provides a guarantee that the agreed debt treatment reaches its intended goal of putting debtor countries' debt burdens on a sustainable footing.

Keeping these principles in mind, what have been the main concrete achievements of the Paris Club?

The first Paris Club restructuring took place, as mentioned, in 1956, when Argentina and its official creditors agreed to reschedule payments due on officially supported credits. At that time, the Club had no formal rules or procedures and was only intended to provide pragmatic responses to specific problems. Until 1980, Paris Club creditors on average signed no more than four agreements per year, applying the standard "classic terms", whereby credits were rescheduled at the appropriate market rate. During these early years of the Paris Club, negotiations and agreements were more and more standardised, preparing this forum for the busy times that were to come.

I remember well those years of intense negotiations and the overall activities of the Club. I remember well the members of the Club at the time and I see some of them here in this room. To you I would like to express all my friendship and gratitude. We had intense discussions but it was always possible to find solutions because the members of the Club had an extraordinary level of both professionalism and mutual confidence.

I remember well the officials and members of governments of the debtor countries, officials from Mexico, Brazil, Argentina, Poland, Egypt, Nigeria, Morocco, the Soviet Union and Russia, and so many more. Among all those officials let me mention Angel Gurría, the present Secretary General of the OECD, who was the first negotiator I encountered, defending the interests of Mexico with remarkable professionalism and lucidity.

I remember well the major partners of the Club in the period from 1982-1993 in both the public and private sectors. I would like to mention the names of Jacques de Larosière and Michel Camdessus in the IMF, Paul Volcker, Alan Greenspan and Bill McDonnough from the Federal Reserve, Bill Rhodes as regards the private sector rescheduling. Without all those remarkable people, without their lucidity and tireless activity the world would not have been able to surmount difficulties of an enormous global magnitude.

The Paris Club felt the fall-out from this crisis as its workload increased exponentially: the number of agreements concluded rose to well above ten per annum and reached an all-time high of 24 in 1989. Many countries negotiated multiple debt agreements with the Paris Club. They were coming from all over the globe, the bulk from sub-Saharan Africa and Latin America, but also from Asia (the Philippines), the Middle East (Egypt and Jordan) and central and eastern Europe (Poland, Yugoslavia and Bulgaria).

While the Paris Club confined its mandate solely to debt rescheduling up to 1988, it changed radically its modus operandi in the late 1980s, given the severe impact of debt crises on the poorest and most highly indebted countries. The Paris Club adopted a completely new approach to the treatment of debt of those countries whose debt burdens remained unsustainable. It agreed to reduce the net present value of eligible debt, thus moving to increasingly concessional rescheduling terms, which have in fact included a reduction of up to a third since 1988 under the Toronto terms, a half since 1991 under the London terms, and two-thirds since 1995 under the Naples terms. On the latter occasion, the Paris Club agreed for the first time to also consider implementing stock treatment – and not only flow relief, as had been done until that time – to facilitate an exit from repeated reschedulings. Finally, middle-income countries benefited from the introduction of the more favourable Houston terms in 1990.

When it became clear that even the more concessional debt rescheduling and reduction mechanisms were still not sufficient to attain sustainable external debt levels, particularly in a number of African low-income countries, another key policy initiative was launched in 1996 by the IMF and the World Bank: the Heavily Indebted Poor Countries Initiative (HIPC). Under this initiative, the entire international community, including some multilateral institutions, decided to take coordinated action to reduce the debt burdens of eligible countries to sustainable levels. In this context, Paris Club creditors agreed to increase the reduction in the net present value of eligible debt up to 80% under the Lyon terms and, in 2000, up to 90% or even more under the Cologne terms. The financial implications of these decisions were substantial: around 36% of the initiative's total cost, amounting to USD 38 billion thus far, has been borne by Paris Club creditors. Finally, the HIPC initiative has been supplemented in 2005 by the Multilateral Debt Relief Initiative, which allows for 100% debt relief by multilateral institutions for countries completing the HIPC process. This marked a major break with the principle of preferred creditor status of international financial institutions.

Looking at the most recent past of the Paris Club, another development worth noting is that the number of countries rescheduling with Paris Club creditors has been declining significantly. Besides the more general macroeconomic developments I recalled at the beginning of this talk, this desirable trend is also due to two more specific developments: first, the more comprehensive debt stock treatment of low income countries; and second, a graduation from rescheduling of most middle-income countries as a result of the implementation of economic reforms that have increased their access to market financing and thus private creditors. Indeed, while official flows to emerging markets were dominant in the 1980s, reaching on average over 60% of total flows, the 1990s saw a dramatic increase in private flows, which on average accounted for around 85% in the period from 1990 until 2003. Accordingly, the Paris Club has been paying increasing attention to coordination with private sector creditors. In particular, early discussions can be scheduled when the proportion of private external debt is deemed significant and when comparability of treatment is an issue. Also, interaction between Paris Club creditors and private sector representatives can be initiated if private creditors indicate their willingness to help restore debt sustainability in good faith and if a comprehensive debt treatment is envisaged.

As a result of the enhanced access by middle-income countries to market financing, the Paris Club has already concluded an increasing number of prepayment agreements with debtor countries. Recent such agreements include Poland, the Russian Federation, Peru and Brazil. In passing, let me mention that the IMF is making a similar experience as it has been facing a considerable decline in demand for its resources during recent years.

Let me conclude this part of my talk by responding to those who claim that the Paris Club lacks transparency and predictability. I would argue that, quite to the contrary, the rules applied by the Paris Club are clear, transparent and well-tailored to address different country groupings. In particular, while the Club's classic terms are standard treatment, the Houston terms, the Naples terms and the Cologne terms are applied respectively to highly-indebted lower-middle-income countries, highly-indebted poor countries, and countries eligible for the HIPC initiative. Moreover, being embedded in the international financial system, the Paris Club works closely not only with creditor and debtor countries, but also with the IMF and market participants.

Crisis prevention and resolution

In my reflections, I have presented the Paris Club as an important forum for negotiations, both between the creditor countries and individual debtor countries and among the creditors themselves. I now wish to take a wider perspective and share with you some thoughts on where the international community stands in the area of crisis prevention and resolution.

Starting with crisis prevention, I would like to underline the growing number of initiatives undertaken by policy-makers and market participants to improve transparency and promote best practices. One of the weaknesses identified during the financial crises of the 1990s was that there had been considerable information asymmetries between local authorities, market participants, and the international financial institutions. Transparency is a key precondition for well-functioning markets since it facilitates better risk management and leads to strengthened market discipline. It is therefore welcome that significant changes have been introduced in a number of fields. For example, the IMF started to disclose information on its policies and to encourage increased transparency by its membership. A large number of international standards and codes of good practice have been agreed upon, covering such different fields as transparency in fiscal policy or monetary and financial policies, banking supervision, corporate governance, accounting and auditing. The Paris Club has in turn also taken steps to increase the transparency of its procedures, for instance by convening meetings with private sector representatives and by providing comprehensive information on its website.

Turning to crisis management and resolution, I would argue that important lessons have been learnt from past experiences. Discussions have continued on the appropriate involvement of the private sector in solving debt crises. This is not only important because the availability of official funds is limited, but also because there are moral hazard concerns associated with large financial assistance provided by the official sector. Since every single crisis is different, the challenge arises again and again to strike the right balance between the debtor country's domestic adjustment, private sector involvement and official support. As regards the role of the official sector in the area of crisis management, work continues at the IMF on a number of issues in the context of the strategic review of its activities. First, an open issue is the lack of clear guidelines for involvement of the IMF in the process of sovereign debt restructuring in the event a country faces an unsustainable debt situation. The case of Argentina is an example of a very difficult debt restructuring process. It is crucial that authorities cooperate closely with their creditors, while the IMF remains closely involved in the process and takes an active role in providing information. In that context, further discussions will be needed on how the Fund should financially support a country that is in the process of renegotiating its debt with private creditors, i.e. the lending-into-arrears policy. Second, discussions continue on the framework for large financial assistance programmes – the so-called exceptional access policy – that sets guidelines in order to make Fund lending more predictable. Finally, proposals are being examined for a possible new instrument to provide high access contingent financing. All in all, what is important in these different discussions in my view is to increase predictability and clarity on the part of the official sector so as to set the right incentives for all the actors involved.

While there are several issues that still need to be addressed in the context of crisis resolution, substantial progress has been achieved on two fronts, both aimed to improve debtor-creditor relations and define ex ante the best conditions to address possible financial crises leading to debt restructuring. By doing so, these two initiatives are eventually also beneficial in terms of crisis prevention.

First, following the pioneering issuance by Mexico of bonds with collective action clauses (CACs) in February 2003, the adoption of CACs in international sovereign bonds has become much more widespread. Practically all international sovereign bonds issued since mid-2005 contain CACs, which, while not yet being tested, have by now become the market standard. As is confirmed by market participants, the inclusion of CACs has not affected the pricing of international sovereign bonds, as was initially feared. The share of outstanding bonds including CACs increased, as a result, to 60% at the end of February 2006. This means that we are gradually moving towards a time when the entire stock of outstanding debt will include CACs. I deem this development remarkable, in particular in view of the rather sceptical attitude that many countries and private sector representatives had taken in the past vis-à-vis the recommendations of the Rey report published after the 1994 Mexican crisis.

Second, I am pleased to note that the *Principles for Stable Capital Flows and Fair Debt Restructuring in Emerging Markets*, which were endorsed by the G20 in November 2004, are gaining more and more international support. The aim of these market-based and voluntary Principles is to provide guidelines for the behaviour of sovereign issuers and their private creditors regarding information sharing, dialogue, and close cooperation in times of financial distress. From the outset, I have been personally involved in the launch of the Principles since I promoted the idea that such guidelines carry the potential to help prevent liquidity problems from turning into a deep financial crisis with serious repercussions for all parties involved. The Principles are also likely to improve the handling of possible future private sector debt restructurings.

Conclusion

In my view, seen over a long-term horizon, the concept of the Paris Club seems to have been in many respects a precursor signalling some of the main features that later proved appropriate to handle the very stimulating but complex globalised economy and finance of the world today.

First the Paris club was ***global*** from the start. It is remarkable that as early as 1956 in the case of Argentina it appeared necessary to embark on a single concept for public credits restructuring and not on a series of bilateral agreements. In the same way, as soon as some creditors from the emerging world expressed the desire to participate in the activities of the group of creditors they were accepted. Brazil was a creditor of Poland, for example.

Second, the Paris Club was and is ***open and transparent***. It was a bold initiative at the end of the 70s and the beginning of the 80s to invite all international institutions, in particular the IMF, the World Bank and the Regional Development Banks, together with the United Nations UNDP and the OECD to participate in the discussions and/or observe the rescheduling negotiations. This unseen level of transparency would compare with the very discrete bilateral negotiations that were the norm before the setting-up of the Club.

Third, the Paris Club was and is based on a set of ***principles*** that are applied by all parties concerned in a ***purely voluntary*** fashion. There was no setting-up of a new institution, no new official piece of legislation or regulation. Globalisation and global ownership, transaparency and voluntary implementation of principles are, in my view, three of the major avenues that have proved not only necessary but also very successful in the world today. I would particularly stress the systemic importance of the codes of good conduct and good practices, reflected now in the “Principles”, that are agreed upon by a very large degree of global consensus, are voluntary and incorporate enhanced transparency. This is a key to better understanding today's global trends in international economics and finance. I feel proud, along with all those in this room I am sure, that the Paris Club may be among the first to invent and try out what was and is so promising.

I thank you for your attention.