## Stanley Fischer: "The Paris Club at Fifty"

Address by Professor Stanley Fischer, Governor of the Bank of Israel, at the celebration of the 50th anniversary of the Paris Club, Paris, 14 June 2006.

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It is a pleasure and an honor for me to take part in this celebration of the fiftieth anniversary of the Paris Club – both as a former official of the IMF, who learned so much from the former Chairman of the Paris Club with whom I had the pleasure of working for over five years, and as Governor of the Bank of Israel.

The Paris Club is the gifted child of the French Tresor. But it is also in many ways a British institution – and I take that to be a compliment. It is a club, a voluntary gathering of interested parties, it operates without a written constitution, it operates case-by-case, and it displays a remarkable pragmatism and flexibility that has enabled it to evolve and deal with an enormous variety of debt problems over the years – over 400 agreements with over 80 debtor countries and more than $500 billion rescheduled. In performing its essential task, it has stood the cause of development well over the past fifty years. And at the age of fifty, it faces new challenges that ensure that it will have to continue to evolve with the times.

### I. Debt relief

Like the Bank for International Settlements, the Paris Club grew out of the need for debt relief – a need which has been with us for as long as debt has existed. In gradually developing a flexible set of rules for granting relief on inter-governmental debts, mostly the debts of developing countries, the Club has made a major contribution to the orderly operation of the international financial system.

The principle of conditionality is critical. By making the conditionality that of the IMF, the Paris Club gained at least two major benefits for the international community: that of operating with the Fund's skilled professionals, who understand how to design and monitor an economic program; and the legitimacy of operating within an institutional framework in which both the creditors and debtors are members. In turn, by putting the IMF at center stage in developing and enforcing conditionality, the Club contributed to the development of the Fund's analytic and operational approach.

There are nonetheless major questions about the effectiveness of the combination of conditionality, concessional loans, and debt relief. These can be summarized by recognizing that many countries that received conditional debt relief once, received it again – and again. The underlying question is why it has turned out to be so difficult for many of the poorest countries to begin to grow on a sustained basis, despite receiving aid that amounted to double digit percentages of their GDP over long periods, and despite being in IMF and World Bank programs. I suspect that if we were to go back to the participants in Paris Club discussions in the fifties and sixties, they would say that income levels in many of the countries whose debts they rescheduled are much lower today than they would have imagined in their most pessimistic moments.

These concerns relate mainly to some African countries. Many African countries have been growing more rapidly recently, so maybe we are beginning to turn a corner. The renewal of growth is helped by the global commodities boom, and the fact that several African countries are now exporters of oil. Developments in South Africa are encouraging, and South African growth affects the countries around it. Nigeria too is making progress, helped by a Paris Club agreement and by the price of oil. But the facts remain that the number of people in poverty in Africa is increasing, that a greater share of the world's poor live in Africa than ever before, and that AIDS and other diseases are exerting a devastating effect on populations in many countries.

It is easier to raise questions about the effectiveness of conditional debt relief than to answer them. For the problem is not particularly that of conditional debt relief, it is rather the question of what development strategies are most likely to succeed. I will not go into that question in any detail now, beyond saying that while we know many of the necessary conditions for growth, we do not yet know the sufficient conditions.

Over the course of its lifetime, Paris Club rescheduling became increasingly far-reaching. The original approach of flow rescheduling combined with new money lasted for about thirty years. In the late 1980s under the Brady Plan, Paris Club reschedulings began to include relief on the stock of debt. Now we all know that to a first approximation what matters is the present value of the debt, so that there is no difference in the economics of flow versus stock reschedulings.[1] Nonetheless the shift from flow to stock debt reduction was a major change, in part because budget accounting in some countries made stock reduction more difficult politically – and in part no doubt because once the principle of not reducing the stock of debt was breached, there was only one logical resting point for the process.

That resting point is the cancellation of all outstanding debts, and a switch from loans to grants. That approach has now been accepted by first the G8 and then by most of the creditor nations, in several cases reluctantly. So long as net transfers to the countries in need of aid rise, the grant approach is obviously better from the viewpoint of debt sustainability, ceteris paribus. But it is not yet clear that net transfers will rise as the approach to aid switches from loans to grants. Indeed, the main argument against the new approach is that it may reduce the net flow of aid to countries most in need. It remains to be seen whether that will be the case.

In discussing loans versus grants it is sometimes argued – and I confess to having sometimes argued – that by making loans rather than grants, the donors encourage greater responsibility on the part of the recipient governments who have to contemplate repaying the loans. The fact that these loans often have long grace periods, and that governments often have short horizons, reduces the plausibility of this argument. I put more weight on a related argument: that for many governments it is politically easier to make concessional loans rather than grants, and that the IDA cum Paris Club approach in effect turns these loans into some sort of high-risk but concessional bond claim on the recipient country.

Those who believe aid is in any case ineffective would see a reduction in aid as a benefit of the new approach. I continue to believe that aid targeted to particular needs, including health and education, and project aid can be useful and should be supported if the circumstances are reasonable, and that for governments following the right policies, general budgetary assistance can also be productive. On balance I believe the empirical evidence supports this view.

But there is little doubt that the overall record of the aid process is disappointing, that in some cases aid failures are associated with serious government corruption, and that the aid process itself may contribute to government corruption. All these issues have come to the fore in the last decade, and the increasing attention they have been receiving should help improve the record.

## II. On the creditor side

The Paris Club solved the free rider problem by seeking to bring all the major creditors into the Club, by requiring a consensus for each decision and requiring participant creditors not to seek better terms outside the framework, and by insisting that the debtor not give better terms to any other creditor. Because the Club does not require uniformity of treatment among different debtors – a principle which would be difficult to enshrine in a written charter – it has shown considerable flexibility and ingenuity in dealing with the different forms in which creditors are willing to provide relief, and in inviting relevant non-Paris Club members to take part in meetings as needed. Of course this also means that political considerations visibly play a role in deciding on the treatment each debtor receives, but that is hardly surprising when inter-governmental debt is being considered.

For many years the Paris Club protected the senior status of the IMF and the World Bank, and did not request any debt reduction on their part. The logic of this approach was quite simple: generally the Fund and the Bank provided new money. This principle has now been breached, and it remains to be seen what the long-term consequences will be. But we should recall that countries include claims on the Fund as part of their reserves, and that at the time of the HIPC debt relief decision, at least one major country said that it would have to reappraise that view.

While the Club is able to produce an acceptable extent of comparable concessions by official creditors operating within its framework, it has increasingly had to deal with the issues arising from the growing

[1] In addition, liquidity is likely to be important for a country without market access

role of the private sector in financing developing countries, and those that result from the growing importance of official creditors who are not members, prominent among them China.

There are two issues with regard to the role of the private sector. The first is the pace at which countries that have received debt relief begin borrowing from the market. So long as a country is in an IMF program, the Fund has been able to exert some – though not necessarily a decisive – influence on the rate of government borrowing from the private sector. If the country has exited from an IMF program, it is left to market and internal fiscal discipline to control its rate of borrowing. We need to remind ourselves that until very recently we were in a phase of optimism about the emerging market and developing countries, with plentiful liquidity, and that these conditions could change. At that point we might discover that market and internal fiscal discipline may not be sufficient to prevent problems in the event of a reduction in capital flows to developing countries.

The second problem arises if debt rescheduling then becomes necessary. At this point coordination and equality of treatment between public and private sector lenders becomes difficult, and the Paris Club has yet to arrive at a fully satisfactory solution. In addition, some members of the private sector argued that the claims of the Fund and the Bank should be included in any restructuring. This demand was clearest in the Argentine case, where some private sector participants demanded that the IMF also agree to debt reduction. The logic of this claim on the organization which operates as an emergency lender was not clear.

The issue of private-public sector coordination in lending and debt restructuring poses a delicate problem for the official sector, which after all would prefer countries eventually to finance themselves through the markets – provided they do so in a sustainable way. The principles of debt restructuring proposed by the IIF, and described in more detail by Jacques de Larosiere in his comments this afternoon are useful in themselves, but putting them into practice will not be easy in individual cases. This was evident in the Argentine case, but that perhaps was exceptionally difficult.

Most recently, the Paris Club has become concerned that countries that have received debt relief are borrowing heavily from other official lenders, who are not members of the Club, notably China. The concerns here are that countries may be taking on more debt than is wise, and that in the event the global financial situation changes, future debt restructurings will be much more difficult than those of the past.

The answer to this concern may well lie in the wider context, in which the global financial architecture that was developed after World War II needs to adapt to the presence of important new players, among them particularly the BRIC countries. As these new players from Asia and elsewhere begin to take more responsibility for the system, and as the system gives them and their concerns a greater role, they may begin to appreciate the importance of existing institutions, formal and informal.

And we may be sure that in any case, the ingenuity and pragmatism that the Paris Club has demonstrated in its first fifty years, will continue to contribute to the development of the international financial system and its ability to deal with official sector debt difficulties.

Thank you.