

THE CLUBS: THEIR ROLES IN THE MANAGEMENT OF INTERNATIONAL DEBT

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Summary

The regularity of default by countries on their sovereign debt has led to the establishment of a number of evolving institutions. These institutions' objective is to optimize the impact of imminent default or actual default on both international lending and borrowing. This article discusses the informal institutions concerned with managing debt between national governments—the Paris Club—debt borrowed by national governments from commercial banks—the London Club—and the currently *ad hoc* dealings with sovereign bonds.

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 Sub-Saharan African debt crisis are discussed. 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. The functioning of principles of comparable treatment of all creditors are discussed with respect to the growing need for a body representing bondholders' interests. Finally, the background to these discussions is the IMF's multiple and sometimes conflicting roles in the international financial system.

1.1 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* (contracts must be performed) 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 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. 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. Other non-OECD creditor countries, including Argentina, Israel, Mexico, South Africa, Brazil and Russia have participated in Paris Club meetings.

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). 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 totaling 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 through 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. It took only three years (1985 to 1987) for another 56 Paris Club reschedulings to be negotiated. The 1990s witnessed a further surge in London and Paris Club reschedulings, totaling 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 1997-99 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 twenty 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, 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 below.

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Biographical Sketches

Richard Brown has over 20 years of international experience as an applied development economist with experience in Africa, Asia, Latin America and the South Pacific. His main areas of interest include: debt, structural adjustment and adjustment policies; the role of the IMF and World Bank in development; cost-benefit analysis; and, the economics of international migration. In relation to debt and the IMF he has published *Public Debt and Private Wealth: Debt, Capital Flight and the IMF in Sudan*. London: Macmillan 1992. He is currently engaged in two areas of research: international migration, and non-market economic valuation methodologies.

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