The Paris Club, the IMF and Debt Sustainability

Remarks by Agustín Carstens
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A Remarkable "Non-Institution" Institution

The Paris Club has been a central pillar of the international financial architecture for the last half century. I am delighted to be here today as the Club marks this significant milestone of its 50th anniversary.

As an informal group of financial officials, the Club is a remarkable "non-institution" institution that has demonstrated time and time again its flexibility in being able to respond to needs in an evolving world. The Paris Club has come a long way since its first meeting with a debtor country in Paris in 1956. Since then, the Club, or adhoc groups of its creditors have reached hundreds of agreements with debtor countries from around the world, covering hundreds of billions of dollars in debt. The Club's willingness to provide exceptional financing has been geared toward promoting strong economic policies and sustainability.

The IMF is most appreciative of the support from and close working relationship that it has enjoyed with the Club during that period. Of course, most noteworthy is the fact that two distinguished Paris Club chairmen, Messrs. Jacques de Larosière and Michel Camdessus, subsequently became managing directors of the Fund.

Let me highlight a few key policies of the Club that have been critical in addressing debt issues.

First, the policy of only providing exceptional debt relief in the context of a Fund-supported program has served to ensure that relief finances adjustment, and not a postponement of good policies. Second, under the wise chairmanship of Mr. Camdessus in the early 1980s, the Club adopted fixed cutoff dates. This subordination strategy provided a basis for export credit agencies to resume cover to countries that were implementing sound policies and were benefiting from Paris Club debt relief. The strategy thereby helped these countries to emerge from severe balance of payments difficulties. Third, more recently, the Club has participated in a number of initiatives to reduce the debt burdens of heavily indebted countries—most notably the Heavily Indebted Poor Country (HIPC) initiative. Here too I salute Mr. Camdessus' leadership role, this time in his capacity as the then managing director of the Fund.

Another critical evolution in policy, aptly described by Mr. Camdessus, was the way in which the Club made the concept of debt sustainability increasingly central to its operations. This led to the introduction of the Evian approach for non-HIPCs in 2003. The Fund's debt sustainability analyses play an important role in this approach.

The Debt Sustainability Concept in Our Operations

Just as it has for the Club, the concept of debt sustainability has also become increasingly central to the operations of the IMF. This has clearly been the case in the HIPC Initiative, which was launched in 1996. Debt Sustainability Analyses, outside the context of the HIPC Initiative, were introduced in 2002 to ensure consistency and discipline in sustainability assessments. Initially, these analyses were principally for middle-income and advanced countries. They were, however, later adapted, jointly with the World Bank, to suit the specific context of low-income countries. They became fully operational about a year ago. This was part of the Fund's efforts to adapt its instruments to assist better its low-income members. These efforts also led to the creation of the Policy Support Instrument and the Exogenous Shock Facility. We now produce debt sustainability analyses on an annual basis, in program and surveillance contexts alike.

Debt sustainability analyses can play an important role in preventing a new round of over-indebtedness and debt distress. Countries that benefit from debt relief need to strike the right balance between faster progress towards the Millennium Development Goals, and avoiding excessive debt accumulation. Debt sustainability analyses can help these countries design sound medium-term debt strategies. These analyses, together with the technical assistance provided by the Fund and the World Bank to build capacity in the area of debt management, have already borne fruit. In our view, debtor countries are now much more mindful of sustainability issues than in the past. Debt sustainability analyses can also be a useful tool to help guide creditors' decisions. There is certainly scope to increase awareness of the framework, and the Fund intends to pursue further outreach with the World Bank. Broader sharing of information should help improve creditor coordination.

A recent review of the Debt Sustainability Framework conducted by the World Bank and the Fund showed that a number of issues need to be addressed to make this framework even more useful to debtors and creditors. An important issue is how to assess debt accumulation in post-Multilateral Debt Relief Initiative (MDRI) countries, which are likely to have a large borrowing space. This is a very complicated analytical issue, which has to do, among other things, with absorptive capacity and the impact of public investment on growth. Yet another issue is the better integration of domestic debt in the Debt Sustainability Framework. The Fund and Bank Boards will discuss these issues later this year.

The MDRI and the Issue of Emerging Creditors

Let me now to turn to two issues raised by Mr. Camdessus: the MDRI and the so-called emerging creditors.

Generous debt relief has been provided to many low-income countries through the HIPC Initiative and the MDRI. This relief has been delivered to countries with sound macroeconomic policies, satisfactory poverty reduction strategies, and public expenditure management systems. This provides some assurances that debt relief will be put to good use. Bank and Fund staff will monitor the use of these resources closely in the future. The Fund's Policy Support Instrument, which is likely to be attractive to Fund members that have benefited from debt relief, will help maintain sound macroeconomic policies and debt sustainability.

We recognize that the MDRI may not exactly be perfect as a tool, but then there is probably no such thing as an absolutely perfect international initiative. Furthermore, even some of the most successful initiatives have had their limitations. A number of observers, including NGOs, consider for instance that the MDRI is restricted to a small number of countries. The MDRI aims at strengthening debt sustainability, in the wake of the HIPC Initiative, but also at freeing up additional resources to help beneficiaries reach the Millennium Development Goals. The international community has indeed recognized that the development needs of low-income countries are huge, and that much more resources need to be channeled to them. The MDRI is part of the international community's efforts in this area, and I agree with Mr. Camdessus that more resources will be needed from donors. In this regard, I hope that donors will make good on their commitments, including increased efforts to provide resources to the international financial institutions participating in the MDRI. Ultimately, it is a useful vehicle through which we can transfer resources to countries that direly need them.

Despite the improved situation of low-income countries, and the enhanced role that the Debt Sustainability Framework will likely play, debt difficulties may, nevertheless, arise again. If they do, the Paris Club will remain an important part of the international financial architecture for resolving debt difficulties. Of course, to fulfill this role, the Club too will have to adapt to new challenges, including the emergence of new official creditors. Indeed, low-income countries increasingly rely on these emerging creditors for new loans, while new financing from Paris Club creditors is provided increasingly as grants.

Some emerging creditors have yet to be included in major international creditor fora. They may be tempted to lend significant amounts to low-income countries that have benefited from debt relief initiatives. This not only raises issues of burden-sharing among creditors, but also of macroeconomic and debt sustainability in low-income countries.

The international community needs to find ways to engage with emerging donors. It must convince them that financing to low-income countries should be shaped by coordinated international efforts, rather than independent national policies. In this regard, a lack of coordination among traditional donors/creditors would complicate these efforts. Further outreach to emerging creditors by various groups would certainly be helpful. High-level bilateral contacts may also be necessary to support the process. The Club should very much be part of this outreach effort since non-Paris Club creditors raise issues that are directly relevant to the Club. For example, they may raise issues that pertain to the role of the Club in debt treatments when it is not (as a whole) the main official creditor; or they may raise questions on how to handle the limited participation of some non-Paris Club creditors in the HIPC Initiative.

Let me close by emphasizing, once again, how appreciative we are of the support and excellent working relationship that we have enjoyed with the Club. Our **"institutions"** need to continue working as closely as we can in order to ensure, as Mr. Camdessus has stressed, that we keep providing coordinated solutions to the problems of the past. We commend the Club for a strong 50 years, and are pleased to work alongside you for many more to come.

Thank you.

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