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# **THE PARIS CLUB**

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## Foreword

This publication series has been launched in response to the increasing number of requests *Debt Relief International (DRI)* has received for information on the activities of the *Heavily Indebted Poor Countries (HIPC) Initiative Capacity Building Programme (CBP)* and on the technical aspects of debt analysis and negotiations needed to develop and implement national debt strategies. The aim of the HIPC CBP, funded by five European governments (Austria, Denmark, Sweden, Switzerland and the United Kingdom), is to build and strengthen the capacity of HIPC governments to develop and implement their own national debt relief strategy, and a new borrowing policy consistent with long-term debt sustainability, without having to rely on international assistance. DRI is its non-profit implementing organisation.

This series arises from DRI's experiences of working with 32 HIPC countries and in particular conducting national, regional and international workshops on debt strategy, debt negotiations, macroeconomic forecasting and poverty reduction. It is targeted mainly at senior officials and policy makers in HIPC countries, but it will be useful for officials of regional African, Asian and Latin American organisations, NGOs and academics in developing and developed countries.

The aim of the series is to present particular topics in a concise, accessible and practical way for use and implementation by HIPC governments. The series should enable senior officials and policy makers to focus on some of the key issues relating to long-term debt sustainability, macroeconomic forecasting and poverty reduction in HIPC countries. Each publication is intended to be reasonably self-contained.

The views expressed in the publications are those of the authors and not necessarily those of the HIPC CBP donors.

We welcome any comments on this publication or suggestions for other topics to be included.

Alison Johnson  
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# CONTENTS

|   |           |
|---|-----------|
| <b>SUMMARY</b> .....  | <b>i</b>  |
| <b>I. INTRODUCTION</b> .....                                    | <b>1</b>  |
| <b>II. WHAT IS THE PARIS CLUB?</b> .....                        | <b>1</b>  |
| <b>III. PRINCIPAL ELEMENTS OF PARIS CLUB NEGOTIATIONS</b> ..... | <b>2</b>  |
| 3.1 Prerequisites.....  | 2         |
| 3.2 Procedures .....  | 2         |
| 3.3 Eligible Debt.....  | 3         |
| <b>IV. EVOLUTION OF RESCHEDULING TERMS</b> .....                | <b>4</b>  |
| 4.1 Toronto Terms.....  | 4         |
| 4.2 London Terms.....   | 6         |
| 4.3 Naples Terms .....  | 6         |
| 4.4 Lyons Terms.....  | 8         |
| 4.5 Cologne Terms.....  | 9         |
| 4.6 Topping-up of Previously Refinanced Debt.....               | 10        |
| 4.7 Debt Conversions.....                                       | 12        |
| <b>V. DEBT RELIEF ADDITIONAL TO HIPC</b> .....                  | <b>13</b> |
| <b>VI. TREATMENT OF DEBT TO THE RUSSIAN FEDERATION</b> .....    | <b>15</b> |
| <b>VII. BILATERAL AGREEMENTS</b> .....                          | <b>15</b> |
| <b>TABLES:</b>  |           |
| Table 1: Paris Club Rescheduling Terms .....                    | 5         |
| Table 2: The Naples Terms .....                                 | 8         |
| Table 3: The Lyons Terms.....                                   | 9         |
| Table 4: The Cologne Terms.....                                 | 10        |
| Table 5: Treatment of Previously Refinanced Debts.....          | 12        |
| Table 6: Paris Club Debt Relief Additional to HIPC.....         | 14        |
| Table 7: Bilateral Interest Rates.....                          | 17        |
| <b>ANNEX:</b>   |           |
| Glossary of selected terms used by the Paris Club.....          | 19        |

## **SUMMARY**

The Paris Club, founded in Paris in 1956, is an informal group of creditor countries with no permanent members who function under the principle of general consensus and burdensharing. The Paris Club's real influence was not felt until the 1980s and the early 1990s, with the occurrence of the debt crisis in most of the world's developing countries.

This paper is a practitioner's guide to the Paris Club. In addition to setting out the preconditions and principal elements of the Paris Club negotiations, it focuses on the rescheduling terms, their evolution and an explanation of how they are applied to concessional bilateral aid debt and non-concessional bilateral debt, including the distinction between Options A and B. It also discusses the implementation of the Cologne Terms for 90% debt relief and additional creditor pledges of debt cancellation.

## I. INTRODUCTION

Founded in Paris in 1956, the Paris Club was initially created to provide debt relief to debtor countries with temporary liquidity problems, with the aim of preventing imminent default. However, the continued rescheduling of interest over the years served only to greatly worsen the debt burden in many countries, as rescheduled interest was being capitalised as new debt. At the beginning of the 1980s, the creditor countries of the Paris Club took stock of the situation and increased debt relief to the poorest countries not merely to avoid further liquidity problems as in the past, but also to assist each country by reducing the burden of debt on their economies.

Initially rescheduling terms were applied on a strictly case-by-case basis. It was after the debt crisis in 1980, when it became clear that many developing countries faced problems of long-term debt sustainability (rather than of short-term liquidity) that creditors of the Paris Club began to grant more long-term rescheduling to reduce the debt burden. However, this did not resolve the problem and so in 1987 the Paris Club agreed, for the first time, to reschedule debt on concessional terms, by offering longer grace and maturity periods to the poorest countries in Sub-Saharan Africa. Subsequently, more debt relief, including an element of debt cancellation, has been provided to the poorest countries. Nowadays, the Paris Club is one of the most important debt relief fora for the world's poorest countries, and one of the essential steps in the Heavily Indebted Poor Countries (HIPC) Initiative.

This paper is designed to highlight the key features of Paris Club debt restructuring that will not only assist Government officials in preparing for renegotiating their Paris Club debts but also in analysing the impact of Paris Club debt restructuring on external debt sustainability. The remainder of the paper deals with the following:

- what is the Paris Club and who are its participants;
- principal elements of Paris Club negotiations, including the prerequisites for refinancing, procedures and what is included in eligible debt;
- evolution of debt restructuring terms from Toronto to Cologne, topping up of previously rescheduled debt and debt conversions;
- debt cancellations for HIPCs which are additional to the Paris Club terms considered for the HIPC Initiative;
- treatment of debt owed to the Russian Federation; and
- bilateral agreements and the key issues to consider.

## II. WHAT IS THE PARIS CLUB?

The Paris Club is an informal group of creditor countries with no permanent members which function on the principles of unanimity on the terms to be provided to debtor countries and of equal burden sharing amongst its creditor members. Since 1979 the French Treasury has provided the Paris Club with a permanent secretariat responsible for the preparation and co-ordination of meetings, and acting as its Chairman. The meetings always take place in Paris.

There are 4 types of participants in Paris Club meetings, namely:

- Delegates from the debtor country. It is recommended that the delegation be kept to 4-6 members.
- Creditor country representatives. Although the majority belong to the OECD, there are exceptions to this rule, and other countries which provide export credits, such as Brazil, also participate in the meetings.
- International Monetary Fund (IMF), which plays an active advisory role in the meetings but does not have any decision-making powers.
- International organisations which are invited as observers. This group includes representatives from organisations such as the Organisation for Economic Co-operation and Development (OECD), United Nations Committee for Trade and Development (UNCTAD), the World Bank and the regional development banks, such as the Asian, African, Caribbean and Inter-American Development Banks.

### **III. PRINCIPAL ELEMENTS OF PARIS CLUB NEGOTIATIONS**

#### **3.1 Prerequisites**

A country wanting to restructure its debt with Paris Club creditors must carry out the following terms:

- Demonstrate that it is not able to meet its financial obligations, preparing a detailed memorandum on its macroeconomic situation, with particular emphasis on the projected balance of payments and the burden of its debt.
- Prepare a detailed request, clearly outlining the type of debt relief that it hopes to obtain, and present a detailed review of all its debt stock and scheduled debt service.
- Implement a structural adjustment programme supported by the IMF (PRGF, formerly ESAF or SAF).

#### **3.2 Procedures**

Once these conditions have been fulfilled the country must formally seek a meeting with its Paris Club creditors by writing to the Paris Club Secretariat. At this meeting, which takes place at the offices of the French Treasury in Paris, the debtor country presents its case for debt relief in an Opening Statement to all the creditor representatives and observers. Various organisations (IMF, World Bank and UNCTAD) make formal statements on the need for relief and creditors ask questions of clarification on its debt situation, macroeconomic policy and poverty reduction programmes. Thereafter the country delegates retire to a side room and negotiations are carried out via the French Treasury representative who acts as a mediator between the debtor and the creditors. There is no opportunity for face-to-face negotiations.

When the negotiations have been concluded<sup>1</sup>, the country and its creditors sign the Agreed Minutes which state:

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<sup>1</sup> It has been known for negotiations to take up to 24 hours.

- the debt which is eligible for debt restructuring and relief;
- the *consolidation period*<sup>2</sup>, defining the period in which debt service payments falling due are to be restructured;
- the *cut-off date*, if not previously decided;
- the total amount of relief to be received; and
- the terms and conditions of the debt relief, in other words, the period of grace and maturity.

Concluding a Paris Club agreement is only the start of the process. It provides the framework agreement under which the debtor country must then negotiate separate bilateral agreements with each of its Paris Club creditors, which can take months, if not years, to complete and involves a great deal of staff time, discussed in Section 7 below. In addition, the debtor country also agrees to negotiate comparable terms with all its non-Paris Club creditors, including other developing countries<sup>3</sup>.

### 3.3 Eligible Debt

Official loans from bilateral creditors (inter-government debt) and export credits which have been guaranteed by official bilateral agencies are the only types of loan that can be considered during Paris Club negotiations. Debt eligible for restructuring therefore comprises public and publicly-guaranteed medium-term and long-term term debt. Short-term debt is usually excluded so as to protect new short-term commercial loans.

Debt contracted on concessional terms<sup>4</sup> is commonly referred to as *official development assistance (ODA) debt*, whereas export credits and other market-related debt is known as *non-ODA debt*. The Paris Club applies different treatment to ODA and non-ODA debt.

Furthermore, there are various different categories of debt, both ODA and non-ODA, that can be included in Paris Club negotiations. These can be graded hierarchically:

1. Debt service on debt that has not yet been rescheduled, which is due during the consolidation period.
2. If the renegotiation of this debt is insufficient to solve the balance of payment problems, then arrears and current maturities on the debt service are also considered.
3. If this new total still does not fill the financing gap, rescheduling can be extended to debt which has already been rescheduled.

A *cut-off date* is applied whereby all loans must have been contracted before a given agreed date in order to qualify for rescheduling. The cut-off date is generally determined during the first negotiation and is normally set some months before the first agreement. Since 1984, initial cut-off dates have been maintained in later rescheduling agreements. In addition, creditor countries generally demand that all accumulated arrears on any post-cut-off debt are paid as a prerequisite

<sup>2</sup> See Annex 1: *Glossary of Selected Terms Used by the Paris Club* for more detailed definition of terms.

<sup>3</sup> See DRI (2001), *HIPC Experiences of Debt Renegotiations* (forthcoming) for more information.

<sup>4</sup> Concessional debt is defined as loans and credits that have long maturities and/or below-market interest rates such that they have a grant element of 35% or more.



to reschedulings agreed with the Paris Club. In some cases, however, arrears and current service on debt contracted after the cut-off date have been deferred for several years, including up to 10 years maturity and 3 years grace.

#### IV. EVOLUTION OF RESCHEDULING TERMS

As noted above, rescheduling terms were initially negotiated on a case-by-case basis but, with the advent of the debt crisis in the 1980s, standard terms were introduced for debt rescheduling on market-related terms. However, this changed in September 1987, when Paris Club creditors agreed for the first time to lengthen grace and maturity periods by granting the *Venice Terms* to the poorest countries of Sub-Saharan Africa<sup>5</sup>. Subsequently the Paris Club has provided greater debt relief with each new set of terms, as described below, culminating in the Cologne Terms of July 1999. These terms are summarised in Table 1.

In the case of middle-income countries, the *Houston Terms* were introduced in 1990, which allow for deferral of payments but do not provide any debt reduction. The Houston Terms apply to lower middle-income countries and provide for rescheduling over 20 years for ODA debt and up to 15 years for non-ODA debt, with the exception of the Russian Federation which has received better terms. Upper middle-income countries receive debt rescheduling on what are known as *standard terms*, which reschedule debt on market-related terms.

##### 4.1 Toronto Terms

The Toronto Terms, introduced in 1988, granted 33% debt relief.

ODA debt - The treatment consisted of a rescheduling of 25 years maturity, including a 14-years grace period. In addition, the *moratorium interest rate*, that is, the interest rate levied on debt rescheduled or deferred, was at least as low as the original interest rate.

---

<sup>5</sup> The names given to the sets of terms are derived from the cities where the G7 creditors met and agreed them.

**Table 1: Paris Club Rescheduling Terms**

|  | 1988                                | 1990                                | 1991                                | 1994                                | 1996                                | 1999                                |                                     |                                     |                                     |
|--|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
|  | Toronto Terms                       | Houston Terms*                      | London Terms                        | Naples Terms                        | Lyons Terms                         | Cologne Terms**                     |                                     |                                     |                                     |
|  | Flow Approach                       | Flow Approach                       | Flow Approach                       | Flow Approach                       | Stock Approach                      | Flow Approach                       | Stock Approach                      | Flow Approach                       | Stock Approach                      |
| <b>Concessional (ODA) debt</b>         |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
| cancellation %                         | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  |
| reschedule %                           | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                |
| maturity (years)                       | 25                                  | 20                                  | 30                                  | 40                                  | 40                                  | 40                                  | 40                                  | 40                                  | 40                                  |
| grace (years)                          | 14                                  | up to 10                            | 12                                  | 16                                  | 16                                  | 16                                  | 16                                  | 16                                  | 16                                  |
| interest rates                         | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate | less than or equal to original rate |
| <b>Non-concessional (non-ODA) debt</b> |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
| <b>Debt Reduction (Option A)</b>       |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
| cancellation %                         | 33%                                 | na                                  | 50%                                 | 67%                                 | 67%                                 | 80%                                 | 80%                                 | 90%***                              | 90%***                              |
| reschedule %                           | 67%                                 |                                     | 50%                                 | 33%                                 | 33%                                 | 20%                                 | 20%                                 | 10%                                 | 10%                                 |
| maturity (years)                       | 14                                  |                                     | 23                                  | 23                                  | 23                                  | 23                                  | 23                                  | 23                                  | 23                                  |
| grace (years)                          | 8                                   |                                     | 6                                   | 6                                   | 6                                   | 6                                   | 6                                   | 6                                   | 6                                   |
| interest rates                         | market rate                         |                                     | market rate                         | market rate                         | market rate                         | market rate                         | market rate                         | market rate                         | market rate                         |
| <b>Debt Reduction (Option B)</b>       |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
| cancellation %                         | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  | 0%                                  |
| reschedule %                           | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                | 100%                                |
| maturity (years)                       | 14                                  | up to 15                            | 23                                  | 33                                  | 33                                  | 40                                  | 40                                  | 125                                 | 125                                 |
| grace (years)                          | 8                                   | up to 8                             | 0                                   | 0                                   | 3                                   | 8                                   | 8                                   | 65                                  | 65                                  |
| interest rates                         | reduced rate                        | market rate                         | reduced rate                        | reduced rate                        | reduced rate                        | reduced rate                        | reduced rate                        | reduced rate                        | reduced rate                        |
| <b>Previously refinanced debt</b>      |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
|  |                                     |                                     | Top up to 50% PV relief             | Top up to achieve 67% PV relief     | Top up to achieve 80% PV relief     | Top up to achieve 90% PV relief     |                                     |                                     |                                     |
| <b>Debt Conversion Option</b>          |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |                                     |
| ODA debt                               |                                     | no limit                            | no limit                            | no limit                            | no limit                            | no limit                            | no limit                            |                                     |                                     |
| non-ODA debt                           |                                     | 30% or SDR 40m                      | 10% or US\$ 10m                     | 20% or SDR 30m                      | 30% or SDR 40m                      | 30% or SDR 40m                      |                                     |                                     |                                     |

na = not applicable

\* Applies to lower middle income countries, with per capital income > \$785 and < \$3,125

\*\* Cologne Terms are the benchmark terms: some countries may receive less and others more depending on the relief needed to reach sustainability.

\*\*\* Countries which cannot cancel debt can reschedule the part of the debt that would be cancelled with low interest rates (0.0001%) and a single bullet maturity of between 6 and 350 years, with maturity depending on the appropriate market interest rates.

Sources: Debt Relief International, World Bank, IMF

Non-ODA debt – creditor countries could choose from various options:

A. Partial write-off

This option allowed for the cancellation of a third of the consolidated debt. The remainder was rescheduled using market interest rates, which had a maturity of 14 years, including an 8-year grace period.

B. Concessional interest rates

The consolidated debt was rescheduled using below-market interest rates (either half those of market value or at least 3.5% lower than the market rate, depending on which option gave the greatest reduction). The maturity of the new loan was 14 years including 8 years' grace.

C. Longer repayment periods

The consolidated debt was rescheduled with market interest rates over a 25-year maturity period including 14 years' of grace.

#### **4.2 London Terms (also known as the Enhanced Toronto Terms)**

The London Terms were formulated in 1991 to replace the Toronto Terms, and provided 50% debt reduction.

ODA debt- was rescheduled for 30 years, including a 12-year grace period, at interest rates at least as low as the original interest rates.

Non-ODA debt – Creditor countries could choose between the following options, with the aim of achieving a reduction of 50% in the present value of the debt:

A. Write-off

Cancellation of 50% of the service scheduled during the consolidation period. The remainder was rescheduled over 23 years, including 6 years' grace at the market interest rate.

B. Interest rate reduction

Rescheduling 100% of the consolidated debt with 23 years maturity, no grace period but low enough interest rates to reduce the present value of debt service by 50%.

C. Combining reduction of interest rates with partial interest payment capitalization. The repayment period was 23 years with 5 years' grace, and interest was not charged on the capitalized interest.

The London Terms introduced 2 major improvements to the Toronto Terms. The first was a graduated repayment scheme to avoid a drastic rise in service payments at the end of the grace period, as had occurred with previous reschedulings.

The second major improvement was the inclusion of a clause stipulating that 3 or 4 years after the agreement, creditor countries would consider a reduction in the stock of debt, provided that the debtor countries maintained satisfactory relations with creditor countries and fulfilled the adjustment programme goals stipulated by the IMF.

#### **4.3 Naples Terms**

The Naples Terms, adopted in December 1994, increased the percentage of debt relief to 67%

for the poorest and most indebted countries<sup>6</sup>. However, the 67% relief is determined on the basis of the present value of the debt, not its nominal value. In addition, the Naples Terms introduced, for the first time, an option designed to allow countries to exit from the debt restructuring process by reducing the stock of debt.

The Naples Terms comprise of the **Flow Approach**, which applies to service falling due within the consolidation period, and the **Stock Approach**, which applies to the stock of debt outstanding three years after the signing of an Agreed Minute for the Flow Approach under Naples Terms. To be eligible for the stock treatment, a country needs to demonstrate that the outlook for its balance of payments is sufficiently strong to enable it to exit from further rescheduling following the reduction of its debt stock.

Only Heavily Indebted Poor Countries or countries that had previously benefited from either the Toronto or London terms are eligible for treatment under the Naples Terms.

The details on the different options under these terms are set out in Table 2.

---

<sup>6</sup> When the Naples Terms were first introduced some countries with a per capita income of more than US\$500 and a present value/export ratio of less than 350%, received a reduction of only 50% in present value. However, this condition has been dropped and all countries are now eligible for 67% relief.

**Table 2: The Naples Terms**

| <b>FLOW APPROACH</b>  |
|---|
| <p><b><u>Non-ODA Debt</u></b></p> <ul style="list-style-type: none"> <li>• 50% or 67% reduction of present value of payments during the consolidation period. The creditors can choose between the following: <ol style="list-style-type: none"> <li>1. Debt Reduction Option (DR / Option A)<br/>The debt is written off by 67%. The remaining debt is rescheduled over a period of 23 years, including 6 years of grace, at the market rate.</li> <li>2. Debt Service Reduction Option (DSR / Option B)<br/>Debt service is reduced by 67% through rescheduling at reduced interest rates, over 33 years, with no grace period.</li> </ol> </li> <li>• Commercial Option<br/>Due to budgetary, legal or policy reasons, creditors can choose to reschedule debt service obligations over extended periods (40 years maturity with 20 years grace) at market rates. This option does not provide any debt reduction (no creditor currently applies this option).</li> </ul> <p><b><u>ODA Debt</u></b></p> <p>Concessional debt can be refinanced over a 40-year repayment period, including 16 years' grace.</p> |
| <b>STOCK TREATMENT</b>  |
| <p><b><u>Non-ODA Debt</u></b></p> <ul style="list-style-type: none"> <li>• Reduction of the stock of debt by 67%.<br/>Creditors can choose between: <ol style="list-style-type: none"> <li>1. Debt Reduction Option (DR / Option A)<br/>Debt is written off by 67%. The remaining debt is rescheduled over a period of 23 years, including 6 years of grace, at the market rate.</li> <li>2. Debt Service Reduction Option (DSR / Option B)<br/>Reduction of the present value of debt by 67%, through rescheduling at reduced interest rates, over 33 years with 3 years grace period.</li> </ol> </li> </ul> <p><b><u>ODA Debt</u></b></p> <p>Same treatment as in the flow approach.</p>   |
| <b>PREVIOUSLY REFINANCED DEBT</b>   |
| <p>Under the Naples Terms, any loan that has already been refinanced must be treated with special terms in order to ensure that the debt relief on the total debt (sum of that previously obtained and that which is about to be obtained) reaches 67% (see section 4.6 below).</p>   |

#### **4.4 Lyons Terms**

In 1996, the Paris Club agreed on the Lyons Terms which provided 80% present value reduction. These were available only to Heavily Indebted Poor Countries which had received relief under the Naples Terms, and which qualified for the HIPC Initiative. These countries could receive

Lyons Terms on debt service (at the Decision Point) and on their stock (at the Completion Point).

In the same manner as previously implemented terms, the treatment offered different options for ODA and non-ODA debt.

**Table 3: The Lyons Terms**

| <b>FLOW &amp; STOCK APPROACH</b>  |
|---|
| <p><b><u>Non-ODA Debt</u></b></p> <ul style="list-style-type: none"> <li>• 80% reduction in the present value of repayments during the consolidation period. Creditor countries can choose between the following options:               <ol style="list-style-type: none"> <li>1. Debt Reduction Option (DR / Option A)<br/>80% of debt service which is accrued during the consolidation period is written off. The balance (20%) is refinanced with a maturity of 23 years, including 6 years of grace, at the market rate.</li> <li>2. Debt Service Reduction Option (DSR / Option B)<br/>Debt service is reduced by 80% by refinancing 100% of the service with a reduced interest rate over 40 years maturity with an 8 year grace period.</li> </ol> </li> </ul> <p><b><u>ODA Debt</u></b></p> <p>Concessional debt is refinanced with a 40-year repayment period, including 16 years' grace.</p> |
| <b>PREVIOUSLY REFINANCED DEBT</b>   |
| <p>Under the Lyons Terms, any loan that has been previously refinanced under other terms, must be treated with special terms to ensure that the total debt relief (including what was previously granted) reaches 80% (see Section 4.6 below).</p>  |

#### **4.5 Cologne Terms**

The Cologne Terms were adopted in June 1999, allowing for up to 90% forgiveness of non-concessional ODA debt *and more in individual cases if needed* in order to reach the new sustainability thresholds under the HIPC Initiative.<sup>7</sup> The details of these terms (grace and maturity periods) are set out in Table 4. The Cologne Terms also called on all creditor countries to forgive bilaterally all ODA debt of qualifying countries on top of the amounts required to achieve debt sustainability thresholds. The status of debt cancellations is discussed in Section 4.7.

<sup>7</sup> Report of the G7 Finance Ministers on the Cologne Debt Initiative to the Cologne Economic Summit, 18-20 June 1999

**Table 4: The Cologne Terms**

| <b>CONSOLIDATION OF FLOWS AND STOCK</b>  |
|--|
| <p><b><u>Non-ODA Debt</u></b></p> <p>90% reduction (or more if required) of the actual value of payments falling due during the consolidation period (flow) or of the stocks. The creditor countries can choose from the following options:</p> <ol style="list-style-type: none"> <li>1. <b>Debt Reduction Option (DR / Option A)</b><br/>Debt is reduced by 90% or more. The remaining amount is re-scheduled over a period of 23 years, with 6 years grace, at market interest rates with the same repayment profile as the Naples / Lyons Terms. Countries that cannot cancel debt can adjust this option to reschedule the part of the debt which would be cancelled with low interest rates (0.0001%) and a single bullet of maturity between 60 and 350 years (with the maturity depending on the level of the appropriate market interest rates).</li> <li>2. <b>Debt Service Reduction Option (DSR / Option B)</b><br/>Debt service or stock is rescheduled over a period of 125 years, with 65 years' grace, and appropriate market interest rates as utilised under the Lyons Terms.</li> </ol> <p><b><u>ODA Debt</u></b></p> <p>The Cologne Summit recommended that all creditor countries cancel 100% of ODA debt (before and after the cut-off date). See Section 4.7 below.</p> |
| <b>PREVIOUSLY REFINANCED DEBT</b>  |
| <p>Under the Cologne Terms, any loan that has been previously refinanced under other terms, must be treated with special terms to ensure that the total debt relief (including what was previously granted) reaches 90% (see Section 4.6 below).</p>   |

#### **4.6 Topping-up of Previously Refinanced Debt**

Although the Paris Club provided an element of debt relief, starting with the Toronto Terms, many developing countries still found themselves returning time and again to negotiate successive agreements for debt relief. However, debts which had been restructured under, for example, the Toronto Terms had already received an element of debt relief and so, when a country comes to negotiate further debt relief, for instance, on Cologne Terms, the debt relief already received has to be taken into account. Hence the practice of *topping up* of debt refinanced under an earlier Paris Club agreement was introduced<sup>8</sup>.

The following example illustrates how topping up works for the Debt Reduction Option (Option A). A non-ODA loan previously refinanced under the Naples Terms would have received relief equivalent to 67% cancellation, so the remaining debt would be equal to 33% of the original loan amount. If this loan is now to be refinanced on Cologne Terms, then the remaining balance (33% of the original debt) must be topped up to provide relief equivalent to 90% cancellation of the original loan amount. The formula for calculating the top up (T) from the Naples Terms is as follows:

<sup>8</sup> Topping up only applies to non-ODA debt.

$$T = \frac{(X - 67\%)}{(100\% - 67\%)}$$

where X = the actual percentage relief to be obtained from the Paris Club.

In this case, the percentage top up, T, is calculated as:

$$T = \frac{(90\% - 67\%)}{(100\% - 67\%)} = \frac{23\%}{33\%} = 70\%$$

This means that 70% of the current debt is cancelled and 30% of it is rescheduled, which when applied on top of the Naples Terms, yields debt relief equivalent to 90% relief on the original loan amount.

Table 5 sets out the top up percentages to achieve the Naples, Lyons and Cologne Terms. See Section 7 for a discussion of the Debt Service Reduction Option (Option B).



**Table 5: Treatment of Previously Refinanced Debts**

| <b>To Naples Terms – 67%</b>                   |          |           |
|--|----------|-----------|
| From previous rescheduling                     | Option A | Option B  |
| Toronto Stock/Flow Treatment                   | 50%      | 67% - eDR |
| London (Enhanced Toronto) Stock/Flow Treatment | 34%      | 67% - eDR |
| <b>To Lyons Terms – 80%</b>                    |          |           |
| From previous rescheduling                     | Option A | Option B  |
| Toronto Stock/Flow Treatment                   | 70%      | 80% - eDR |
| London (Enhanced Toronto) Stock/Flow Treatment | 60%      | 80% - eDR |
| Naples Terms Stock/Flow Treatment              | 39%      | 80% - eDR |
| <b>To Cologne Terms – 90%</b>                  |          |           |
| From previous rescheduling                     | Option A | Option B  |
| Toronto Stock/Flow Treatment                   | 85%      | 90% - eDR |
| London (Enhanced Toronto) Stock/Flow Treatment | 80%      | 90% - eDR |
| Naples Terms Stock/Flow Treatment              | 70%      | 90% - eDR |
| Lyons Terms Stock/Flow Treatment               | 50%      | 90% - eDR |

eDR = Equivalent Debt Reduction. See Section 7 below.

#### **4.7 Debt Conversions**

From 1990, with the introduction of the Houston Terms for lower middle-income countries, the Paris Club introduced the option for further reduction through official debt conversion mechanisms, including debt-equity, debt-for-development swaps, subject to certain limits<sup>9</sup>. There

<sup>9</sup> See M. Moye (2000), *Overview of Debt Conversions*, DRI, for more details.

are no limits for ODA loans, but a limit of 10% or some US\$10 million, whichever is higher, on what was set for non-concessional loans.

In 1991, the debt conversion programme was extended to highly indebted low-income countries, under the London Terms, and later under the Naples, Lyons and Cologne Terms. Under the Cologne terms the ceiling for non-ODA debt conversions was raised to 30% or up to SDR40 million. Furthermore, the Paris Club has agreed to increase the limit on debt swap options for middle income countries to this level as well.

## **V. DEBT RELIEF ADDITIONAL TO HIPC**

At the June 1999 summit in Cologne the G7 countries promised to provide additional debt relief to HIPC countries by cancelling all official development assistance (ODA) debt. This includes not only pre-cutoff date debt, that is all ODA loans eligible for Paris Club restructuring, but also all post-cutoff date ODA debt. In addition, Canada, the United Kingdom and the United States have gone further and promised to cancel all bilateral debt, which includes the more expensive export credits. Subsequently Australia, the Netherlands, Norway and Sweden have agreed to cancel all ODA, including post-cutoff date debt, while Spain has agreed to do so on a case-by-case basis. Australia is also considering cancelling post cutoff date non-ODA debt as well.

The devil, however, is in the detail of how these cancellations will be enacted. The UK and the US are committed to cancelling debt service when a country reaches its Decision Point under the HIPC Initiative, whereas all others will cancel the debt at the Completion Point – which occurs about three years after the Decision Point. For post-cutoff date debt, the UK will cancel all debts incurred prior to 1 January 2000 at the Completion Point, whereas the US will cancel loans signed prior to 20 June 1999.

Table 6 sets out the status of this additional bilateral debt relief.

**Table 6: Paris Club Debt Relief Additional to HIPC**

| Creditor country            | Countries covered | Debt Relief Additional to the HIPC Initiative |                        |                     |                  | Method of delivery |                  |
|-----------------------------|-------------------|---|------------------------|---------------------|------------------|--------------------|------------------|
|                             |                   | ODA   |                        | Non-ODA             |                  | Decision Point     | Completion Point |
|                             |                   | pre-cutoff date                               | post-cutoff date       | pre-cutoff date     | post-cutoff date |                    |                  |
| Australia <sup>1</sup>      | HIPCs             | 100%  | 100%                   | 100%                | 100%             | to be finalised    | to be finalised  |
| Austria <sup>2</sup>        | HIPCs             | 100% (case-by-case)                           | 100% (case-by-case)    | 100% (case-by-case) | -                | case-by-case       | case-by-case     |
| Belgium                     | HIPCs             | 100% (case-by-case)                           | 100% (case-by-case)    | case-by-case        | -                | flow               | stock            |
| Canada <sup>3</sup>         | HIPCs             | 100% already cancelled                        | 100% already cancelled | 100%                | 100%             | 100% flow          | stock            |
| Denmark                     | HIPCs             | 100%  | case-by-case           | -                   | -                | -                  | stock            |
| Finland                     | HIPCs             | 95%   | 98%                    | -                   | -                | -                  | -                |
| France                      | HIPCs             | 100%  | 100%                   | 100%                | -                | 100% flow          | stock            |
| Germany                     | HIPCs             | 100%  | 100%                   | 100%                | -                | 100% flow          | stock            |
| Italy                       | HIPCs             | 100%  | 100%                   | 100%                | -                | 100% flow          | stock            |
| Japan                       | HIPCs             | 100%  | 100%                   | 100%                | -                | -                  | stock            |
| Netherlands <sup>4</sup>    | HIPCs             | 100%  | 100%                   | 100%                | -                | 90-100% flow       | stock            |
| Norway                      | HIPCs             | 100% already cancelled                        | 100% already cancelled | 100%                | 100%             | 100% flow          | stock            |
| Russia                      | case-by-case      | -   | -                      | -                   | -                | -                  | stock            |
| Spain                       | HIPCs             | 100%  | case-by-case           | case-by-case        | case-by-case     | -                  | stock            |
| Sweden                      | case-by-case      | 100% already cancelled                        | -                      | 100% (case-by-case) | -                | -                  | stock            |
| Switzerland                 | HIPCs             | 100% already cancelled                        | 100% already cancelled | case-by-case        | case-by-case     | flow, case-by-case | stock            |
| United Kingdom <sup>5</sup> | HIPCs             | 100%  | 100%                   | 100%                | 100%             | 100% flow          | stock            |
| United States <sup>6</sup>  | HIPCs             | 100%  | 100%                   | 100%                | 100%             | 100% flow          | stock            |

<sup>1</sup> For post-cutoff non-ODA debt, relief to be applied to debt incurred prior to date to be decided. Timing details for flow and stock relief to be finalised.

<sup>2</sup> Countries covered on case-by-case basis.

<sup>3</sup> Countries = HIPCs + Bangladesh. Canada has granted a moratorium of debt service as of January 2001 on all debt disbursed before end-March 1999 for 11 out of 17 HIPCs with debt service due to Canada. The debt will be written off at completion point. The countries to be covered are Benin, Bolivia, Cameroon, Ethiopia, Guyana, Madagascar, Mali, Senegal, Tanzania and Zambia. 100% ODA debt already cancelled, except for Myanmar.

<sup>4</sup> 100% pre- and post-cutoff date ODA debt will be cancelled at the Decision Point. Non-ODA: 100% cancellation of consolidated flows at Decision Point for Bolivia, Burkina Faso, Ethiopia, Mali, Nicaragua and Tanzania; 90% reduction of consolidated amounts as interim relief for all other HIPCs. At Completion Point, 100% cancellation of remaining pre-cutoff debt.

<sup>5</sup> Full write-off of all debts of HIPCs at Decision Point, with reimbursement of any debt service paid before the Decision Point.

<sup>6</sup> For post-cutoff non-ODA debt, 100% cancellation on debt assumed prior to 20/06/1999 (date of Cologne Summit).

## VI. TREATMENT OF DEBT OWED TO THE RUSSIAN FEDERATION

As part of the discussions surrounding HIPC, an agreement was reached with the Russian Federation in 1997, under which the Paris Club agreed to admit the Federation as a creditor member, and the Russian Federation agreed to provide the following terms for debt relief:

- maintenance of the original exchange rate of the rouble defined in the contract (generally around RBL0.65 = US\$1);
- an up-front cancellation of 70% of debts for countries whose debts to Russia were principally non-military, and of 80% for countries whose debts were principally military; and
- application to the remaining balance of the appropriate Paris Club terms (50%, 67% 80% or 90% reduction), using Option B – interest rate reduction.

The total present value reduction can therefore be as high as 98% (80+90) of the debt.

In the implementation of the subsequent agreements with the Russian Federation, three complex issues have arisen:

- the need for lengthy and complex reconciliation of rather old debts;
- the application by the Russians of late interest on arrears, which can substantially increase the debt stock eligible for rescheduling; and
- the application by the Russians of a cutoff date on debts which is the same as that of the Paris Club. Post-cutoff date debts are in principle to be paid on schedule (and arrears cleared immediately) which has risked causing huge cash flow burdens for some debtor countries. As a result, Russia has agreed that HIPCs with cash flow problems can spread payments over a period as long as 10 years.

## VII. BILATERAL AGREEMENTS<sup>10</sup>

Having signed an Agreed Minute with the Paris Club, the debtor country negotiates bilateral agreements with each Paris Club creditor government (and in some cases with separate agencies within that government). Though the Paris Club sets deadlines for the conclusion of these agreements, usually around 6 months after the multilateral meeting, the process can be lengthy, often in the past taking up to 18 months.

The most important issues in bilateral agreements are the precise loan amounts to be rescheduled and the interest rates. Reconciling creditor and debtor data on the precise amounts (especially on arrears, on the interest charged on arrears, on short-term debt and on publicly-guaranteed private sector debt) is often time-consuming.

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<sup>10</sup> For more details on the process of bilateral negotiations, see Goreux and Martin, *Paris Club Bilateral Agreements*, a study for the UNCTAD Secretariat, 1992.

### **Consolidation Methods**

The way in which the debt service due during the consolidation period is treated can affect the cost of debt rescheduling. The main methods of consolidating debt service are as follows:

- *Staggered annual consolidation.* this means that the debt service falling due in each year is effectively rescheduled separately. For example, in the three-year consolidation period 2000–2002, the service falling due in 2000 is rescheduled, then the service falling due in 2001 is rescheduled and so on. So the grace and maturity periods are calculated from the year in which the service falls due. Moratorium interest is levied on the annual rescheduled amount.
- *Single-centred consolidation.* this method adds up the service each year as it falls due so that by the end of the consolidation period there is a single amount rescheduled. The grace and maturity periods applied to this sum are as of the mid-point of the consolidation period. So with the three-year consolidation period, 2000-2002, grace and maturity will be counted from mid-2001. Interest is levied on the annual amount rescheduled.

The second method results in an earlier repayment of the rescheduled principal.

The interest rates used for rescheduling the concessional (ODA) debt have generally been the same as those on the original loans, except where (for example in the case of Japan) falls in commercial market interest rates have necessitated cuts in the interest rates in order to ensure that the loans remain concessional.

Calculating the interest rate for non-concessional (non-ODA) loans is more complicated, especially for those creditor countries which have ever adopted Option B of the Toronto, London, Naples or Lyons Terms. The Agreed Minute refers to the *Appropriate Market Rate* (AMR). Before the adoption of concessional terms by the Paris Club, creditor countries chose appropriate floating or fixed market rates and added a margin to cover their administrative costs. For some countries, the rates (or at least the margins above them) are negotiable, but the room for negotiation is usually less than half of one percentage point. A list of the rates and margins is given in Table 7.

**Table 7: Bilateral Interest Rates**

|                    | OPTION | DEBT TYPE          | INTEREST BASE         | MARGIN<br>% | PENALTY<br>% |
|--------------------|--------|--------------------|-----------------------|-------------|--------------|
| <b>Austria</b>     | B      | OEKB               | ASEPS <sup>1</sup>    | 0.6         | +0           |
|                    | na     | Aid                | Fixed 4%              | -           | +0           |
| <b>Belgium</b>     | B      | Ducroire           | BEF=BIBOR; US\$=LIBOR | 0.5-0.75    | +0-2         |
|                    | na     | Concessional       | Fixed 2%              | -           | +0-1         |
| <b>Brazil</b>      | B      | Banco do Brasil    | LIBOR                 | 1-1.5       | +1           |
| <b>Canada</b>      | A      | CWB                | Prime or LIBOR        | 0?          | +1           |
|                    | A      | EDC                | LIBOR                 | 1           | +1           |
|                    | na     | CIDA               | Fixed 0.5-2           | -           | +0           |
| <b>Denmark</b>     | B      | Ex. Credit         | DK=Fixed US\$=LIBOR   | 0.5         | +0           |
|                    | na     | DANIDA             | Fixed 2.5%            | -           | +0           |
| <b>Finland</b>     | na     | Concessional       | Fixed +0.5-0.75       | 0.2         | +0           |
| <b>France</b>      | na     | CFD                | Fixed 2.5-4           | -           | +0-1         |
|                    | A      | COFACE             | FF=TMO (or Fixed)     | 0-1.5       | +1           |
|                    | A      | Banque de France   | Other=LIBOR           | 0-1.5       | +1           |
| <b>Germany</b>     | na     | Kfw/Concessional   | Fixed 2.5-3           | -           | +0-1         |
|                    | A      | Hermes             | Bond rate*: +0.2      | 0.1-0.5     | +0-1         |
| <b>Israel</b>      | A      | Ex. Credit         | LIBOR                 | 1.125       | +1           |
| <b>Italy</b>       | B      | M'credito          | Fixed 1.5             | -           | +0           |
|                    | B      | SACE               | BOT**                 | 0.5-1       | +0           |
|                    | na     | Concessional       | Fixed 4               | -           | +0           |
| <b>Japan</b>       | na     | OECD/JICA          | Fixed 2-4             | -           | +0           |
|                    | B      | Eximbank           | Fixed 3.5             | ?           | +0           |
|                    | B      | MITI               | Bond rate             | ?           | +0           |
| <b>Netherlands</b> | na     | MDC (Concessional) | Fixed 2.5             | -           | +0           |
|                    | A      | NCM                | CIRR***               | 0.2-1       | +0           |
| <b>Norway</b>      | na     | Concessional       | Fixed 2.5             | -           | +0           |
|                    | A/B    | Ex. Credit         | ?                     | ?           | ?            |
| <b>Portugal</b>    | na     | Tesouro            | Fixed 3-4             | -           | +1           |
| <b>Spain</b>       | na     | ICO                | Fixed 4.5             | -           | +1           |
|                    | B      | CESCE              | LIBOR; US Bonds       | 0.3         | +0.2-1       |
| <b>Sweden</b>      | A      | EKN                | SEK=STIBOR;US\$=LIBOR | 0.5-0.75    | +0           |
| <b>Switzerland</b> | na     | SDC                | Fixed 2.5             | 0.5-0.75    | +0           |
|                    | B      | Ex. Credit         | Swiss Bonds           | ?           | +0           |
| <b>UK</b>          | na     | DFID               | Fixed 2-3             | 0           | +0           |
|                    | B/A    | ECGD               | LIBOR                 | 0.5-1.5     | +0           |
| <b>USA</b>         | na     | USAID              | Fixed 3               | 0           | +0           |
|                    | na     | PL480              | Fixed 3               | 0           | +0           |
|                    | A/B    | Eximbank           | FFB****               | 0-0.5       | +0           |

<sup>1</sup> ASEPS: Austrian Statutory Export Promotions Scheme Rate

\* Rate applied is for bonds with same maturity as rescheduling agreement, averaged over the 12-month period preceding the rescheduling date.

\*\* Index of 6-month Treasury Bill rates.

\*\*\* OECD 'Commercial Interest Reference Rate' for new export credits

\*\*\*\* Cost of Federal Financing Bank interest for Treasury notes of less than 1 year maturity.

na = not applicable

As described earlier, creditor countries adopting Option A of the concessional terms apply the appropriate market rate plus margin. However, for those countries which adopt Option B, it is necessary to calculate an appropriate market rate which provides the same percentage debt reduction (in present value terms over the life of the whole rescheduling) as Option A. Since the adoption of the London Terms, this has been calculated manually using tables supplied by the Paris Club.

The method of calculation for a creditor using Option B for the first time is relatively simple. The Appropriate Market Rate is adjusted downwards to a percentage providing the necessary reduction, using Table F annexed to the Paris Club Minute, which calculates the appropriate rate based on the currently applicable market rate (including margin) and the percentage reduction needed.

In subsequent agreements, however, it becomes more complicated:

- i) It is necessary to calculate the Equivalent Debt Reduction (eDR) which has already been achieved under the previous agreement (because the interest rate reduction provides the present value debt relief only little by little throughout the life of the rescheduling). This is done using an eDR table which shows the number of semesters which have elapsed since the date of the relevant Agreed Minute, and the past average (during the period since the relevant Agreed Minute) appropriate market interest rate.
- ii) It is necessary to calculate the amount of reduction which still needed in order to reach the reduction percentage appropriate to the new concessional terms. For example, if the Equivalent Debt Reduction provided under a London agreement has reached only 4.5% by the time of a Lyons agreement, it will be necessary to reduce the debt by a further 75.5% (80%–4.5%).
- iii) It is necessary to identify the Appropriate Market Rate (AMR) to use in order to achieve the remaining necessary reduction. This is done using Table F annexed to the Paris Club Agreed Minute.

This is a relatively lengthy process. Fortunately, these calculations can now be done in the Debt-Pro computerised debt strategy system.

## **Annex: Glossary of Selected Paris Club Terms**

**Agreed Minute** – Concise document signed by the debtor, the participating creditors and the chairman at the end of the Paris Club meeting. The Agreed Minute specifies the terms of consolidation and/or rescheduling which participating creditors undertake to recommend to their respective governments. Since these recommendations have always been adopted by the governments of creditor countries, the agreed minute can be considered, for practical purposes, as the terms of the multilateral agreement between the debtor and the participating creditors. The agreed minute leaves a number of issues to be cleared in bilateral negotiations.

**Arrears** – Unpaid amounts that fell (or will fall) due before the beginning of the consolidation period.

**Bilateral Agreements** – Agreements reached bilaterally between the debtor country and each of the participating creditor countries and agencies within those countries. These agreements establish the legal basis of the debt restructuring outlined in the agreed minute.

**Bilateral Deadline** – Date by which all bilateral agreements must be concluded: a deadline has been specified in the agreed minute since mid-1962.

**Consolidation Period** – Period in which debt service payments to be consolidated or rescheduled under the terms applicable to current maturities fall due. The beginning of the consolidation period may precede or follow the date of the agreed minute. The end of consolidation period usually coincides with the end of the IMF arrangement. Some of the Paris Club multi-year arrangements are implemented in stages in order to match the successive IMF programmes.

**Current Maturities** – Principal and interest payments falling due within the consolidation period.

**Cut-off Date** – The date before which loans must have been contracted in order for their service to be covered by the rescheduling. Debt service of loans contracted after the cut-off date is excluded from the rescheduling.

**De minimis Clause** – Creditors whose total claim is less than a specified amount do not sign the agreed minute and do not participate in the rescheduling agreement. Creditors falling below the specified threshold benefit from the ‘de minimis’ clause and are expected to be paid in accordance with the original contract. The ‘de minimis’ amount was originally set at around SDR 1 million but has been reduced to SDR 0.25 million in some cases, related to the total debt stock.

**Enhanced Treatment** – Terms introduced in December 1991 as ‘Enhanced Concessional Treatment of the debt of the poorest and most indebted countries’ to supersede the Toronto Terms introduced in mid-1988.

**Flow Rescheduling** – The rescheduling of specified debt service falling due during the consolidation period. This, together with the rescheduling in some cases of the stock of specified arrears outstanding at the beginning of the consolidation period, was the approach used in most Paris Club reschedulings until the adoption of the Naples Terms.

**Goodwill Clause** – Creditor willingness to consider further debt rescheduling, subject to fulfilment of specified conditions.



**Grace Period** – Period during which only interest is paid on rescheduled debt.

**Late Interest** – Interest accrued on principal and interest in arrears.

**Maturity Period** – Sum of the grace and the repayment periods.

**Moratorium Interest** – Interest charged on amounts deferred or rescheduled under the agreement. This is specified in the bilateral agreement.

**Participating countries** – Representatives of the creditor governments signing the agreed minute which defines the terms of the rescheduling.

**Special Account** – Account established by the debtor and lodged with the central bank of a participating creditor country with the purpose of servicing the rescheduled debt. The schedule of deposits to be made by the debtor is specified in the agreed minute.

**Stock-of-debt-operation** – Rescheduling of the eligible stock of debt outstanding as opposed to flow reschedulings. Stock-of-debt operations by the Paris Club are applied only to HIPCs.

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