DEBT RESCHEDULING

By

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> MEXICAN DEBT RESTRUCTURED. PHILIPPINES DOESN'T EXPECT IMF APPROVAL OF DEBT RESCHEDULING PLAN UNTIL MARCH. ARGENTINA'S INABILITY TO MEET TERMS OF IMF SEEN FORCING U.S. BANKS TO TAKE HEAVY CHARGES. SIGNING OF BRAZIL'S LOAN OF $6.5 BILLION DELAYED. NATIONS INDEBTED TO 'OBSCURE' CLUB. BRAZIL SUSPENDS DEBT. "The government of Brazil suspended payment on $1.5 billion of its debt to Western government banks and institutions, and the country's economic leaders were trying to secure new funds. Last week Brazil asked the Paris Club to renegotiate the $1.5 billion Brazil owes for this year and next."[1]

These are just a few of the headlines and comments noted in the Wall Street Journal and local newspapers during the past year. In January 1984 The Beavercreek (Ohio) News published an article by Mary Tobin entitled, "The Third World Debt Remains Worrisome," in which an International Monetary Fund (IMF) study -- "Recent Multilateral Debt Restructurings with Official and Bank Creditors" -- was cited. The study indicated that at the end of 1982, 27 countries were engaged in bank debt restructurings. Through October 1983, 22 countries had completed official and bank debt restructurings. According to another IMF report, the total external debt of 115 non-oil producing developing countries came to $612.4 billion at the end of 1982 and was expected to rise to approximately $664 billion by the end of 1983. At least 34 nations were seeking to "reschedule" their loans -- to postpone payments in interest and principal.

As of September 30, 1983, debts owed to the US Government (USG), excluding those arising from World War I, totaled $63 billion. About 54% of the debt was owed by the non-oil exporting developing countries, 18.1% by the Organization for Economic Cooperation and Development (OECD) countries, 6% by members of the Organization of Petroleum Exporting Countries (OPEC), and about 4% by the USSR and Eastern Europe. Six countries accounted for $27.5 billion, or over 40% of the total debt owed to the US Government: Israel, $8.2 billion; Egypt, $6.6 billion; Korea, $3.5 billion; India, $3.2 billion; Turkey, $3.2 billion; and the United Kingdom, $2.8 billion.[2]

DISAM is often asked, what is debt rescheduling? What is the "Paris Club?" What effect does debt rescheduling have on the FMS Direct and Guaranteed Loan program? The following information is provided to assist in the understanding of debt rescheduling. The author visited the Department of State, Department of Treasury, and the Defense Security Assistance Agency (DSAA), to gather information for the preparation of this article and is

indebted to those who discussed and provided material concerning debt rescheduling.

Normally loans are repaid on schedule. Occasionally unusual circumstances require the modification of loan terms. Legislation authorizing government lending programs includes authority for debt renegotiation. The Department of Defense (DoD) does not arbitrarily reschedule DoD loans. DoD rescheduling is a result of multilateral and bilateral implementing agreements. When renegotiation is required, it is the policy of the US Government to negotiate with the debtor country in a multilateral framework. Such a framework is essential so that all creditor countries share equitably the burden of debt relief. Over the past two decades, official creditors have usually negotiated debt relief arrangements in the "Paris Club."

THE "PARIS CLUB"

The "Paris Club" is an ad hoc group of western official creditors and is informal in the sense it has no charter or rules. Meetings are not publicized and officially the group doesn't even exist. For approximately 27 years the "Paris Club" has operated in relative obscurity. The so-called club is actually a meeting of representatives of the world's major creditor governments convened in the French capital whenever a country needs to reschedule debts owed to these governments. Club meetings are chaired by the French Treasury and usually bring together foreign and treasury ministry officials from the creditor nations. The primary purpose of the "Paris Club" is to make orderly and expeditious arrangements for recovering specific debt-service obligations to creditor governments that the borrower is unable to meet.

Argentina was the Club's first client in 1956. Since then, there have been more than 76 multilateral debt negotiations involving about 30 debtor countries. The United States has participated in virtually all of these reschedulings. Recent international economic difficulties have resulted in more frequent official debt rescheduling. In fact, 1983 was the Club's busiest year. In October and November 1983, the Club met to reorganize debts owed by Morocco, Niger, Malawi, and Brazil, and to resume debt talks with Polish officials. For example, the Paris Club agreed to reschedule 85 percent of Morocco's interest and principal to the end of 1984, in a deal worth about $640 million to Morocco.[3] Brazil successfully renegotiated payments on more than $3 billion owed through the end of 1984. Eighteen countries were expected to appeal to the organization for relief during 1983, according to Michel Camdessus, director of the French Treasury and chairman of the Club.[4] The Club was expected to roll over as much as $15 billion in 1983.

In many ways, the Club's founding fathers never dreamed, much less wanted, their informal gathering to become an enduring fixture. They initially saw the Club as a convenient method to sort out the tangle of negotiations that arose when developing countries sought debt relief. But after exports from non-oil producing, less developed countries (LDCs) stopped growing, debtor countries were slow in making policy changes. Imports continued to grow, interest rates climbed, and countries as diverse as Mexico and Malawi ran out of the foreign exchange needed to meet their external debt service obligations. For example, during recent years every percentage-point rise in international interest rates added over a half a billion dollars to the debt

service payments of countries such as Brazil and Mexico. Also, during the international recession, the market for exports of the heavily indebted countries was drastically reduced. Many countries found their interest payments soaring just as foreign currency receipts from export sales were stagnating. A whole series of borrowers have been paying approximately half of their export earnings just to service their debt. During 1982, "debt service payments as a proportion of total exports reached or topped two-thirds in Mexico, Brazil, Argentina, Chile, and Ecuador, hitting 98 percent of exports in Argentina."[5]

RESCHEDULING PROCESS

The common practice for convening the Paris Club is that a request for a meeting is initiated by the debtor country. Official creditors reschedule debts only when a debtor is in a state of "imminent default," that is, the country does not have sufficient foreign exchange to pay all of its creditors on schedule. Official creditors also insist that a debtor country negotiate comparable rescheduling agreements with its commercial creditors and other official creditors who are not participating in the Paris Club negotiations. The Paris Club considers only government obligations. Observers include the International Monetary Fund (IMF), the World Bank, the Commission of European Communities, and the United Nations Conference on Trade and Development (UNCTAD). The most important observer is the International Monetary Fund, which plays a crucial role in policing the economic policy reforms that debtor nations undertake in exchange for debt deferral.

A normal condition for debt rescheduling is an economic adjustment program by the debtor country, usually supported by an IMF standby or extended arrangement, which addresses the underlying balance of payments problems and improves prospects that sufficient foreign exchange will be available to meet future debt-service obligations. In fact, Paris Club agreements are not normally concluded until the borrower has obtained a standby or extended arrangement with the IMF.

Insolvent debtors generally end up calling on the IMF for balance of payments financing. In return, the borrower agrees to far-reaching economic reforms to bring its economy back into line. The IMF has made billions of dollars available to countries that agreed to cut government spending, reduce imports, and pursue other necessary measures. However, a few countries have had trouble meeting IMF requirements or have been unwilling to adopt tough economic measures and the IMF has suspended loan disbursements.

During a Paris Club meeting a multilateral debt rescheduling agreement will be drawn-up. Basically all participants agree to reschedule principal or interest, or both, considering such things as terms, grace periods, percent of principal or interest to be rescheduled and number of years for repayment. The Paris Club does not determine interest rates. This is done by the individual creditors. The USG is normally represented by personnel from the Departments of State and Treasury after a USG negotiating position has been approved by the National Advisory Council on International Monetary and Financial Policies (NAC). The DoD is not a formal member of the NAC but is represented in weekly meetings of the NAC Staff Committee.

The Paris Club formal agreement is titled "Agreed Minute on the Consolidation of (country name) Debts." In one example of a formal agreement representatives of 17 nations (plus observers from the IMF, the World Bank, and the Commission of the European Communities) met and signed an agreement recommending that their governments or appropriate governmental institutions provide relief for a borrowers' external debt. The participating creditors were requested to establish individual Bilateral Implementing Agreements with the borrower based on the principles set forth in the Paris Club multilateral agreement. Multilateral agreements are not legal documents. They are recommendations.

Subsequent to the Paris Club agreement the United States and borrowing country sign a Bilateral Implementing Agreement in which it is agreed certain borrower repayments with respect to debts which were owed to, guaranteed by, or insured by the United States Government or its agencies will be consolidated and rescheduled. USG agencies that are normally involved in the bilateral agreement are the Agency for International Development (AID), the Export-Import Bank (EXIM), Department of Agriculture, and the Department of Defense (DoD). Article III of the typical USG Bilateral Agreement identifies the terms and conditions of payments, such as the number and dollar amount of repayment installments, when due, and interest rate. Annexes to the Bilateral Implementing Agreement identify each agencies' specific applicable loans and a summary by agency of the total debt by dollar value. An example of one Bilateral Implementing Agreement is titled, "Agreement Between the United States of America and (country) Regarding the Consolidation and Rescheduling of Certain Debts Owed to, Guaranteed or Insured by, the United States Government and its Agencies."

The Bilateral Implementing Agreement requires the borrower and the DoD to enter into an Agency Implementing Agreement setting forth the terms and conditions of, and the procedures to be followed in the rescheduling of principal and interest installments. For example, the DoD might prepare an Agency Implementing Agreement between the United States and the borrower regarding the consolidation and rescheduling of Direct Loan and Guaranteed Loan debts. In 1981 one country had a mixture of eleven DoD Direct Loans and Guaranteed Loans, with payments due between 1 July 1981 and 15 June 1982, that were consolidated and rescheduled in an implementing agreement. The DoD would include in its implementing agreement amounts which it will pay the Federal Financing Bank (FFB) pursuant to contracts of guaranty covering Guaranteed Loan contracts between the FFB and the borrower (NOTE: Arms Export Control Act (AECA), Section 24, Guaranteed Loans and the related Guaranty Reserve Fund are discussed in the DISAM Journal, Vol. 4, No. 4, Summer 1982, pp. 38-39.) An example of one Agency Implementing Agreement is titled, "Implementing Agreement Between the United States of America and (country) Regarding the Consolidation and Rescheduling of Certain Debts Maturing From July 1, 1981 through June 30, 1983 owed to the United States Department of Defense." Bilateral and Agency Implementing Agreements are legal documents.

In essence, rescheduled amounts become new loans. Direct Loans are repaid to the Defense Security Assistance Agency (DSAA) under the new schedule at a slower rate than in the original loan. Rescheduled Guaranteed Loans are also repaid to DSAA against the new negotiated (extended rate) payment schedule. However, the original Guaranteed Loan repayment

schedule remains the same. DSAA must withdraw funds from the Guaranty Reserve to make payments to the FFB according to the schedule in the original Guaranteed Loan agreement. Consequently, appropriated funds (Guaranty Reserve) are required to make up the shortfall between receipts from the borrower and required payments to the FFB.

The Guaranteed Loan, Guaranty Reserve Fund operates as a revolving fund. DoD makes payments from the Guaranty Reserve account to the FFB when a borrower is late with its repayments. When a borrower provides DSAA with its late repayment, the funds are deposited in the Guaranty Reserve to replace those funds previously disbursed by DSAA to the FFB. Likewise, as DSAA receives funds from rescheduled loans, those funds are deposited to the Guaranty Reserve to replace disbursements to the FFB on the original loans. Unfortunately, at the present time, disbursements are exceeding deposits. In addition to country defaults during repayments of loans, rescheduling of loans has caused the Guaranty Reserve to decrease from over $1 billion to less than $750 million in the last three years. Falling below the $750 million level has triggered a statutory Congressional notification requirement (AECA, Section 24, Guaranties, "The President shall report promptly to the Congress whenever the payment of a claim under any such guaranty reduces the total amount of funds in the single reserve under this subsection to an amount less than $750,000,000, together with his recommendations for the authorization of appropriations of additional funds for such reserve."). According to the FY 1985 Congressional Presentation Document (CPD) the closing FY 1984 Guaranty Reserve cash balance is estimated to be $621 million. The Administration has requested an appropriation of $274 million in FY 1985 to replenish the Reserve.

Although rescheduling has caused DSAA to utilize the Guaranty Reserve, it has occasionally reduced the need by the Administration to invoke the "Brooke Amendment." The "Brooke Amendment" refers to Section 517 of the Foreign Assistance and Related Programs Appropriations Action, 1982 (Public Law 97-121). According to Section 517, "No part of any appropriation contained in the Act shall be used to furnish assistance to any country which is in default during a period in excess of one calendar year in payment to the United States of principal or interest on any loan made to such country by the United States pursuant to a program for which funds are appropriated under the Act." Once the Brooke Amendment has been invoked, new Letters of Offer that rely on FMS loans or MAP funds will not be processed or implemented. A borrower may have substantial funds remaining on a loan agreement, but DSAA is not authorized to commit any of the funds on new cases. Likewise, no new loan agreements will be signed. If a country is successful in having its debts rescheduled pursuant to international debt rescheduling agreements prior to falling twelve months in arrears on a loan repayment to DSAA or the FFB, it can forestall coming under the provisions of the "Brooke Amendment."

SUMMARY

As the world economic situation has deteriorated, many countries have been unable to make loan repayments on schedule and have been forced to reschedule their loan repayment programs in a multi-national forum. The Paris Club, an ad hoc group of official creditors, negotiates a debt

rescheduling agreement after the debtor country has adopted an IMF-supported economic adjustment program. Subsequent to the Multilateral Agreement the United States and borrowing country sign a Bilateral Implementing Agreement, in which certain borrower repayments will be consolidated and rescheduled. The DoD then prepares an Agency Implementing Agreement concerning Direct Loan and Guaranteed Loan debts, as applicable. Rescheduling has impacted the Guaranteed Loan Guaranty Reserve and caused the Administration to request additional appropriations for FY 1985. However, through rescheduling, some countries have been able to continue participating in DoD credit and loan programs.

ENDNOTES:

1. Wall Street Journal, 24 August 1983, 26 August 1983, 14 January 1984, 16 January 1984, 9 March 1984; Dayton Journal Herald, 24 November 1983, Dayton Daily News, 24 July 1983.

2. "Foreign Indebtedness to the US Government," GIST (Washington DC: Bureau of Public Affairs, Department of State), October 1983.

3. "Morocco: Rescheduling Saga Draws to a Close," Middle East Economic Digest, Vol. 28 No. 2, 13-19 Jan 84, p. 26.

4. "Nations Indebted to Obscure Club," Dayton Journal Herald, 24 November 1983, p. 63.

5. Jeff Frieden, "International Finance and the Third World," Middle East Research and Information Project, No. 117, Vol. 13 No. 7, September 1983, p. 9.

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