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Mansoor Akbar Kundi

Introduction

The debt regime is important in the international system in general and in the international political economy in particular. Stephen D. Krasner defines regimes as, 'principles, norms, and decision-making procedures around which actor (actors') expectations converge in a given issue-area.'¹ To Robert Keohane and Joseph Nye, regimes are 'sets of governing arrangements', comprising networks of rules, norms and procedures that regularize behaviour and control its effects.' They claim that regimes are a reality as they are pervasive and entrenched.² To John Baylis and Steve Smith, regimes are global phenomena which 'regulate international relations around the world with states becoming enmeshed.'³ Regimes govern the behaviour of the actors in the international system, giving them choices, compulsions, and bargaining powers.

In the international system, as Samuel Huntington argues, 'states are and will remain the dominant entities in world affairs'⁴, this is the perception of a leading realist school. Being rational and unitary actor states, they operate in a worldwide environment where roles are defined as core, semi, or periphery. Non-state actors have become equally important with the shifting role of power, influence, and interests. Non-state actors include international governmental organizations (IGOs), non-governmental organizations (NGOs), multinational corporations (MNCs), individuals, transnational banks, and cartels. All of these have an impact on global transactions, whether political, socio-cultural, or economic. This is particularly true in the case of those non-state actors, such as IGOs or MNCs, which enjoy the support of their home countries. They ultimately serve the interests of the countries they represent or belong to, with loose or strong strings of interests between them.

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¹ Stephen D. Krasner (ed.), *International Regimes* (Cornell University Press, 1983), p. 2.

² Ibid., p. 4.

³ John Baylis and Steve Smith, *The Globalization of World Politics: An Introduction to International Relations* (Oxford University Press, Second Edition, 2001), p. 299.

⁴ Samuel P. Huntington, *The Clash of Civilizations and the Remaking of the World Order* (London: Touchstone Books, 1997), p. 34.

The international system is unevenly structured with nation-states divided into three categories: the First World, the Second, and the Third. First World countries are industrialized, democratically sound, and socio-culturally developed compared to the developing Second and Third World countries. A school of western international relation scholars divides states into developed and developing, omitting the underdeveloped world. The Third World is a reality for researchers, particularly in respect of the debt regime where its entity becomes more conspicuous and where countries belonging to this category are classified as less or heavily indebted countries.

The roots of regimes can be centuries old, but international relations scholars largely agree that regime formation in the present sense began in the post-Second World War period, with a more visible role in the international system in the 1970s. The debt regime emerged in the 1970s after the oil crises of 1973 where the rich Organization of Petroleum Exporting Countries (OPEC), having quadrupled the oil prices in 1974, accumulated a huge amount of petrodollars and deposited them in leading European banks. The banks emerged as important non-state actors in the debt regime with many enjoying the support of their home countries. Like other necessary regimes of the international system which are security, nuclear proliferation, energy, trade, and terrorism, the debt regime has rule-governed behaviour where actors interact under defined principles, norms, rules, and decision-making procedures.

The actors in the debt regime can broadly be divided into creditors and debtors.⁵ The creditors are rich, industrially-advanced countries. Simultaneously, in the debt regime there is a growth of IGOs representing and enjoying the support of those countries. In the presence of an uneven division in the international system, where a number of countries belong with the have-nots, the role of non-state actors has grown in the existing debt regime. They largely represent the developed world by controlling, influencing, and facilitating transnational business and have a major say in the patterns of decision-making. The use of power and influence, decision-making patterns, interactions amongst members, and articulation of interests lead ultimately to the emergence of regimes.⁶ Less developed countries, for the most part, are debtors and have little say in the system. According to a report, each person in the

⁵ Charles Lipson, 'The International Organization of Third World Debt', *International Organization*, Vol. 35, Issue 4, Autumn 1981, pp. 603-631.

⁶ Mansoor Akbar Kundi, *Elements of International Political Economy* (Karachi: Maktaba-e-Faridi, Third Edition, 2005), p. 161.

Third World is indebted to the West to the tune of around 400 dollars.⁷ The debt burden directly and indirectly touches upon governments as well as the people in the Third World.

This article is an attempt to focus on the role and importance of the Paris Club in the international debt regime about which students of international political economy are usually unaware. The article will also focus on the terms and strategies adopted by the Club under its debt settlement mechanism. It will also touch upon the different transactions of the Paris Club with Pakistan between 1972 to 2001 for the settlement and restructuring of its external debt schedule.

IGO, NGO, or hybrid

The Paris Club is an IGO that has had an important say in international economic governance and the debt regime since its inception in 1956. It appears to be a hybrid, with the characteristics of both an IGO and an NGO, with a strong tilt towards an IGO. The Paris Club originated as the ultimate result of a mechanism created by rich creditors to restructure their large bilateral debts as a consortium. Its role and impact have grown over the years, through various terms and methods. The Club's official statements and handouts stress the fact that it is an informal association of creditors whose rulings and decisions have no legal binding without the involvement of state parties. However, it cannot rule out the official involvement of the concerned governments. On many important occasions, regarding bilateral negotiation with debtors, meetings for final rescheduling, and issuance of fresh and new loans, government desks have been used for the final settlement. The Paris Club enjoys the full support of the French treasury.

The Club's routine meetings, held after every six weeks or 10 times a year, are held in a place none other than the French Ministry of Finance, Economy, and Industry. Those who preside over the meetings represent the French treasury. Similarly, representatives from its 20-member countries are not private individuals but important public servants with backgrounds in economics and finance. For example, in all cases, the American representative is from the US treasury. The terms the Paris Club has adopted to deal with the nature of a country's debt resettlement has enjoyed endorsement at the G-7 summit meetings with US, France, and Japan being vocal members.

⁷ <http://www.theguardian.com/global-development/poverty-matters/2012/may/15/developing-world-of-debt>

An additional factor in the governmental capacity of the Paris Club is the close interaction between the International Monetary Fund (IMF) and the World Bank. There exists close liaison of the Club with the two IGOs over the settlement of bilateral debts. For example, in May 2014, the landmark debt agreement of the Club with Argentina to facilitate it to repay 9.7 billion dollars (the debt due over the next five years) was facilitated by the IMF and the German government to whom Argentina owed the largest amount. It was discussed at a G-7 meeting, with Germany being the most vocal. Two years earlier, in the wake of 9/11, when Pakistan agreed to accept the US seven-step formula for action against the Taliban, there was a sudden change in the behaviour of many Paris Club creditors towards Pakistan.

Pakistan, in fact, got the best possible treatment from the Paris Club in 2001 due to the u-turn on its Taliban policy. There are many cases where the Paris Club and the IMF have taken opposing directions for days, finally reaching a unanimous decision. President Cristina Kirchner of Argentina is on record as saying that in Argentina's case, the Paris Club was lenient, with the IMF aggressive and imposing tough conditionalities. In fact, the IMF plays an important role in the Debt Treatment Sessions of the Paris Club. It is the IMF which certifies to the Club's creditors that the country concerned is unable to finance the external obligation of its debt except with fresh funds in debt or a waiver.

The Club mechanism depends on G-7 decisions too. Its debt schedule formulas, such as the Houston or Cologne terms, are named after the cities where summit meetings have been held. As the Club's records show, the debtor parties are nation-states with representative negotiators and leaders not below the rank of finance minister. For example, during the negotiations between the Club and Pakistan between 1974 and 2001, Pakistan was represented by its former finance minister Shaukat Aziz who successfully conducted negotiations with the Club. In 2001, the Paris Club rescheduled Pakistan's external debt of 12.5 billion dollars over 38 years. The Paris Club came into existence informally in June 1956 in Paris, regarding a debt solution for Argentina which had shown bankruptcy or default over the repayment of its debt to Western countries after president Juan Domingo Perón was overthrown by army officers and an interim government was installed. Argentina owed 450 million dollars to Western European countries: UK, France, Belgium, Austria, Norway, Switzerland, Sweden, the Netherlands, and Italy. Germany was not in the settlement but it joined the consortium a few months later. The loan had been taken by the Perón government during his first tenure of office in 1946-1955. The concerned countries acted as a consortium but the loan was facilitated bilaterally. Together they designed a two-principle settlement formula for Argentina. First, it ended the bilateral

trade system established by the Perón government, allowing Argentina to enter into multi-trade agreements with outside countries. Second, the debt was divided into three categories: government debt; debts due to central banks; and liabilities to private concerns under long-term orders.⁸ The European central banks also played an important role in the settlement. The Argentina debt was not waived but was restructured with a maximum grace period. The settlement led to the formation of the consortium which later was named the Paris Club.

The process of reaching an arrangement with Argentina highlighted three principles on the basis of which the successful debt arrangement emerged. First, the debt problem was one of the emerging problems for a number of developing countries. Excessive borrowing by governments and regimes, without considering the pros and cons, put the debtor countries in jeopardy. Second, repayment is a problem for countries with inadequate industrial and economic structural setups. Third, creditors need to be considerate and conduct bilateral rounds of negotiations with debtors.

Membership

The permanent members of the Club in alphabetical order are Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Ireland, Israel, Italy, Japan, the Netherlands, Norway, the Russian Federation, Spain, Sweden, Switzerland, the United Kingdom, and the United States. There is no fixed criterion mentioned for permanent membership; however, a country's economic credibility and political stability are regarded as essential for membership. For example, South Korea, which had observer status as a nation-state in the Club, has been offered and assured membership due to its possession of 650 billion dollars in external bonds. Its membership will strengthen the Club's overall capability of external bonds which, for the last few years, has been bearish.⁹ The external bond power of a country or consortium is considered as a capability for exerting influence in the international economic system. In James H. Nolt's words, 'bond markets were the decisive innovation that enabled Europe to dominate world trade for five centuries and colonize the world.'¹⁰ Developed European countries need it now, and so it is for the Paris Club. Israel's membership is a new addition to the Club with many reservations from academia. It does not meet the general criteria of the members' economic, socio-cultural, and representative

⁸ Ibid.

⁹ https://en.wikipedia.org/wiki/Paris_Club

¹⁰ James H. Nolt, *International Political Economy: The Business of War and Peace* (New York: Routledge, 2015), p. 21.

governance background. It became a member of the Organisation for Economic Co-operation and Development (OECD) in 2010 after a wait of six years.

On the eve of Israel's joining the Club, a pro-Zionist newspaper, *Haaretz*, published a news item: 'the news that Israel had been accepted into the influential group of rich nations that help poor indebted economies was welcomed by Israeli policymakers, who are facing calls to reduce high-levels of poverty and inequality even as the country's economy hums along.'¹¹ Israel's membership maybe subject to debate in some circles on the grounds that it does not meet the overall criteria for joining the Club. These include political stability and a good human rights record with a broader recognition in the comity of nations. However, the fact remains that Israel has achieved economic stability at home with massive support from American and European countries.

International Jewish support for a strong role for Israel cannot be ruled out. Mearsheimer and Walt opine that the transnational support of state and non-state actors, particularly America, is a significant factor for Israel at the national and international level. These include NGOs such as the American Israel Pacific Affairs Committee (AIPAC), non-Jewish Israel supportive lobbies inside and outside the government, and an influential Jewish population in leading European countries such as the UK and France.¹² Israeli membership of the Paris Club has added to its influence and recognition in international political and economic relations.

Presidency

France has been leading the Paris Club since its inception and the chairperson of the Paris Club is Bruno Bézard, director general of the French treasury. It established its secretariat with limited staff in 1974. By keeping the captainship of the institution in its hands, France has an upper hand, with Paris as an important venue for routine or emergency meetings. Emergency meetings can be called with mutual consent at any time. Similarly, the French treasury office holds an upper hand in the management of the affairs of the Paris Club due to two main reasons: First, that there are no formal or written rules for the Club's role. Second, the *modus operandi* in all bilateral arrangements, is that the employees dealing with business keep the minutes and decisions highly

¹¹ <http://www.haaretz.com/israel-news/1.600977>

¹² John Mearsheimer and Stephen Walt, *The Israel Lobby and US Foreign Policy* (New York: Farrar, Straus and Giroux, 2007), pp. 11-13.

confidential, following the code of 'Control the Information Flow to Maximum Advantage'.¹³

Terms and conditions

The principles of the Paris Club are informal and mostly unwritten; nevertheless, there are norms and practices that have been agreed upon between creditors and debtors for settling issues. Solidarity rules business at the Paris Club. The final decisions of the Club are reached through consensus, but it is said that creditors with the largest share of the debt have a bigger role to play as did Germany in the case of the 2014 debt crisis of Argentina. They are all and all in bilateral arrangements which are run on a case-by-case basis.¹⁴ The restructuring and rescheduling of cases at the Paris Club have increased over the years. According to a survey, there were around 26 cases between 1956 and 1976 which, by 1997, had increased to 306 cases, and so it goes on.

Ad hoc arrangements

Ad hoc arrangements are the original method of arrangements at the Paris Club. The first debt treatment was ad hoc. It suited the bilateral nature of the debt settlement mechanism of the Club. It means that the members (who can be specific, but whose names do not come on record) to whom the debtor owes money can fix the terms and conditions for rescheduling and restructuring if required. In 1972, 1974, and 2001, Pakistan was dealt with under ad hoc terms. The terms discussed below emerged out of an ad hoc arrangement, with some changes discussed at the creditors' end. The bilateral nature of debt relief was the result of the ad hoc arrangements.

Classic terms

Classic terms are general terms. They were applicable between 1956 and 1987 and were mostly applied to countries seeking assistance from the Club for the first time. This assistance could be for fresh loans or for debt resettlement. Repayment entailed renegotiating the debt on a case-by-case basis, with a 10-year repayment period at the appropriate market rate with the possibility of a three-year grace period. They are known as the least of all concessional loans advanced at market rates.

¹³ 'Paris Rules come under Attack'(September 2000), <http://www.euromoney.com/Article/1004144/Paris-Club-comes-under-attack.html>

¹⁴ Martin A. Weiss, 'The Paris Club and International Debt Relief', Congress Research Service (CRS) Report for the US Congress, No. 21482, December 2013.

Toronto terms

These were introduced in 1988 and are applicable to the present day in case-by-case agreements but are not widely applied. Under this arrangement, the major concession was to waive 33 per cent of the total debt to a country that was encountering repayment problems.

Houston terms

These terms are named after the city in the US, where the G-7 summit meeting was held in 1990 and terms were finalized. They were designed for lower income countries with debt problems. The terms offer a longer grace period on development assistance. Pakistan's debt rescheduling in January 1999 and 2001 was dealt with under the Houston terms by the Paris Club.

Naples terms

The Naples rules were adopted at the G-7 meeting in 1994 in Naples for the cancellation and rescheduling of debts with countries with adverse poverty. Only those countries were eligible for treatment under the terms which qualified for the World Bank's concessional facility, the International Development Agency (IDA). In other words, these rules were applicable only to those countries that had a per capita Gross Domestic Product (GDP) less than 755 dollars. Countries once declared eligible under the Naples terms can avail of a waiver of 50 per cent to 67 per cent of the eligible debt. The Club offered two methods for the debtor to implement the concession. They could either cancel the eligible amount by rescheduling the remaining debt at market rates for up to 23 years or reschedule the total eligible debt, with a minimum interest rate with repayment terms extending up to 33 years.¹⁵

Cologne terms

Named after the G-7 summit meeting in Cologne, Germany, in June 1999, the Cologne terms were designed for those debtor countries which qualified for the 1996 Heavily Indebted Poor Countries (HIPC) criterion of the IMF and the World Bank. Under the formula, 90 per cent of a country's eligible debt could be cancelled: a huge favour for a debtor.

Evian approach

The Evian approach was initiated by the Club members in October 2003 as a form of debt relief by cancelling the debt for countries not able to pay

¹⁵ Ibid., p. 3.

back the debt. The approach was known to be more flexible and concessional than all of the previous terms of the Club. Under this approach, many countries could ask for cancellation of their debts, such as post-US invasion Iraq. In fact, the approach was widely believed to have been adopted for that country. The Club's debtors were divided into two groups: HIPC and non-HIPC. HIPC could get a 90 per cent debt cancellation under the Cologne terms and, in some cases, up to 100 per cent (the US and a few European countries agreed to this, but not all members). The US was sanctioned by the Congress under the Foreign Operations Appropriations, §570, P. L. 103-87 to cancel its share of the debt.¹⁶ Pakistan is not one of the countries to have benefitted under the programme until 2012. Non-HIPCs could be treated on a case-to-case basis. Considering the terms, Pakistan could be treated as a non-HIPC. Comparing all 10, Pakistan has a better GDP and infrastructure. Besides Iraq, these countries were Kenya, Georgia, Kyrgyzstan, the Dominion Republic, Grenada, Moldova, Djibouti, Seychelles, Antigua and Barbuda. Many analysts believe that, at the height of the Afghan struggle against the Soviet Union, Ziaul Haq could pressurize the G-7 countries for cancellation of the debt the country owed to international institutions bilaterally. Pakistan's external debt was not much in the early 1980s.

Pakistan and the Paris Club: Debt treatment

Pakistan was one of the four Asian countries to which the Paris Club extended debts during 1956-1987. The other three were Turkey, Indonesia, and Cambodia. They were treated under the classic terms which were then the most widely applied terms under which 'debtors were granted a rescheduling of credit, ODA or non-ODA, at the appropriate market rate with the repayment profile negotiated on a case-by-case basis on a 10-year period with an additional three-year grace period.'¹⁷ Pakistan is not one of the HIPCs, although its external debt on 31 December 2015 reached its highest level at 68.550 billion dollars. Out of this amount, 11.580 billion dollars are owed to the Paris Club.¹⁸ According to the Paris Club's overall loan standard allotment, Pakistan is a medium-sized debtor country. Unlike many debtor countries, Pakistan has not been given any debt cancellation by the Paris Club, while

¹⁶ Martin A. Weiss, *op. cit.*, p. 4.

¹⁷ Thomas Lambert, 'Debt Restructuring Experience: The Paris Club', December 2011, <http://www.mecon.gov.ar/finanzas/deuda%20soberana/lambert.pdf>

¹⁸ 'Pakistan's External Debt and Liabilities – Outstanding', <http://www.sbp.org.pk/ecodata/pakdebt.pdf> and <http://labs.tribune.com.pk/foreign-debt/>

Nigeria, the seventh largest oil producing country, was given a waiver of 18 billion dollars.

Pakistan first interacted with the Paris Club in 1972 when its request was accepted and treated under the ad hoc arrangement for 234 million dollars. The amount was small compared to the one restructured in 1974. A total of 650 million dollars debt was restructured for the next 10 years. The terms were as adopted in 1972. In 1981, Pakistan was treated under the Classic terms and it got a waiver on interest. The Club had promised to give 125,000,000 dollars in 1977 with concessional terms, but this aid was stopped due to the military takeover in July by Ziaul Haq.

In January 1999, during the second tenure of the Nawaz Sharif government, a sizeable amount of 3,250 million dollars was sanctioned to Pakistan under the Houston terms. A number of debtor countries were treated under these rules, as the Houston terms were meant for those debtor countries which were encountering high indebtedness and a stock of official bilateral debt, totalling at least 150 per cent of their private (external) debt. The Houston terms were not as soft as the Toronto terms which introduced a 33 per cent reduction term. Pakistan would have been at a greater advantage, had it been treated under the Toronto terms. While negotiating its debt with the Club, Pakistan, like many other countries with whom a one-on-one strategy had been adopted through a unanimous decision, definitely would have requested for treatment under the Toronto terms. But as mentioned earlier, the Paris Club transactions and accords are kept secret.

The favourable treatment that Pakistan was given in 2001 by the Paris Club was during Shaukat Aziz's tenure as finance minister and he played an important role. In December 2001, Pakistan's overall external debt was around 33 billion dollars out of which 13.3 billion dollars was loaned by the Club. The debt was treated under the ad hoc terms with maximum support. Japan and the US, the two major creditors at the Paris Club – to whom Pakistan owed the largest amount – were instrumental in rewarding Pakistan for its services in providing help to the US-led alliance against the Taliban. Abdul Sattar, in his book, *Pakistan's Foreign Policy 1947-2009*, describes the story thus:

After 9/11, Japan, like most Western countries, welcomed the change in Afghanistan and appreciated Pakistan's cooperation against terrorism. It decided to provide \$300 million as grant assistance and supported Pakistan's case in the IMF and the Paris Club. Prime Minister Junichiro Koizumi invited President Musharraf to visit in March 2002, and accorded him a warm reception. Japan's support in the Paris Club for rescheduling bilateral debt brought substantial relief, as with 5 billion

dollars Japan was the biggest creditor of Pakistan. In April 2005, Koizumi announced recommencement of official development assistance that had been suspended after Pakistan conducted nuclear tests in 1998. Until then Japan's ODA amounted to \$500 million a year.¹⁹

Pakistan was given long-term debt relief by the Club with lower interest rates which mitigated its debt burden to 30 per cent.²⁰

Conclusion

The Paris Club is an important actor in the international debt regime as well as in the international political economy. It has two caps: a non-IGO as a consortium of 20 countries with the top 10 highly industrialized democratic countries as its members, as well as of an IGO with the support of the home government. For example, the US Federal Reform Act of 1990 necessitates that, 'Congress must be involved in any official foreign country debt relief and notified of any debt reduction and debt renegotiation.'²¹

To me, it appears to be more of an IGO representing the interests of member states with a strong role in international debt and resettlement than merely a consortium of member states. According to data available until May 2014, the Paris Club had entered into agreements worth more than 440 billion dollars, covering 90 debtor countries with a total debt of 583 billion dollars.²² Unofficially and tentatively, around 450 billion dollars were owed by 92 countries, including Pakistan, by May 2016. In total, the obligations of debtor countries are the awesome amount of more than 650 billion dollars. Its role, since its inception, has been growing in the international economic system with the full support of its member states, particularly the leading G-7 countries, which have a strong role in the IMF and the World Bank. The Paris Club's debt resettlement strategies and terms are discussed at the G-7 summit meetings and unanimous decisions reached. The Club is in regular liaison with the IMF and the World Bank for the nature and terms to be adopted in any particular case.

¹⁹ Abdul Sattar, *Pakistan's Foreign Policy 1947-200: A Concise History* (Karachi: Oxford University Press, second edition, 2006), p. 276.

²⁰ Ibid.

²¹ Thomas M. Callaghy, 'Innovation in the Sovereign Debt Regime: From the Paris Club to Enhanced HIPC and Beyond', the World Bank Report, Washington DC, 2004.

²² https://en.wikipedia.org/wiki/Paris_Club