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Iraq's Tangled Web of Debt Restructuring

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Throughout the debt crisis of the 1980s and early 1990s, debtor states faced a concerted group of creditors seeking to reap the largest possible amount of repayment; this classical sovereign debt regime, for lack of a better phrase, involved the International Monetary Fund (IMF) at the core (Kahler, 1993: 363). Meanwhile, Paris Club creditors, today a conglomerate of 19 official or state creditors, surrendered much of its power and control to the IMF by tying its debt rescheduling to IMF programs. In particular, the Paris Club required that IMF programs be put in place with all of their debt restructuring agreements and thereby "shifted the centre of gravity" to the IMF (see Callaghy, 2004). Private creditors, often represented by the London Club, similarly had a lot of faith in IMF assessment of debtors' capacity to repay and often followed the Paris Club and IMF's lead on the terms of repayment. The IMF, known for its hardline analysis of debtors, was entrusted with the dual role as judge of a country's capacity for repayment and as monitor of debtor economic and fiscal policies (Lipson, 1985). For a time, the IMF "linked the entire nexus" of creditors because it had provided the largest source of funds to debtors and was entrusted with these roles by the international creditor community at large (Germain, 2002: 22). However, the political implications of Iraqi success in debt restructuring changed the way in which the international debt negotiations regime has typically been structured.

Under the Baathist regime, the Iraq's economy was clearly statist and inward looking. With exception of oil, Iraq's economy was far removed from global trade. Plagued by crony capitalism and rentier state behaviour, the Iraqi state was fraught with economic inefficiencies (see Sanford, 2003). Its economic isolation was made worse throughout the 1990s by ten years of United Nations–led sanctions and international isolation of Iraq. In the meantime, Iraq had accumulated nearly $120 billion in public debt: $38.9 owed to industrialized states represented at the Paris Club (of which $4 billion was owed to the United States); $60–65 billion owed to 26 countries that were not Paris Club members, primarily and most notably in the neighbouring Persian Gulf states; and $15 billion to private commercial creditors (see Table 9.1). This debt represented more than 400 percent of Iraq's annual Gross Domestic Product (GDP) earnings—a crushing debt-to-earnings ratio. Even before the United States (US) invaded Iraq, American political leaders understood the importance of Iraqi debt relief as a prerequisite to American "success" in Iraq.

Initially, the United States attempted to coax other creditors to forgive Iraqi debt on moral grounds. When this was rebuked, the Americans turned to the Paris Club and the IMF. The other Paris Club creditors, specifically France, Germany and Russia, refused to go along with the American and IMF program until they received "undisclosed concessions" from the Bush administration. These are widely believed to have included opportunities to participate in the reconstruction of Iraq, which had been previously limited to countries that had, in the words of US officials, "put boots on the ground." Eventually, however, the United States was able to use the United Nations Security Council to limit Iraq's reparation payments to its creditors. Then the US also managed to have the Paris Club offer its most generous of terms to any middle-income country ever received: 80 percent debt write-off and generous repayment conditions. With pressure exerted on the IMF, the US also managed to have the fund underestimate the Iraqi ability to repay their debt. Thus the stage was set for subsequent negotiations with Iraqi creditors.

Private creditors, both sovereign and commercial, were tied to the terms of the Paris Club agreement based on the club's "comparability of treatment" clause. After a number of years, private creditors settled their claims to Iraq's satisfaction. The remaining creditors, and by far the largest, were the Arab Gulf neighbours: principally Saudi Arabia, Kuwait, the United Arab Emirates (UAE) and Qatar. The political and historical animosity between Iraq and its Gulf neighbours had effectively put the brakes on Iraq's easy ride with its creditors. Therefore, despite US power and influence in the international political and economic system, Iraqi

Table 9.1 Iraq: Estimated External Debt Stock, 2004–10 (in billions of US$ unless otherwise indicated)

	2004 before debt reduction[a]	2004 before debt reduction[b]	2005	2006	2007	2008	2009	2010
Without the second and third stage of debt reduction[c]								
Paris Club creditors	36.6	23.8	25.0	26.3	27.6	28.8	29.9	30.6
Non Paris club creditors	76.4	53.5	56.2	59.0	61.9	64.7	67.1	68.6
Of which: official creditors	61.4	43.0	45.1	47.4	49.8	52.0	53.9	55.2
Multilateral creditors[d]	0.6	0.9	0.9	1.0	1.3	1.7	2.4	3.4
Total debt	113.6	78.2	82.1	86.3	90.8	95.2	99.4	102.6
Total debt (in percent of GDP)	444.9	306.2	279.8	221.2	200.9	185.3	179.6	170.1
Total debt service[e]	…	0.0	0.0	0.0	0.0	0.7	1.6	2.7
With the second and third stage of debt reduction[f]								
Total debt	113.6	78.2	51.1	53.5	56.3	31.0	32.9	34.1
Total debt (in percent of GDP)	444.9	306.2	174.3	137.2	124.6	60.3	59.4	56.6
Total debt service[f]	…	0.0	0.0	0.0	0.0	0.6	0.8	1.1

Sources: The Paris Club and staff estimates; IMF Article IV agreement. http://www.imf.org/external/pubs/ft/scr/2005/cr05294.pdf.

[a] Some debt has been reconciled, and the amount of reconciled debt is less than the initial claim. As a result, the estimates of debt outstanding prior to debt reduction are lower than those in the 2004 EPCA staff report (IMF Country Report 04/325).
[b] Assumes comparable debt reduction to all external debt.
[c] The projection assumes the deferral of payments of principal and most interests until 2011.
[d] The project includes new debt. Iraq cleared its arrears to the Fund and the Bank in 2004.
[e] Debt service is actual amount paid (not accrued), excluding repayment of arrears.
[f] Assumes no additional debt other than a larger disbursement of Fund credit.

debt restructuring would hit an impasse when the time came to negotiate with its neighbours.

Bargaining Iraqi Debt Relief: The Paris Club and the IMF

More than a month prior to the US invasion of Iraq, the US Congress discussed the need for economic reforms in Iraq. Congress urged President Bush "to organize debtor and donor conferences in order to restructure Iraq's debt and post–Persian Gulf War obligations and accumulate sufficient resources to fund the needs of an interim government during transition" (United States Congress, 2003a). The March 2003 US invasion of Iraq would end decades of Iraqi economic isolation and force Iraq to confront the forces of globalization; however, the question of what to do with the heavy burden of Iraqi debt, with its strain on the Iraqi interim government and its successor remained unanswered.

In the first month after the US invasion and of the occupation of Iraq, the US government sent initial signals regarding the future of Iraq's public debt. A number of senior Bush administration officials, such as Deputy Secretary of Defense Paul Wolfowitz and Treasury Secretary John Snow, called on official creditors to cancel Iraqi debt. Similarly, US Congress approved a number of bills that deemed Iraqi debt to be odious and called on creditors, including the IMF and World Bank, to cancel outstanding claims (United States Congress, 2003d). At the behest of Congress, Secretary Snow also instructed the IMF's US Executive Director to oppose any loans to Iraq unless "there are sufficient safeguards in place to prevent the loan proceeds from being used to reimburse the persons and governments holding the debt, as of such date of enactment, for any losses with respect to the debt" (United States Congress, 2003c).

Snow noted that he would take the issue of Iraqi debt relief to the G7 meeting of finance ministers held in April 2003. He stated: "Certainly the people of Iraq shouldn't be saddled with those debts incurred through the regime of the dictator who's now gone" (Beattie, 2003). In effect, the United States did not want the new Iraqi regime to pay the burden of Iraq's past debt; instead, the United States wanted official creditors to share the burden of what it started to characterize as "odious debt." The term "odious debt" has no international legal standing, but it has been used in the past to characterize debt incurred by oppressive governments that, in turn, burden their oppressed citizens. By April 2003, US Congress had agreed to a resolution that pointedly asked France, Germany and Russia to cancel Iraqi debt (United States Congress, 2003b). The United States was taking the position that the international community now needed to share the burden of reconstructing Iraq.

Consequently, the United States proceeded to call and organize a Paris Club meeting of Iraq's official creditors in May 2003.[1] The Paris Club, established in 1956, has been used by creditor states to organize common stances on rescheduling the debt of those debtor states in arrears. France, Germany and Russia were the largest official creditors in the 2003 meeting.[2] When the meeting commenced, the Bush administration, influenced by the US Christian right movement, framed Iraqi debt forgiveness in moral terms (see Helleiner and Cameron, 2006). The future of the Iraqi people, President Bush argued, should not be mortgaged to the enormous burden of debt incurred to enrich Saddam Hussein's corrupt and repressive regime (Bush, 2003). Similar appeals were made by the White House Press Secretary: "They [Iraqis] should not be burdened with a debt of a brutal regime that had little interest in helping the Iraqi people, but had a lot of interest in building palaces and building torture chambers and pursuing weapon programs" (McClellan, 2003). Carefully framing debt relief in a moral imperative was intended to garner support for debt relief from the international community, most of whom had vehemently opposed the war. As one US Congressmen noted, "I believe there is money that needs to be spent in Iraq but not only our money...We had a coalition of the willing. Now we need a coalition of the wallet. Let them step up to the plate to share the financial responsibility to create stability and a democracy in Iraq" (Mikulski, 2003). Fearing an upcoming US election, the Bush administration met congressional calls for sharing the burden of the Iraqi reconstruction. The United States thus bent to domestic pressure and convened an international donor conference to raise funds for Iraq.

The October 2003 meeting in Madrid included 73 countries and 20 international organizations and resulted in pledges of US$33 billion in grants and loans (see Table 9.2 for breakdown of donor pledges). The majority of the pledged funds were in the form of loans by international financial institutions (IFI), mainly the IMF and World Bank. To enable the release of these IFI loans, however, debt restructuring would be needed. To assist in the process, the Paris Club introduced the Evian debt relief terms—some of the most generous, and politically charged terms of debt relief to be introduced at the forum (see Weiss, 2009). Consequently, two months later, President Bush appointed James Baker, a respected former Chief of Staff and Secretary of Treasury under the Reagan administration, and a former Secretary of State under the Bush Sr. administration, as his special envoy on Iraqi debt relief.[3] The appointment of Baker signalled a new, multilateral phase after the invasion of Iraq; perhaps an implicit message that America was ready to bargain. Baker soon began a whistle stop tour of Russia, UK, France, Italy, Germany, Japan, South Korea, China, Saudi Arabia, Kuwait, Qatar and the United Arab Emirates to bolster support for debt cancellation. Baker quickly reached a consensus with Iraq's main European creditors under the terms of the Paris Club agreement. The US, France and Germany released a joint statement agreeing to a substantial reduction of Iraqi debt (White House Press Release, 2003). Iraq's major European creditors would cancel a significant portion of Iraq's outstanding debt, and others indicated willingness to work within the parameters of the Paris Club. Table 9.2 summarizes pledges made at the International Donor's Conference for Iraq in Madrid, Spain, on October 23–24, 2003.

The Paris Club creditors, however, were not the majority of Iraq's creditors (see Figure 9.1). Both commercial creditors, many represented

Table 9.2 International Donor Pledges[a] for Iraq (in USD millions[b])

Donor	2005	2005–2007	Unpecified by Year[c]	Total[d]
Countries	569.59	758.62	25,118.50	26,446.71
Australia	45.59	0.00	0.00	45.59
Austria	1.94	3.53	0.00	5.48
Belgium	5.89	0.00	0.00	5.89
Bulgaria	0.64	0.00	0.00	0.64
Canada	0.00	0.00	187.47	187.47
China	0.00	0.00	25.00	25.00
Cyprus	0.00	0.00	0.12	0.12
Czech Republic	7.33	7.33	0.00	14.66
Denmark	26.95	0.00	0.00	26.95
Estonia	0.08	0.00	0.00	0.08
Finland	5.89	0.00	0.00	5.89
Greece	0.00	0.00	3.53	3.53
Hungary	1.24	0.00	0.00	1.24
India	10.00	0.00	0.00	10.00
Iran[e]	5.00	0.00	0.00	5.00
Ireland	3.53	0.00	0.00	3.53
Iceland	1.50	1.00	0.00	2.50
Italy[f]	0.00	0.00	235.62	235.62
Japan[g]	0.00	0.00	4,914.00	4,914.00
Korea	0.00	0.00	200.00	200.00
Kuwait	0.00	0.00	500.00	500.00
Luxembourg	1.18	1.18	0.00	2.36
Malta	0.00	0.00	0.27	0.27
Netherlands	9.42	0.00	0.00	9.42
New Zealand	3.35	0.00	0.00	3.35
Norway[h]	4.29	8.58	0.00	12.87
Oman	0.00	0.00	3.00	3.00
Pakistan	0.00	0.00	2.50	2.50
Qatar	0.00	0.00	100.00	100.00
Saudi Arabia	120.00	380.00	0.00	500.00
Slovenia	0.27	0.15	0.00	0.42
Spain	80.00	140.00	0.00	220.00
Sri Lanka	0.00	0.00	0.00	0.00
Sweden	0.00	0.00	33.00	33.00
Turkey	0.00	0.00	50.00	50.00
United Arab Emirates	0.00	0.00	215.00	215.00
United Kingdom	235.48	216.85	0.00	452.33
United States[i]	0.00	0.00	18,649.00	18,649.00
European Community	235.62	0.00	0.00	235.62
EC+EU Member States + Acceding Countries	614.83	369.04	272.54	1,256.41
International Financial Institutions	1,350.00	4,200.00–7,900.00	0.00	5,550.00–9,250.00
IMF[j]	858.00	1,700.00–3,400.00	0.00	2,550.00–4,250.00
World Bank	500.00	2,500.00–4,500.00	0.00	3,000.00–5,000.00
Total	2,155.21	4,958.62–8,658.62	25,118.50	33,232.33–35,932.33

Source: UNDP, http://iraq.undg.org/uploads/doc/summary%20tables.pdf.

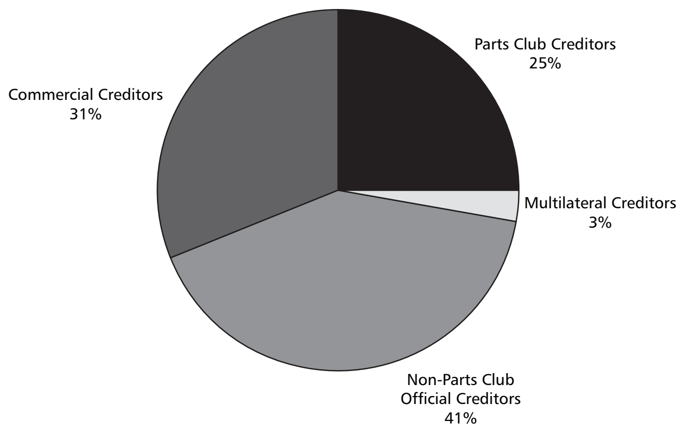
Table 9.2 cont'd

[a] A pledge is an indication of intent to mobilize funds for which an appropriate sum of contribution is specified. Most donors were not able to specify the type of grant assistance at the time of the Donor's Conference. The following countries offered in-kind assistance: Bahrain, Chile, Egypt, Germany, Jordan, Latvia, Mexico, Poland, Portugal, Slovakia, Sri Lanka, Switzerland, Thailand, Tunisia, Vietnam.
[b] Source for all exchange rates: IMF exchange rates in SDR terms for October 24, 2003.
[c] Many donors were not able to provide a breakdown by year.
[d] Amounts do not include identified humanitarian assistance (total of 115.17 M USD). Amounts do not include exports credits and guarantees: Austria 11.78 M USD, Saudi Arabia 500 M USD, and Denmark 154.54 M USD.
[e] In addition to the amount in the table above, Iran pledged an economic package, with an estimated value of 1,495 M USD, which includes credit facilities, restoration of religious sites, tourism and pilgrimage, technical and advisory services, trade, investment, market access and humanitarian assistance.
[f] Amounts unspecified between grants and loans are: Italy (235.62 M USD) and Qatar (100 M USD).
[g] Japan's assistance of 4.914 M USD consists of (i) grant assistance of 1,414 M USD for the immediate reconstruction needs of Iraq within the Japan's commitment, chiefly corresponding to the reconstruction needs anticipated through 2004; and (ii) assistance of up to 3,500 M USD, basically utilizing concessional yen loans, chiefly corresponding to the medium-term reconstruction needs for a period extending approximately through the year 2007, taking into account the situation of Iraq including security and the advancement of political process, the progress of the reconstruction projects, developments toward the solution of debt issue, and discussion of the international community, etc.
[h] In addition to the amount in the table above, Norway pledged up to 30 M NOK from NORAD's global facilities for promoting private enterprises.
[i] The US pledged 20.3 B USD at the Donor's Conference, subject to Congressional approval. Subsequently, the US Congress approved 18.6 B USD in grants toward security and reconstruction needs.
[j] The World Bank and the IMF announced a range of assistance.

by the London Club, and non-Paris Club creditors—mainly Arab Gulf states—were reluctant to reschedule Iraqi debt. As noted in a variety of media sources, many creditors saw Iraq as an oil-rich country that held promising chances of debt repayment. Many of these creditors, moreover, were reluctant to make a hard commitment regarding the amount of debt they would forgive until Iraq was deemed to be a sovereign state (transfer of power occurred on June 28, 2004) and until the IMF released a study of how much debt Iraq could bear to repay, called a Debt Sustainability Analysis (DSA).

The IMF's DSA report was released to the Paris Club in June 2004 and found that 67 to 95 percent of Iraq's debt was unsustainable. The IMF, it should be noted, used a controversial assumption in its DSA report: the price of oil was assumed to be \$26 a barrel, yet market prices at the time were closer to \$60 a barrel (Chung, 2005). The IMF's DSA greatly underestimated Iraqi income potential and therefore overestimated the amount of unsustainable debt. In the meantime, however, the United States managed to get the United Nation Security Council to protect Iraq from its creditors by protecting Iraqi assets and income from debt collectors. But the Bush administration still had to work to reach a consensus with Iraq's creditors on the amount of debt they would write off. As National Security Advisor, Condoleezza Rice declared to reporters soon after reading the IMF report, "We're going to work this

Figure 9.1 Iraq's External Public Debt, December 2005



Source: World Bank, 2006, Data Sheet for Iraq. 10 December.

now with people—again, people need to be clear that Iraq is not going to be capable of recovering if it has to pay a crushing debt burden. Eventually, this will go to the Paris Club, but we're still in discussion with members" (Rice, 2004). Paris Club members continued to debate in their capitals whether they would forgive 50 percent of Iraqi debt, a position favoured by Russia, France, and Germany, or 95 percent of Iraqi debt, favoured by the US and the United Kingdom (UK). In the meantime, Iraqi authorities entered into agreement with the IMF in September 2004.

The IMF's three-year Emergency Post-conflict Assessment (EPA) agreement with Iraq guaranteed $436 million loans to Iraq in exchange for conditions that outline the ways in which Iraq would liberalize its economy.[4] The Iraqi authorities did not intend to draw on the IMF loan; more importantly, the agreement would set targets and deadlines that would be used to gain the confidence of the Paris Club in Iraqi reform efforts. Specifically, under the EPA, Iraq was obliged to peg its Iraqi dinar to the US dollar and raise interest rates. Iraqi authorities were required to significantly curb spending on wages, pensions and other social programs. Structural adjustment, in the form of taking steps to privatize the country's financial sector and increasing private participation in the nation's oil industry, was also espoused. Price stability, which entailed increases in the price of gasoline, taxes on manufactured goods and cuts in consumer subsidies, was listed as an important facet of the IMF's conditions (see Looney, 2009).

Two months after the IMF approved the prerequisite program, the Paris Club agreed to cancel 80 percent of Iraq's debt. The US, Belgium, Canada, Italy and Japan were the first to react swiftly in the Paris Club. This would be one of the most generous debt write-offs for a middle-income country in Paris Club history; previously, former Yugoslavia had received 66 percent debt reduction after the overthrow of Milosevic. The US went further and announced it would also conditionally cancel 100 percent of its share of Iraq's debt (amounting to $4 billion). President Bush would later add that he hoped "more nations should do the same so that the Iraqi people are not held back by the crushing burden of debt accumulated by Saddam Hussein" (Lynch, 2006). The Paris Club Agreement would be implemented in three stages, and portions of Iraqi debt would be canceled upon successful completion of each stage. In phase one, 30 percent of debt owed to the Paris Club members would be canceled immediately. This amounted to a $11.6 billion write-off of the overall $38.9 billion owed to Paris Club members. In phase two, another 30 percent of Iraq's debt would be canceled when a new IMF standard program, called a Stand-by Agreement (SBA), was initiated (scheduled for end-2005). In the final phase, 20 percent of Iraq's debt to the Paris Club would be canceled upon meeting the terms of the new IMF SBA agreement (originally scheduled to end in September 2008, but achieved in December 2008 under a new IMF SBA signed in Dec 2007). As is customary practice, the IMF would be in charge of monitoring Iraqi progress on economic reforms and endorsing the completion of each phase. The IMF was now entrusted with the geopolitically important task of monitoring and assessing Iraqi progress on economic reforms.

With new Iraqi elections also slated to take place in December 2005, the IMF stepped up its press briefings about its objectives for the year, in the hopes that the incoming government would honour the commitments of the previous government and continue the progress of the program. In December 2005, the IMF Executive Board approved a 15-month Standby Arrangement of $475.4 million. Noting the difficulty of implementing the SBA, Deputy Managing Director and Acting Chair of the IMF's Executive Board Takatoshi Kato stated that: "The Iraqi authorities were successful in promoting macroeconomic stability in 2005, despite the extremely difficult security environment… [Inflationary] pressures moderated, although prices remained volatile. On the other hand, because of security concerns and capacity constraints, the implementation of structural benchmarks … was slower than envisaged" (IMF, 2005b).

The 2005 SBA meant that the IMF recommended the implementation of phase two of the Paris Club arrangement. The fund, however, explicitly called for strengthened reforms on "controlling the wage and pensions bill, reducing subsidies on petroleum products and expanding the participation of the private sector in the domestic market for petroleum products" (IMF, 2005b). The IMF staff also stressed the enormous reconstruction needs and considerable risks facing the implementation of Iraq's IMF program, "including a continuing very dangerous security situation, political uncertainties associated with the implementation of the new constitution, a possible decline in export prices and a lower than projected expansion in oil production" (IMF, 2006a: 18). Iraq continued to struggle in meeting the IMF's economic reform targets that were required to initiate the final phase of Paris Club debt cancellation.

The fund agreed to a number of extensions to the SBA, as well as waivers on conditions not met, noting considerable deterioration and slippage in almost every category of reforms. Clearly, the deteriorating security situation continued to make it difficult for Iraqi authorities to implement reforms. Specifically, IMF staff reported that the security condition remained very difficult, economic growth continued to be below target, inflation had recently begun to accelerate, structural reform had been slowed by the delay in forming a government, the pensions bill required reform before going into effect, corruption was damaging the credibility of the government and the IMF program and private imports of gasoline had not yet been liberalized. In fact, only a few items in the report noted success in Iraqi targets: mainly stable exchange rates, fiscal surpluses and government commitment to reforms (IMF, 2006b: 3–7). Although the al-Maliki government had taken steps to bring the program back on track, the momentum of reforms slowed. Controlling inflation and institution building also stalled, while the negative effect of the IMF program on the poor increased (IMF, 2007). Nevertheless, the IMF has shown that it will continue to approve Iraqi reform measures in the interest of the greater good of assisting Iraq to meet its Paris Club terms of agreement and in helping its greatest economic and political benefactor: the United States. Finally, the IMF decided to terminate the 2005 SBA in December 2007 and signed a new two-year SBA to replace the old one. This effectively bought the Iraqis more time and allowed them to renegotiate the terms of their agreement with the fund.

Iraq's Private Creditors

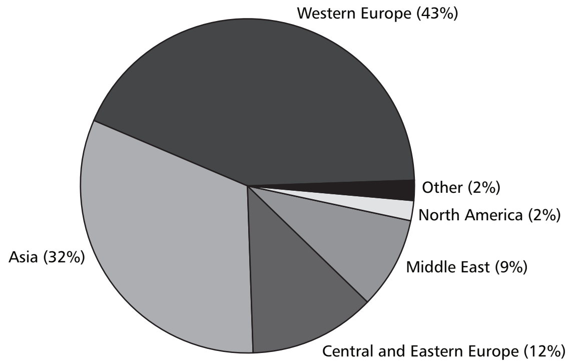
Iraq's private debt amounts to claims by commercial interests of $20billion. Most of these commercial claims were held by Western Europe and Asia (see Figure 9.2 for geographical distribution of claims). Meetings with Iraq's private creditors first took place in Dubai in May 2005 and were followed by a number of agreements and advancements in negotiations. Iraq tried to persuade its private creditors to accept the same 80 percent debt write-off agreed to at the Paris Club, vying to follow the principle of equal treatment of Iraqi creditors. With the assistance of Ernst and Young, the Iraq Debt Reconciliation Office (IDRO) was established to invite commercial creditors to submit their claims.[6] Iraqi private creditors were essentially divided into two groups: the majority were supplier credit issuers and the minority were foreign banks (see IMF, 2005a). The foreign banks formed their own coordinating body called the London Club Coordination Group (LCCG) in early 2005 and tried to invite the supplier credit issuers to join their group, so as to fully represent all of Iraq's private creditors (London Club Coordinating Group, 2005).

The LCCG of Iraq's bank creditors included Union de Banques Arabes et Franciases (UBAF) as chair, Arab International Bank (ALUBAF), British Arab Commercial Bank (BACB), Banca Nazionale del Lavoro (BNL), BNP Paribas, Gramercy Advisors and The Arab Investment Company. In June 2005, the LCCG stated their preferred outcomes:

1. A fair bilateral and transparent reconciliation exercise. We do not want validation of claims through a unilateral process (especially since missing files both on creditor and debtor side might jeopardize debt acknowledgement).
2. Recognition by the Iraqi Authorities of the LCCG as a representative creditors committee thus leading to good faith negotiations between both parties to achieve a successful private debt restructuring
3. A realistic offer with new instruments, taking into account the comparability of treatment clause, which does NOT mean identical treatment, as comparable NPV [Net Present Value] can be reached with different financial terms treatment. (London Club Coordinating Group, 2005)

Overestimating their bargaining leverage, the LCCG initially resisted the Paris Club terms of an 80 percent write-off and opted to negotiate directly with Iraqi authorities. Already handicapped by a "2003 UN [United Nations] Resolution preventing creditors from resolving their

Figure 9.2 Geographical Distribution of Private Creditors, 2005



Source: Martin Weiss, "Iraq's Debt Relief" CRS Report for Congress. 2 October 2008, http://www.fas.org/sgp/crs/mideast/RL33376.pdf

debt claims through litigation or attempting to attach liens on Iraqi energy resources until 2007" (Chung, 2005), the London Club was at the mercy of Iraqi authorities. Frustrated, complaining that Iraq "pursued a unilateral and coercive, take-it-or-leave-it approach" (Chung, 2005), the London Club was powerless and eventually succumbed to the Paris Club's rescheduling terms.

Responding to the London Club's presentation of its terms, the Iraq government offered many of its private creditors a cash buyback offer that amounted to 10.25 percent of the original loans for creditors with claims under $35million and a debt-for-debt exchange (issuing Iraqi government bonds) for creditors with larger amounts (Government of Iraq Debt Reconciliation Office, 2005). By mid-2006, 11,776 claims had been settled with 491 commercial creditors that amounted to $19.7 billion, or 96 percent of the value of Iraq's outstanding private credit (Government of Iraq Debt Reconciliation Office, 2006). The Iraqi government again offered the same settlement terms to the few remaining private creditors in early 2008 (closed in March 2008) and settled an additional $1.2billion in claims. The issue of Iraq's private creditors had been effectively settled.

Reasserting Power in the Gulf: Iraq's Remaining Creditors

Although much of the international community's focus concerning Iraq's debt restructuring centred on the Paris Club terms, it was non–Paris Club creditors, specifically the Persian Gulf states, that held the bulk of Iraq's outstanding debt. As such, the successful redevelopment of the Iraqi economy was heavily dependent upon securing debt relief from the Gulf States. Iraq's debt forgiveness reached a low point in December 2003, when Saudi Arabia, Kuwait, the UAE, and other Gulf nations refused US calls to forgive more than $40 billion in debt (*New York Times*, 2003). It was not surprising that the Gulf States were uncooperative; in part, this was because they had once been the target of Saddam Hussein's transgressions. These countries had also realized that their large creditor role gave them significant leverage in negotiating debt relief with the United States. Facing mounting domestic political pressure to end the war, it became clear to the Bush administration, that the only way to do so successfully, or while saving face at the very least, was to provide the conditions for the redevelopment of Iraq's economy, in the hopes that the possibility of a better future might quell the violence.

In May 2007, US Secretary of State Condoleezza Rice met with the Iraqi Prime Minister Nouri al-Maliki to discuss steps that the Iraqi leadership must take to secure debt relief from its Gulf neighbours. Among those commitments, Rice noted that Iraq must begin the process of national reconciliation, hold provincial elections and a constitutional review and dismantle militias (Kralev, 2007). This was echoed by America's Ambassador to the United Nations, who told the body, "Iraq's main creditors, including Saudi Arabia, will not write off billions of dollars in debt until they see progress on national reconciliation, economic reform and security" (Lederer, 2007b). At the same time, Vice President Cheney traveled to Egypt to urge nations in the region to cancel Iraq's debt (Xuequan, 2007).

Under the auspices of the United Nations and the World Bank, the US urged nations to join the International Compact for Iraqi debt forgiveness in a May 2007 meeting held in Sharm al-Sheikh, Egypt.[6] The meeting was attended by 60 nations, including many of Iraq's neighbours in the Gulf, and 12 regional and international organizations. Iraqi officials presented a five-year plan to implement democratic governance, economic reforms and commitment to work with the international political and economic community (Republic of Iraq, 2008). Specifically, the Iraqis signalled their intention to give Sunnis more political power by amending the constitution and allowing former Baathists to return to public life. The meeting produced commitments of $3 billon composed mainly of debt relief and bilateral agreements to apply Paris Club terms.[7] Moreover, a number of countries made new pledges of approximately $700 million in aid or grants. International support for the compact, however, was less than enthusiastic. Saudi Arabia, Kuwait, Russia, Qatar and the United Arab Emirates, holding a significant amount of Iraq's debt, refused to provide debt forgiveness or relief at the International Compact meeting.

By the second International Compact for Iraq meeting, hosted by Sweden in May 2008, Russia had announced that it would forgive part of Iraqi debt (60 percent of reduced debt stock of $4.5billion). Similarly, China had stated in June 2007 in its official newspaper that it would also forgive Iraqi debt (reported by some to be worth $8.5billion), but did not state how much would be forgiven and when. Chinese and Iraqi officials are said to have signed a memorandum of understanding, but little else has been disclosed, and this debt forgiveness, to date, has yet to be realized. Both the Russians and the Chinese wanted greater investment access to Iraq's oil industry. Moreover, both had lucrative oil investment contracts with the Saddam Hussein regime that were canceled by the transitional government. Revival or recognition of these contracts was a factor in both the Russian and Chinese bargaining over debt forgiveness and restructuring.

With little progress made in Stockholm, Rice went to Bahrain and Kuwait in April 2008 to join in meetings of Gulf leaders. Again, she urged them to provide Iraq debt relief and to open diplomatic missions in Baghdad. Subsequently, the United Arab Emirates announced 100 percent debt cancellation of $7billion owed in July 2008. This effectively left Iraqi debt owed to Saudi Arabia (estimated at $30billion), Kuwait (estimated at $27 billion) and Qatar (estimated at $4billion); the first two were effectively the largest overall creditors that were still uncommitted to debt forgiveness.[8] That said, prior to the 2007 International Compact meeting, Saudi Arabia's foreign minister had announced that the Kingdom would forgive Iraq of its debts along Paris Club terms, but made no public pledge during the meeting, dashing hopes of analysts and Iraqi officials. According to one UN official, part of the impasse had to do with disagreements between Saudi Arabia and Iraq on the total amount owed. Neither party kept written records of the transactions and no formal agreement had been kept (Lederer, 2007a). After the Stockholm meeting, the Saudis continued to hint that they would use the Paris Club terms to forgive Iraqi debt, but this failed to materialize again. To add insult to injury, both Saudi Arabia and Kuwait sent junior ministers to the Stockholm meeting, a move that has been interpreted as dismissive of the meeting.

Instead of reconstruction contracts or investment opportunities in Iraq, the remaining Gulf countries with debt owed to them demanded something more onerous: they demanded that national reconciliation become tied to the issue of debt relief. Fearing that civil strife in Iraq would cross into their respective territories, the Gulf States demanded Iraqi national reconciliation as their price for debt relief. Initially, this seemed to resonate well with the American political establishment, as both senior legislators and Bush administration officials had urged the Shi'a-led Iraqi government to start a process of national reconciliation in an attempt to pacify the violence ravaging the country and bring American troops home. The US obliged, and Condoleezza Rice urged Iraqi Prime Minister Nouri al-Maliki to meet these international demands and carry out its commitments to receive conditional international support in return. Besides paying lip service to the idea at the International Compact for Iraq meeting, the Iraqi regime was largely unresponsive. The political rift between Iraq and the US widened when al-Maliki publicly chastised President Bush, who was under significant pressure from US Senators who publicly demanded greater effort on national reconciliation (Karim, 2007).

The Gulf States were suspicious of the growing power wielded by Iran's influence over Shi'a leaders in Iraq, which also troubled Iraq's Sunni neighbours. Saudi Arabia continued to fear the influence Iraq's Shi'a would have on its own minority groups as well as the spill over of al-Qaeda-inspired militia into its territory (McMillan, 2006). Kuwait was also reluctant to forgive Saddam's debt, and understandably so, as much of it had been incurred through Saddam Hussein's attempts to annex the country. The Gulf States, many of which had felt the brunt of Saddam's aggression, were not about to give up Iraq's debt without gaining something in return. The Gulf States realized this position of strength early on, and refused to write off their share of Iraqi debt in line with the Paris Club conditions. In fact, calls for a write-off from the most senior US officials were, and perhaps will continue to be, politely ignored.

Conclusion

Clearly, the relationship between Iraq and its creditors can be characterized as a tangled web. For the greater part of the negotiations, the US and Iraq seemed to wield most of the leverage. The US negotiated with other Paris Club creditors to achieve lenient debt cancellation terms for Iraq. No doubt the US influence on the UN Security Council was instrumental in leading to the resolution that allowed Iraq to be shielded from its creditors early on in the debt restructuring process. This unprecedented move effectively gave Iraq an upper hand in subsequent negotiations and helped to rewrite the rules on how the international debt restructuring regime worked. The generous terms received at the Paris Club are attributable to the strong influence of the United States in the Club. Similarly, subsequent agreement of the IMF and continued waivers, extensions and, most importantly, a favourable debt sustainability assessment are all attributable to US pressure at the IMF, a familiar tactic for the United States in dealing with geostrategic countries in the Middle East (Momani, 2004). Iraq, an oil-rich nation with access to international liquidity that was abundant at the time, received generous Paris Club terms of repayment thanks to American intervention in the IMF staff's DSA analysis.

Iraq, for its part, took a strong hand with its private creditors, forcing them to accept unfavourable Paris Club conditions. Ultimately, all of Iraq's private creditors had settled with Iraq and on the terms that Iraq had dictated. Iraqi strength in its negotiations with the private creditors was attributable to the following factors. First, the geographical dispersion of the private creditors was wide, and the amount held per individual firm or commercial entity was relatively small. This allowed Iraq to effectively segment its private creditors to its satisfaction. In addition, the precedent set by the Paris Club to give such generous debt forgiveness had set the stage for Iraq to seek comparability of treatment among all its creditors. The private creditors were eventually forced to accept the generous Paris Club terms. Indeed, the Iraq case not only spurred legal debates over the role and use of odious debt, but the case would be remembered as a historically generous debt relief package (see Gulati and Skeel, 2007).

It was not until the Gulf States effectively ignored Paris Club terms, as well as US pressure, that the tables turned on Iraq. Both Saudi Arabia and Kuwait were effectively the largest creditors and have continued to politely ignore the conditions proposed by the Iraqis and the United States. After all, these two countries had little to gain in cross-border trade with Iraq and access to foreign investment contracts. For both of these Gulf states, the perception that Iran wields significant influence in Iraq's

Shi'a led government and the belief that Iraq has yet to pay for its past aggressions were main factors in their dismissal of calls to forgive debt owed to them. Without political resolution of the issues raised by the Gulf States and a change in regional dynamics in the Gulf, the issue of Iraq's debt restructuring will remain unresolved. The case of Iraqi debt restructuring demonstrates that the reintegration of Iraq into the Gulf neighbourhood has yet to be realized.

Notes

1 At the same time, the US sponsored United Nations Security Council Resolution (UNSCR) 1483, which decreased Iraqi reparations to people and firms affected by Iraq's 1990–91 invasion of Kuwait. The new UN resolution required Iraq to place 5 percent, down from 25 percent, of its oil export earnings into a compensation fund. See http://www.foreignpolicy.org.tr/documents/210503.pdf.

2 Creditor states in attendance included: Australia, Austria, Belgium, Canada, Denmark, Finland, Germany, Italy, Japan, Republic of Korea, Netherlands, Russian Federation, Spain, Sweden, Switzerland, United Kingdom and United States of America.

3 The Baker appointment raised some controversy in early 2004 when it appeared that the Carlyle Group, a firm that Baker has vested financial and political interests in, was attempting to represent Kuwait in trying to retrieve all of its debt from Iraq. This conflict of interest was exposed by Naomi Klein (2004).

4 Soon after receiving the conditions of their debt relief, the Iraqi National Assembly declared that "[Iraq's] debts are odious and this is a new crime committed by the creditors who financed Saddam's oppression." See: Al-Ali, 2004.

5 See *Government of Iraq Debt Reconciliation Office*, available from http://www.eyidro.com/.

6 A follow up meeting of the International Compact with Iraq (ICI) took place in Stockholm on May 29, 2008.

7 Egypt, Bulgaria, Poland, and Slovenia all agreed to debt forgiveness at the meeting.

8 Based on estimates by Jubilee Iraq, see: http://www.jubileeiraq.org.

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