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Iraq: Paris Club Debt Relief

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Summary

Iraq's public debt was estimated to be US$120.2 billion in nominal value as of the end of 2004. The debt owed to Paris Club creditors as of December 31, 2004, was estimated to be US$38.9 billion. The U.S. share of this amount is around $4 billion. Non-Paris Club countries, mostly Persian Gulf countries, are owed around $60 - $65 billion. The remaining debts are to private commercial creditors. Iraqi debt relief is a high priority for both the President and Congress (H.R. 2482). This report will discuss efforts to implement Iraqi debt relief and highlight some policy concerns. This report will be updated as events warrant.

Iraqi debt relief is a high priority for both the Bush Administration and Congress. President Bush appointed James A. Baker III as his personal envoy on the issue of Iraqi debt in December 2003. Since then, Secretary Baker has met with numerous international leaders to discuss and secure commitment on Iraqi debt relief from other Paris Club member countries. In addition to Secretary Baker's negotiations, *The Iraqi Freedom From Debt Act* (H.R. 2482) has been introduced in the House of Representatives. This bill calls on Iraq's creditors to cancel or significantly reduce their Iraq debts. Any U.S. debt relief must be authorized and appropriated by Congress, as required by *The Federal Credit Reform Act of 1990* (P.L. 101-508, Title V).

Background

In October 2003, after the release of a major World Bank and United Nations economic needs assessment report for Iraq[1], World Bank President James Wolfensohn said that Iraq's debts needed to be reduced by 33%, from roughly $120 billion to $80 billion in order to fund reconstruction needs and long-term economic development.[2] Iraq's current oil revenues and international donor assistance are limited. Morever, it

[1] The Iraq Needs Assessment report is available at [http://www.worldbank.org/mna]

[2] Crutsinger, Martin, "World Bank Calls on Rich Countries to Forgive Two-thirds of Iraq's Debt" Associated Press, October 29, 2003.

would be difficult for a future sovereign Iraqi government to secure new lending, either from the private or public sector, until the existing debt claims are resolved.

At the September 2003 G-7 finance ministers meeting in Dubai, member countries called on the Paris Club[3] "to make its best effort to complete the restructuring of Iraq's debt before the end of 2004."[4] According to the U.S. Department of the Treasury, Iraq owes Paris Club members approximately $40 billion. Of this amount, $21 billion is principal and $19 million is interest. The International Monetary Fund (IMF) estimates Iraqi debt held by non-Paris club governments - primarily in the Persian Gulf - at $60 to $65 billion, and debt to commercial creditors at roughly $15 billion.[5]

According to most estimates, the United States is owed $4 billion ($2.2 billion in principal and $1.8 billion in interest). This debt is from commercial credits guaranteed by the U.S. government. Between 1983 and 1990, the Commodity Credit Corporation (CCC) — an agency of the U.S. Department of Agriculture (USDA) — guaranteed about $5 billion in commercial credits for the sale of U.S. agricultural products to Iraq.

In 1990, the United Nations (U.N.) imposed economic sanctions on Iraq after its invasion of Kuwait. The Iraqi government subsequently defaulted on its U.S. and other international debts. After the end of major combat operations in May 2003, the U.N., among other things, lifted sanctions and sheltered Iraq from a potential rush of debt claims. U.N. Security Council Resolution 1483 prohibits any country from initiating debt claims against the proceeds of Iraq's petroleum or gas industries until January 1, 2008.[6] Until this time, the resolution requires any proceeds from these industries be deposited in the Development Fund for Iraq, held by the Central Bank of Iraq. Furthermore, the Resolution requires countries to freeze any funds or other financial assets and immediately transfer them to the Development Fund for Iraq, unless they are themselves the subject of legal dispute. Nonetheless, the IMF anticipates some debt servicing before the end of 2004.[7]

Prior to any actual Paris Club debt relief, an IMF program must be put in place for Iraq. The IMF published a macroeconomic assessment for Iraq in October 2003, and is conducting debt analysis that will form the basis for any future IMF lending to Iraq.

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[3] The Paris Club is an informal group of the eighteen countries, who as the major international creditors, on occasion collectively reduce or reschedule official debts owed to them by poor and developing countries. For more information, see CRS Report RS21482, *The Paris Club*.

[4] Statement of G-7 Finance Ministers and Central Bank Governors, September 20, 2003.

[5] Interview with Lorenzo Perez, head of Iraq mission team, IMF Survey, Number 2, Volume 33, February 2, 2004.

[6] The text of United Nations Security Council Resolution 1483 is available at [http://www.un/org/docs/sc]

[7] Interview with Lorenzo Perez, head of Iraq mission team, IMF Survey, Number 2, Volume 33, February 2, 2004.

Debt Relief

After Secretary Baker was chosen by President Bush to head the Iraq debt relief effort, he traveled to Europe, Asia, and the Middle East for discussions with foreign government officials. His efforts have elicited public statements from various countries expressing their willingness to support debt relief. Japan reportedly has stated that it is willing to forgive "the vast majority" of the $7.75 million it is owed by Iraq, if other Paris Club countries follow suit.[8] Russia, which holds around $8 billion in Iraq debt, announced its willingness to forgive more than $4 billion in debt if its companies are eligible to restart oil-contracts signed with the Hussein regime.[9] Germany and France are owed around $4.4 billion and $5.5 billion, respectively. In a joint statement issued in December 2003, Germany, France, and the United States announced that they agree in principal to debt forgiveness, but deferred disclosing any estimates of debt relief until further debt analysis is conducted. Canada and Italy have also expressed their willingness to take part in a Paris Club debt relief program.

Among Paris Club members, there exists an important rule known as comparability of treatment between different creditors. This means that a debtor country cannot grant to one creditor a deal better than the consensus reached for the entire group of Paris Club countries. At such time that a Paris Club agreement is reached, many members would like to see the comparability of treatment extended to Iraq's non-Paris Club creditors.

Since approximately two-thirds of Iraq's debt is held by non-Paris Club countries, for maximum effectiveness of debt relief to be effective in facilitating economic development, significant participation by these other debt-holders is important. During January 2004 meetings with representatives from Saudi Arabia, Kuwait, the United Arab Emirates (UAE) and Qatar - four Persian Gulf countries who combined hold approximately $50 billion in Iraqi debt - Secretary Baker reportedly received assurances that the Persian Gulf countries would significantly reduce their Iraq debt holdings once a sovereign government is established.[10]

Paris Club Options for Iraq

Strong Administration support for Iraq debt relief potentially contributed to the Paris Club's Fall 2003 announcement that is was creating a new approach — The Evian Approach — that would offer debt relief for middle-income countries such as Iraq.[11] [12]

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[8] "Japan/Iraq: Tokyo Offers Debt Forgiveness" Oxford Analytica, December 29, 2003.

[9] White, Gregory L. "Russia Offers Iraq Debt Relief" *The Wall Street Journal Europe*, December 23, 2003, A2

[10] Baker Secures Promises of Iraq Debt Relief from Gulf Oil States, *Agence France Presse*, January 21, 2003.

[11] According to the World Bank, middle income countries are those with gross national income (GNI) per capita greater then $745 and less than $9205. The World Bank estimated in 2003 that Iraq would be classified as a lower middle income country.

[12] The Evian Approach is named after the June 2003 G-7 Summit, held in Evian-les-Bains, France where the approach was first discussed.

The Evian approach applies to countries other then the Highly Indebted Poor Countries (HIPC). The latter are already eligible for significant debt reduction.[13]

Under traditional Paris Club guidelines, Iraq's petroleum and gas reserves would render it ineligible for debt relief. According to the new Evian Approach, a country seeking debt relief will first undergo an IMF debt analysis. This analysis is to determine whether the country suffers from a liquidity problem, a sustainability problem, or both. The Iraqi economy is dependent on it petroleum revenues. Although the U.S. government projects exports of $16.6 billion in 2004, and $21.2 billion in 2005, the very large amount of Iraq's debt, $120 billion, raises concerns.[14] Debt servicing draws money away from reconstruction efforts, and is a disincentive for many to invest in Iraq. Iraq's annual debt service without any debt relief would be $7.2 billion a year, or 37% of its estimated 2004 gross domestic product, according to credit rating agency Fitch/IBCA.[15]

If it is determined that a country suffers from only a liquidity problem, its debts would be rescheduled until a later date. If the country is also determined to suffer from debt sustainability problems, where it not only lacks the current resources to meet its debt obligations, but also the amount of the debt adversely affects its future ability to pay, they would be eligible for debt reduction. Since Iraq appears to have both debt liquidity and sustainability concerns, it is now potentially eligible for debt reduction.

Debt relief for Iraq under this approach would be through a multi-year, three-stage process, beginning with the creation of a sovereign Iraqi government and the implementation of an IMF program. The first stage of a Paris Club program would be a so-called "flow treatment." This is a standard Paris Club agreement that provides debt rescheduling to help a country through a temporary balance of payments problem. The standard rescheduling period is one year. However, creditor countries have accepted debt rescheduling for up to three years.

At such time (between one and three years) when there is a performance record of Iraqi compliance with IMF loan conditions and on-time payments to Paris Club creditors, the second stage would begin. This stage includes a second arrangement with the IMF. For countries with debt sustainability problems that are treated under the Evian Approach, none of the Paris Club's standard terms would be used. A full range of treatment options from additional rescheduling to debt reduction would be considered. In the third stage, after successful implementation of the subsequent IMF program, the debt treatment would be completed. Under this staged approach, Iraq would only receive the full benefits of debt relief (at stage three) if it makes substantial economic reforms throughout the treatment process.[16]

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[13] See "Debt Reduction - HIPC Initiative" in CRS Report RL31811, *Appropriations for FY2004: Foreign Operations, Export Financing, and Related Programs.*

[14] Doggett, Tom, "U.S. Sees 73 pct Jump in Iraqi Oil Export Revenue," *Reuters*, January 21, 2004.

[15] Chance, David, "Iraq Needs Big Debt Write-Off - Fitch Ratings Agency," *Reuters*, February 25, 2004.

[16] For more on the Evian Approach, see [http://www.clubdeparis.org]

On November 21, 2004, Paris Club members agreed on a debt relief program for Iraq providing a total amount of debt reduction of 80% in three phases. Club members recommended that their governments deliver the following treatment:

1) An immediate cancellation of part of the late interest representing 30% of the debt stock as at January 1, 2005. The remaining debt stock is deferred up to the date of the approval of an IMF standard program. This cancellation results in the write-off of $11.6 billion on a total debt owed to the Paris Club of 38.9 billion U.S. dollars;

2) As soon as a standard IMF program is approved, a reduction of 30% of the debt stock will be delivered. The remaining debt stock will be rescheduled over a period of 23 years including a grace period of 6 years. This step will reduce the debt stock by another $11.6 billion, increasing the rate of cancellation to 60%;

3) Paris Club creditors agreed to grant additional debt reduction representing 20% of the initial stock upon completion of the last IMF Board review of three years of implementation of standard IMF programs. This debt treatment would reduce the total debt stock from $38.9 billion to $7.8 billion.[17]

Policy Concerns for Congress

Congressional Procedure for Debt Relief. The United States is a key member of the Paris Club, and Congress has an active role in both Paris Club operations and U.S. policy regarding debt relief overall. Congress must be involved in any official foreign country debt relief. The Federal Credit Reform Act of 1990 (P.L. 101-508, Title V) requires that Congress authorize and appropriate an amount equal to the net present value (NPV) of any international debt forgiven by the United States. The Administration would request appropriations from Congress for debt forgiveness for Iraq after the Paris Club countries mutually decide on a total amount of debt forgiveness. Since actual debt forgiveness would occur after a one to three year IMF program, an appropriations request would not be made until 2005 or 2006 at the earliest. During the initial period, when Iraq's debt would be rescheduled, no congressional appropriations are required for debt relief.

Since the initial rescheduling could last up to three years, it might be necessary to revise the NPV estimate of Iraq's debt. If the Iraqi economy recovers during the next few years, and its creditworthiness improves, the NPV of Iraq's debt to the United States may be higher at the point of appropriation than current estimates suggest.

Comparability of Treatment. In the case of Iraq, where two-thirds of the debt is held outside the Paris Club, ensuring participation and achieving equal terms from private creditors and the non-Paris Club countries who hold the bulk of Iraq's debt are major challenges. Many Paris Club countries have stated that they do not want to reduce their Iraq debt and then have Iraq's non-Paris Club creditors rescind their offers of debt forgiveness. Many Paris Club members have stipulated that their participation in debt relief would be contingent on some agreement on how non-Paris Club debt is treated. Iraq

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[17] See [http://www.clubdeparis.org/en/news/page_detail_news.php?FICHIER=com11011125170]

November 2004 agreement states that it committed to seek comparable treatment from its other external creditors.

Policy Consistency Towards Other Countries. Some analysts express concerns that Iraq is receiving preferential treatment of its debts. Nigeria, Indonesia, Kenya, and Georgia also recently emerged from decades of authoritarian and autocratic rule, and are saddled with extensive government debt, yet receive nowhere near the level of international exposure that has been given to the Iraqi situation.[18] According to Salih Booker, the head of Africa Action, a Washington-based lobbying group, "It's an outrageous double standard."[19] Mr. Booker argues that the executive branch is taking a special interest in Iraq solely for political reasons and that sub-Saharan Africa is equally in need of sustained and coordinated debt relief.

Is the Paris Club the Right Venue for Iraqi Debt Relief? Proponents of a doctrine of "odious" debt assert that some of Iraq's debt's could potentially be classified as non-legitimate under international law since they were undertaken during the Hussein regime and that international law should be able to expunge these debts.[20] The concept of "odious" debt does not appear to be well established in international law.[21] Some contend that by treating the debt under Paris Club rules, the international community is potentially legitimizing the regime and debts accrued during the Saddam regime.

Others express concern that Iraq's debt should be renegotiated by a new Iraqi government and/or an international legal panel, and not by the Paris Club. Some experts have proposed the creation of an international Iraqi debt commission of financial "wise men" to evaluate existing Iraqi debt and to disallow debt used for state security or military aggression.[22] Such a commission would then chair negotiations to restructure the debt. Proponents argue that an international approach of this type would lend greater legitimacy within Iraq for the eventual debt treatment plan, although it could be argued that most Iraqis do not want to pay off any of the debts accrued by the Hussein regime.

While such a commission could increase the legitimacy of a final debt restructuring plan, some believe that Iraq is not likely to seek an "odious" debt claim.[23] Moreover, the U.S. government has made clear its intention to restructure its Iraqi debt through the Paris Club process, and parallel negotiations with non-Paris Club countries in the Middle East and Asia, and Iraq's private creditors.

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[18] Joseph Siegle, "After Iraq, let's forgive some other debts" *International Herald Tribune*, February 19, 2004.

[19] Quoted in Raghavan, Sudarson "African Advocates to U.S.: Reduce Our Debt Like Iraq's" *The Miami Herald*, February 20, 2004.

[20] Probe International, a Toronto-based organization maintains a web-site with information on the concept of odious debt, see [http://www.odiousdebts.org]

[21] See discussion in CRS Report RL31944, *Iraq's Economy: Past, Present, Future*, pp. 51-53.

[22] Mulford, David and Monderer, Michael "Iraq Debt, Like War, Divides the West" *The Financial Times*, June 22, 2003.

[23] Chance, David, "Iraq Needs Big Writeoff - Fitch Ratings Agency" *Reuters*, February 26, 2004.