

CRS Report for Congress

Received through the CRS Web

Iraq: Debt Relief

Martin A. Weiss
Analyst in International Trade and Finance
Foreign Affairs, Defense, and Trade Division

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 (both Paris Club and non-Paris Club) is a high priority for both the President and Congress. This report will discuss efforts to implement Iraqi debt relief, as well as efforts to persuade non-Paris Club countries to forgive their Iraqi debts. It will also highlight several 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. 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).

On December 17, 2004, the United States forgave \$4.1 billion — 100% of Iraqi debt owed to the United States. The cost to the United States Treasury of forgiving this debt was determined to be \$360 million, and was appropriated for in the reallocation of financial resources for Iraq approved by Congress on September 29, 2004.

Background

At the September 2003 G-7 finance ministers meeting in Dubai, member countries called on the Paris Club¹ "to make its best effort to complete the restructuring of Iraq's

¹ 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*.

debt before the end of 2004.”² 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.³

According to most estimates, Iraq owed the United States approximately \$4 billion (\$2.2 billion in principal and \$1.8 billion in interest). This debt was 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, 2008.⁴ 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.

Debt Relief

Paris Club. 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.⁵ 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.⁶ 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 principle to debt forgiveness, but deferred disclosing any estimates of debt relief until

² Statement of G-7 Finance Ministers and Central Bank Governors, September 20, 2003.

³ Interview with Lorenzo Perez, head of Iraq mission team, IMF Survey, Number 2, Volume 33, February 2, 2004.

⁴ The text of United Nations Security Council Resolution 1483 is available at [<http://www.un.org/docs/sc>].

⁵ “Japan/Iraq: Tokyo Offers Debt Forgiveness,” Oxford Analytica, December 29, 2003.

⁶ White, Gregory L. “Russia Offers Iraq Debt Relief,” *The Wall Street Journal Europe*, December 23, 2003, A2.

further debt analysis is conducted. Canada and Italy have also expressed their willingness to take part in a Paris Club debt relief program.

The Paris Club's Evian Approach. Strong Administration support for Iraq debt relief potentially contributed to the Paris Club's Fall 2003 announcement that it was creating a new approach — The Evian Approach — that would offer debt relief for middle-income countries such as Iraq.⁷⁸ The Evian approach applies to countries other than the Highly Indebted Poor Countries (HIPC). The latter are already eligible for significant debt reduction.⁹

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. 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.

The Evian approach allows for a multi-year, three-stage process, beginning with 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.

When there is a performance record of country compliance conditions and on-time payments to Paris Club creditors (between one and three years), 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.

Iraq's Paris Club Debt Treatment. On November 21, 2004, the United States and other Paris Club members agreed on a debt relief program for Iraq providing a total amount of debt reduction of 80% of debts owed by Iraq in three phases. Club members recommended that their governments deliver the following treatment:

⁷ According to the World Bank, middle income countries are those with gross national income (GNI) per capita greater than \$745 and less than \$9,205. The World Bank estimated in 2003 that Iraq would be classified as a lower middle income country.

⁸ The Evian Approach is named after the June 2003 G-7 Summit, held in Evian-les-Bains, France where the approach was first discussed.

⁹ See "Debt Reduction - HIPC Initiative" in CRS Report RL31811, *Appropriations for FY2004: Foreign Operations, Export Financing, and Related Programs*.

- 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 six 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.¹⁰

On September 14, 2004, the Bush Administration proposed re-allocating resources for Iraq approved by Congress on September 29 in P.L. 108-309. This reflects a review conducted by the Iraq Reconstruction and Management Office and the U.S. Embassy country team. The review reallocated \$360 million to subsidize U.S. forgiveness of as much as \$4 billion in bilateral Iraqi debt to the United States. The reallocation of financial resources for Iraq was approved by Congress on September 29, 2004.

On December 17, 2004, the United States forgave \$4.1 billion — 100% of Iraqi debt owed to the United States. The cost to the United States Treasury of forgiving this debt was determined to be \$360 million, and was appropriated in the reallocation of financial resources for Iraq approved by Congress.

Although all Paris Club members have agreed to reduce their share of Iraq debts accordingly, as of March 2005 several countries have yet to complete their Iraqi debt relief.

Non-Paris Club Debt. 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.¹¹ Reportedly, as of March 2005, several non-Paris Club countries, which account for over half of Iraq's debt, have not agreed to forgive their Iraqi debt.

¹⁰ See [http://www.clubdeparis.org/en/news/page_detail_news.php?FICHIER=com11011125170]

¹¹ Baker Secures Promises of Iraq Debt Relief from Gulf Oil States, *Agence France Presse*, January 21, 2004.

Policy Concerns for Congress

Comparability of Treatment. 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.

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.

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.¹² According to Salih Booker, the head of Africa Action, a Washington-based lobbying group, “It’s an outrageous double standard.”¹³ 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.¹⁴ The concept of “odious” debt does not appear to be well established in international law.¹⁵ 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

¹² Joseph Siegle, “After Iraq, let’s forgive some other debts,” *International Herald Tribune*, February 19, 2004.

¹³ Quoted in Raghavan, Sudarson “African Advocates to U.S.: Reduce Our Debt Like Iraq’s,” *The Miami Herald*, February 20, 2004.

¹⁴ Probe International, a Toronto-based organization maintains a web-site with information on the concept of odious debt, see [<http://www.odianousdebts.org>].

¹⁵ See discussion in CRS Report RL31944, *Iraq’s Economy: Past, Present, Future*, pp. 51-53.

aggression.¹⁶ 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.¹⁷ 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.

A major reality is that no matter what action the Paris Club member countries take regarding their Iraq debt, approximately \$60 - \$65 billion out of the total \$120 billion is held by other countries, especially Iraq’s neighbors, many of whom have not agreed to any debt relief program for Iraq and want to be repaid. Many analysts have argued that any resolution to Iraq’s non-Paris Club debt will continue to be unresolved until there is a more stable Iraqi government.

¹⁶ Mulford, David and Monderer, Michael “Iraq Debt, Like War, Divides the West,” *The Financial Times*, June 22, 2003.

¹⁷ Chance, David, “Iraq Needs Big Writeoff - Fitch Ratings Agency,” *Reuters*, February 26, 2004.