

Four Hazard Points Secretary Baker Must Address

Former Secretary of State Baker's trip to European capitals this week to discuss debt restructuring for Iraq is an important step, but talk of a "substantial reduction of debt for Iraq in the Paris Club in 2004" does not take account of the full range of issues regarding Iraq's outstanding financial obligations. Those obligations must be addressed holistically, which will require moving beyond the traditional Paris Club debt restructuring mechanisms.

The maximum amount the Paris Club has ever reduced for a developing country was a 66 percent reduction for the former Yugoslavia after the ouster of Milosevic.¹ In Iraq, reducing the debt level by that amount will still result in an unsustainable burden. Although the Administration should be commended for its efforts to reduce Iraq's external debt burden, its actions will need to be broader and more aggressive, and it should be seeking more radical results.

1. Relieving Iraq's financial obligations requires holistic, innovative strategy

- The current discussions are focused on reducing and restructuring debt owed to Paris Club nations. But Iraq's financial obligations must be addressed as a whole – Paris Club debt, non-Paris Club debt, and reparations.
- Iraq's overall total financial obligations are close to \$225 billion. Its debt is an estimated \$120 billion, of which around \$21 billion (excluding interest) is owed to Paris Club countries and the remainder is owed to governments (mostly Arab countries) and private lenders. Iraq also owes close to \$125 billion in Gulf War reparations.
- International norms hold that a country's maximum ratio of debt to exports should be no more than 150 percent. Under that standard, Iraq could probably carry around \$35 billion of financial obligations overall (assuming that Iraq's export revenues will be almost wholly in the form of oil, and that those revenues significantly increase from where they are now to around \$20 billion).
- The United States should be wary of a standard restructuring here. Any plan that does not include reparations, and that results in Iraq owing more than \$35 billion overall, is unwise.

2. Payback of reparations claims is diverting needed funds

- The United Nations Compensation Commission (UNCC) was established by the UN Security Council (at the U.S.'s instigation) in 1991 to process and pay claims related to the Gulf War. It has settled approximately \$46.5 billion in reparations claims, of which approximately \$18 billion has been repaid.
- Claims payments are ongoing, with nearly \$1 billion having been paid out of Iraq's oil revenue since April 2003.

¹ Craig S. Smith, *France and Germany Join in U.S. Effort to Reduce Iraq's Debt*, New York Times, December 17, 2003 at A1.

- Thus far, claims have been settled at a rate of about 20 percent, or about 20 cents on the dollar.²
- Another \$95.6 billion in claims remain to be settled by the UNCC. Even assuming those claims too will be settled at a lower rate of return than the amounts claimed, the total – when added to the \$28 billion still owed on settled claims and the debt burden – will be unmanageable.

3. Funding gap is constraining reconstruction

- This matter is made more urgent because of the severe liquidity issues facing Iraq. The Coalition Provisional Authority and the Iraqi Governing Council and ministries have spent the regime money that was found in Iraq.
- Reports from the field suggest that coalition troops have run out of this flexible source of funding that has allowed them to engage in quick start projects and other reconstruction tasks.
- The \$18.6 billion recently appropriated by Congress (as part of the Bush Administration's \$87 supplemental request), along with the \$13 or so billion pledged at October's donor's conference, only covers part of Iraq's projected reconstruction needs. The Administration will be hesitant to return to Congress to ask for further supplemental funding for Iraq, but donors are unlikely to make up the \$25 billion gap still remaining.

4. Iraq needs money to fund its government and other internal needs

- Iraq's oil money will simply not be enough to cover both Iraq's internal needs (government budget, reconstruction) and its debt servicing requirements.
- At a minimum, countries owed debt or reparations should agree to a several year moratorium on payback to give Iraq's economy some chance to get back on its feet.

Background

- In January 2003, CSIS issued *A Wiser Peace: An Action Strategy for a Post-Conflict Iraq*; one of its key recommendations was that the Administration start focusing on the debt and reparations issues even before the war started. (Both *A Wiser Peace* and *Supplement I: Background Information on Iraq's Financial Obligations* can be found at www.csis.org/isp/pcr/).

² United Nations Compensation Commission, *Status of Claims Processing*, at <http://www.unog.ch/uncc/status.htm>, accessed December 17, 2003.