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Tracing Iraqi Sovereign Debt Through Defaults and Restructuring

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Tracing Iraqi sovereign debt through defaults and restructuring.[1]

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Abstract

In 1979 Iraq was a net creditor to the world, due to its large oil reserves and lack of external debt. Fifteen years later, its government debt-to-GDP was over 1,000%. At the time of the U.S. invasion in 2003, Iraq was saddled with around $130 billion in external debt that needed to be restructured. How does a country incur so much debt, so fast, and how does it get out of it? In answering this question, the paper makes two key contributions. First, I reconstruct the build-up of Iraqi debt through the 1980s and 1990s using mainly secondary sources. This paper is the first to create a debt series going back to 1979. The rise in Iraqi indebtedness was a consequence of global geopolitical trends in the 1980s where political lending trumped solvency concerns. Second, through primary sources and interviews with key actors involved, I use oral history to tell the story the Iraqi restructuring. It was one of the largest in history, yet no clear and detailed historical account exists. The restructuring was permeated by politics to inflict harsh terms on creditors at the Paris Club, at a time when creditor-friendly restructurings were the norm. In going for a politically expedient deal, however, the restructuring missed an opportunity to enshrine a doctrine of odious debt in international law.

1. Introduction

In 1979 Iraq was a net creditor to the world, due to its large oil reserves and lack of external debt. Fifteen years later, its government debt-to-GDP was over 1,000%, with few assets to speak of. At the time of the U.S. invasion in 2003, Iraq was saddled with around $130 billion in external debt, making it the most indebted nation in the world. How does a country go from riches to ruin in such a

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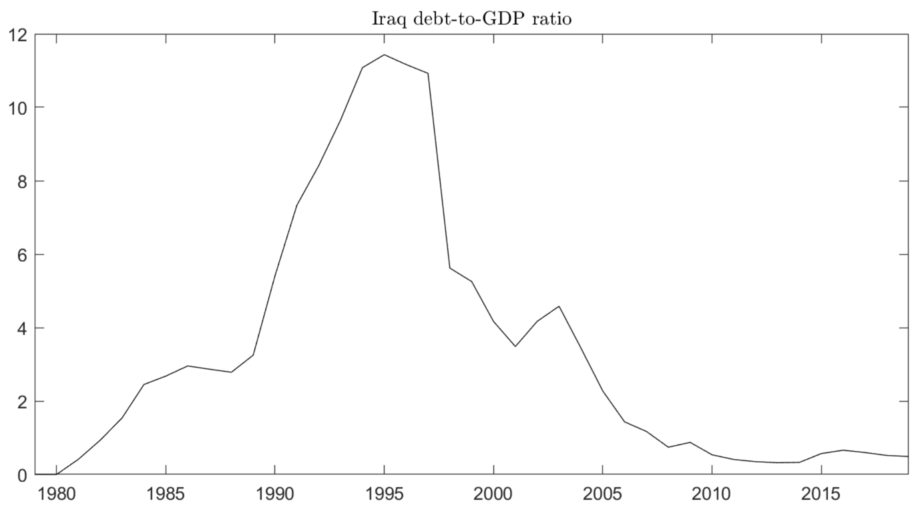
short timeframe? The story of Iraqi debt, defaults and the subsequent restructuring has been scantily covered in the sovereign debt and economic history literatures, with no full historiography of Iraqi debt. In this paper, I make two contributions. First, I reconstruct the build-up of Iraqi debts through the 1980s and 1990s using mainly secondary sources. I identify debt levels at four key points in time: in 1979 as Saddam Hussein took power; in 1988 at the end of the Iran-Iraq War; in 1991 at the end of the First Gulf War; and on the eve of the U.S. invasion in 2003. I work backwards from claims submitted in the 2003-2006 restructuring and trace the loans to the time of their origin.

Second, I combine oral history with the debt series to tell the story of Iraqi debt, default, and restructuring, through primary sources and interviews with key actors involved in the process. I interviewed U.S. and U.K. officials in charge of the restructuring, as well as the lawyers and bankers involved. The restructuring was one of the largest in history, but no detailed historical account exists. The rise in Iraqi indebtedness was a consequence of geopolitical trends, in particular American political and commercial interests in the region. Political lending trumped solvency concerns, and loans were given on below-market terms. The restructuring was a similarly political process setting it apart from most restructurings in the 1990s and 2000s, which were creditor-friendly affairs. The Iraqi restructuring on the contrary required large write-downs from creditors.

Saddam Hussein took power in 1979 after a decade of strong economic growth; but prosperity in the 1970s was followed by economic collapse in the 1980s. The Iran-Iraq War started in 1980 and continued throughout the decade to 1988, with Iraq enjoying broad international political support. Almost all Iraqi debt was incurred during the war, helped along by the West. The U.S. and Europe did not want a post-revolution Iran to win the war, and happily provided money and weapons to Iraq. Half-way through the war, it became clear the country was insolvent, but credit was politically motivated and not given on market terms. Iraq first defaulted on its sovereign debt in the late 1980s. In 1990, after the end of the war, Iraq invaded Kuwait in what became known as the First Gulf War.

But the political winds had shifted: The U.S. led a coalition against Iraq, and the United Nations placed Iraq under international sanctions. The U.N. forced Iraq to pay reparations, leaving it isolated from the global economy for much of the 1990s. The build-up of debt and sudden stop in capital inflows follow the geopolitical trends underpinning Western interests in the Middle East. The outcome is a phenomenal rise and fall in Iraqi indebtedness, which can be seen in Figure 1. This paper is the first to show a continuous debt series going back to 1979.

Figure 1: Iraq government debt-to-GDP ratio.



Sources: Estimated by the author in Section 3.

The increase in the debt-to-GDP ratio between 1979 and 1995 comes from both the numerator and the denominator: the absolute level of debt soared as output also collapsed. After sanctions were imposed in 1991, Iraq was cut off from the global economy. The rise in debt-to-GDP in the early 1990s was therefore due mainly to falling output, while the fall from 1997 was because output doubled, albeit from a low base, as the oil-for-food program improved the economy. By the time the U.S. and its coalition invaded in 2003, the Iraqi economy was in tatters. Dealing with the debt issue became a priority in the U.S. government's reconstruction plans. There was a problem, though. The trend in the early aughts for sovereign debt restructurings was to offer creditor-friendly terms. Enforcement of sovereign debt repayments had become easier with globalisation and the rise of interconnected capital markets. Unlike private debt, sovereign debt is hard to enforce. During the 1990s, holdout creditors increasingly sued wayward debtors, and won by cutting off countries from the global financial system. Iraq had received almost all its foreign currency from the sale of oil (IMF 2004), making it vulnerable. If creditors could attach judgments to oil-related assets, the restructuring could prove tricky, to say the least.

The Iraqi debt restructuring was nonetheless able to circumvent aggressive creditors. Political pressure and the worldwide immunization of foreign assets forced through one of the most complex debt restructurings to date.[2] The U.S. spent significant political capital and used close-to unprecedented tools to force holdouts to exchange debt claims. However, it did stop short of enshrining a doctrine of odious debt in international law, despite initial overtures in that direction. Political expediency was preferred to a new sovereign debt restructuring regime. This paper puts the restructuring in the context of otherwise creditor-friendly resolutions prevalent in the early 2000s. Anyone thinking about sovereign debt restructurings of countries with attachable assets on foreign soil should take note: Iraq offers a template for future restructurings, albeit it requires the backing of a powerful hegemonic creditor.

2. Related literature

My research contributes to the literature on sovereign debt restructurings. Shea and Poast (2018) show war seldom lead to default, but the Iraqi experience thoroughly rebukes their hypothesis: the Iraqi debt build-up was caused by war, from which default followed. It is not the only area where Iraqi history goes against the norm. Two important facts differentiate sovereign defaults from private ones: (i) it is almost impossible to enforce sovereign debt contracts and (ii) there exists no bankruptcy regime to resolve defaulted sovereign debt (Gelpern 2016, p. 47).

[2] The Iraqi debt stock included all types of debt (external bonds, commercial loans, bank deposits, trade credits, export grants, etc.) owed to all kinds of creditors (from governments to all types of commercial creditors).

Sovereign defaults happen because of an inability or unwillingness to pay, and creditors have historically had few remedies to force repayment. Instead, enforcement of debt contracts is based on the reputation of the country, because debtors want to maintain access to future borrowing. Eaton and Gersovitz (1981) first suggested that the cost of default comes from being unable to borrow more money, either via external debt (Na et al. 2018) or local debt (Bocola et al. 2019). The bottom line is that there is no international legal structure in place to make countries comply. U.S. courts can order, say, Argentina to pay its debts, but have no way of forcing a sovereign nation to comply outside of military force.

Before the twentieth century, sanctions or 'gunboat diplomacy' were common. Defaults often resulted in blockades, sanctions, or loss of territory. Enforcement was a matter of raw power, not legal framework (Mitchener and Weidenmier 2010). Sovereign immunity started to slowly erode in the twentieth century, as the U.S. allowed the suing of foreign government by private claimants. In the post-World War I order, through the efforts of the League of Nations, several attempts were made to formalise model arbitration clauses in sovereign bonds (Weidemaier 2014). Until the 1950s, however, defaulting countries were effectively immune from legal action and creditors were only able to seize non-diplomatic assets abroad, of which there were few (Gelpern 2005, p. 396-7). Even in the latter half of the century, restructurings were still largely voluntary ad-hoc affairs (Sgard 2016).

Enforcement of sovereign debt really only changed in the last forty years with globalisation. In 2009, 95 percent of all international bonds issued by emerging market countries were governed by New York or English law (Das et al. 2012, p. 41). The rise of a few global financial centres offered certain tools for aggressive creditors. The best example is the Argentinian restructuring after its default in 2001. Several holdout creditors declined to participate in the 2005 restructuring and sued for equitable payment ('pari passu') on their defaulted bonds, alongside the restructured bonds.[3] The holdouts claimed that Argentina could not pay any money to the restructured bondholders, unless they were first paid in full on the defaulted bonds. The holdouts won and effectively cut Argentina off from making any international payments unless the holdouts were paid too (Buchheit and Gulati 2017). Argentina was far from the only case, and Schumacher et al. (2018) show how aggressive creditors have increased the cost of default through a combination of lost market access and asset seizures in the (largely Anglo-Saxon) court system. The reliance on global financial centres and their court systems means countries lose access to international capital markets—and the Eurobond market in particular—as almost all financial transactions flow through either London or New York. Sovereign debt is increasingly enforceable as a result of the concentration of international capital flows.

Two can play this game of course, and sovereigns in turn have included Collective Action Clauses ("CACs") in debt contracts. CACs mean a creditor majority can force minority groups to accept restructurings. Had CACs been included in Argentine bonds before the 2001 default, it would not have been possible for investors to hold out if a majority had accepted the restructuring, as they would have been automatically restructured. The market-friendly CAC-approach has been favoured over more drastic measures, such as the doctrine of odious debts. CACs were initially included in single bond issues, meaning holdouts could buy a majority stake in one bond to block a restructuring. Second-generation CACs that force an entire debt stock to restructure if the majority accepts it have only become prevalent since the early 2010s. The doctrine of odious debt states that, if debt was issued with no benefit and no consent of the people, a new government should not be responsible for the old regime's debt, which is considered illegitimate (Jayachandran and Kremer 2006).[4] Buchheit et al. (2007) show the defini-

[3] A holdout creditor does not participate in a restructuring, hoping to get better terms later (see e.g. Gulati et al. 2013).
[4] There is an argument that the doctrine of odious debt already exists in international law, but it has never been used in practice (see e.g. Howse 2007 or King 2016). For the doctrine of odious debt to apply, it would have to be recognised in customary international law. It occasionally happens but needs support from powerful nations (Choi and Gulati 2016).

tion as it is usually used has been broadened and now captures debt of odious regimes, rather than just specific debt. The Iraqi debt incurred under Saddam fits the definitions of odious debt but did not have much debtor protection overall. It therefore fell to political players to find out how to resolve the debt, which they did at the Paris Club (an informal group of mostly developed countries that organise debt restructurings, see Section 0 for details). Iraq had oil assets abroad that could be attached by creditors, and it was a clash of creditors with remedies to seize assets, and a debtor with political backing from the U.S. In the end, political pressure forced a deal on the creditors—which they all took.[5] Iraq thus goes against the grain of increased creditor power in defaults.

3. Tracing Iraqi debts (1979-2003)

Iraqi debt restructuring occurred from 2003 to 2006 and included around $130 billion of debt, excluding reparations payments from the First Gulf War. Most of the debt can be traced back to the early 1980s, despite the country having had no external debt in 1979. Table 1 shows who Iraq owed money to in 1979, with foreign exchange reserves at 65% of GDP and little debt.

Table 1: Iraqi debt by creditor, 1979.

	Outstanding debt ($ billion)	% of GDP
Paris Club	2	3%
Gulf States	-	-
Soviet and allies	-	-
Reparations (non-debt)	-	-
Commercial debt	1	2%
Foreign exchange reserves	-35	-65%
Total	**-33**	**-60%**

Sources: Caron (2004, p. 131); Jiyad (2001, p. 19); Alnasrawi (1994, p. 152).
Note: The negative number denotes creditor status for Iraq. The negative number remains the consistent format, appearing again in Tables 3, 4, 5, and 7, all tracing Iraqi debt. The Paris Club is a group of governments that coordinate restructurings (see Section 0).

[5] Almost. See Section 4.

The following sections trace the build-up of debt in Iraq over the decades after 1979, culminating with the restructuring in 2003-2006. The method, where possible, is to take the restructured debt amounts and work backwards, identifying where the loans originated and reconstructing a loan chronology. Below is an attempt to give a best guess of debt levels in 1988, 1991, and 2003. It enables, for the first time, the creation of a continuous time series of Iraq debt-to-GDP going back to 1979. The data in this section is mainly drawn from secondary sources, and to a lesser extent from primary sources (government reports and investigations).

3.1 Origins of Iraqi debt: The Iran-Iraq War (1980-88)

The year 1979 brought momentous change to the Middle East. Saddam took power in Iraq and the Iranian Revolution overthrew the U.S.-backed Shah in favour of Ayatollah Khomeini.[6] Change in Iraq came on the back of the 1970s' roaring economy, where output growth had averaged 12 percent a year after the nationalization of the Iraq Petroleum Company and the rise in oil prices. Oil production had increased fortyfold (Alnasrawi 1994, p. 79-80). Iraqi petroleum fields were among the largest in the world, producing 3.5 million barrels a day in 1979, with revenues from oil totalling $26 billion in 1980 (Mehdi 2018, p. 3; Alnasrawi 1994, p. 93). Two-thirds of output came from oil-related activity and the country relied on fuel exports. The economy was controlled by the state and almost all activity ran through the state bureaucracy, from oil policy to control over imports and the allocation of capital (Foote et al. 2004, p. 51; Alnasrawi 1994, p. 79-103). In 1979, Saddam took over a virtually debt-free economy and $35 billion in foreign exchange reserves. However, the roaring 1970s were replaced by the miserable 1980s, and the Iraq economy plunged into war and disaster: Table 2 shows the average yearly growth rates for the periods. From over ten percent growth on average in the 1970s, the Iraqi economy contracted on average about five percent a year in the 1980s.

[6] The two countries did not get along. Iranian-backed militias attempted to assassinate several Iraqi ministers and Iraq deported thousands of Iranians (Kennington et al. 2004, p. 1)

Table 2: Iraqi growth rates (yearly average).

	1970-79	1980-89
Government consumption	13.6	-2.9
Private consumption	13.2	-6.1
Investments	27.6	-0.9
Exports	4.4	-5.0
Imports	22.5	-5.6
Domestic trade	16.8	-4.8
GDP	**11.7**	**-4.9**

Source: Alnasrawi (1994, p. 101).

This was because of the Iran-Iraq War. After months of aggression, Saddam invaded Iran on September 22, 1980. During the Iranian hostage crisis at the U.S. embassy in Tehran in 1979, the U.S. had frozen all Iranian assets and in turn, the new Iranian government had repudiated all foreign debts (Christopher and Mosk 2007, p. 167). The U.S. went to the International Court of Justice in The Hague which ruled in its favour shortly after, ordering Iran to return the embassy and release the hostages. Iran was massively out of international favour. Consequently, after the Iraqi invasion of Iran, the U.S. designated Italy as a go-between during initial discussions, to avoid being seen as favouring Iraq (Kennington et al. 2004, p. 3). Neutrality was just for show, though. Iranian objections to the invasion fell flat—due to its low standing following the hostage crisis—and its petition to the U.N. went nowhere (Caron 2004, p. 128).[7] The international community was on the Iraqi side— explicitly or implicitly—with few even daring to sell arms to Iran. From early in the war, Iraq had access to politically motivated borrowing from both its Gulf State neighbours and the U.S., neither based on any expectation of repayment.

In 1981, Italy started selling vessels to Iraq worth $1.8 billion; the Soviet Union supplied arms (initially through its Eastern European satellites); Britain signed a trade pact; and French nuclear physicists arrived on the ground to help build a nuclear reactor near Baghdad. The Iraqi government might have thought a quick

[7] For a full timeline of the Iran-Iraq War, see Kennington et al. (2004, p. 3-44); for the economic impact of the war on Iraq, see Alnasrawi (1994, p. 79-126) and Caron (2004, p. 128-33); and for a discussion of the geopolitical origins of the war, see Swearingen (1988).

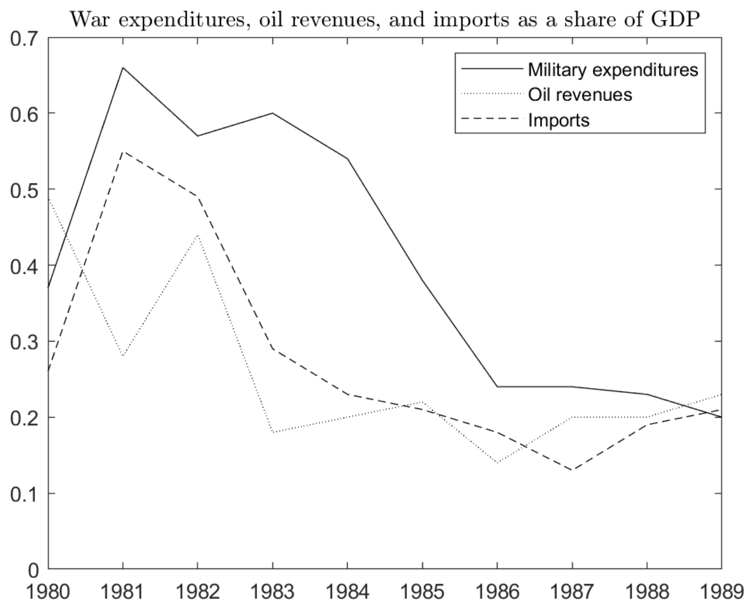
victory was possible but as Iran started to fight back, the economy began to hurt. Oil exports collapsed by 75%, as export facilities and terminals were destroyed by bombs (Mehdi 2018, p. 3). Iraq had relied on two oil pipelines—one through Syria, one through Turkey— that quickly dwindled to one: Syria declared support for Iran and cut off access. Iraq quickly depleted its foreign reserves and was forced to borrow; loans from the Gulf States totalled $16 billion through 1981. The Gulf States backed Iraq throughout the war, lending a total of $40 billion (Alnasrawi 1994, p. 109). The Gulf States considered the money a loan; for Iraq, on the other hand, they had been grants. The disagreement is still outstanding (as are most of the loans) but the U.S. Treasury pushed (unsuccessfully) to include them in the 2003-6 restructuring.

The U.S. removed Iraq from its list of countries sponsoring terrorism in 1982, making it easier to undertake commerce (Kennington et al. 2004, p. 11). The arms sales to Iraq increased, both directly from the U.S. and through proxies. In June 1982, President Reagan issued a secret directive to make sure Iraq would not lose the war, putting the CIA in charge of supplying Iraq with weapons (Hersh 1992). The decision came after the CIA (1982) warned that from a military perspective, Iraq had essentially lost the war.[8] Fighting escalated throughout 1983 and the U.N. was unable to negotiate a ceasefire. Iraq continued to have easy access to weapons and credit. Jordan joined in, extending loans worth $125 million to Saddam (Kennington et al. 2004, p. 19). The total eventually reached $1.3 billion. U.S. support for Baghdad became explicit in 1984—even after Iraq started using chemical weapons—and the CIA stepped up its war effort (Woodward 1986). France provided $500 million in new loans and refinanced $1.4 billion of maturing debt (Kennington et al. 2004, p. 21). The international community—via bilateral negotiations by the U.S. with the Soviet Union and the U.N.—pushed to end the conflict in 1985, with no luck. Instead, Iraq went on the

[8] The warning was given in a Special National Intelligence Estimate written by the CIA (1982), declassified in 2007.

offensive in early 1986 via air raids, secretly urged on by the Reagan administration, to little effect.[9] Despite Iraq's best efforts, the war was being fought on Iraqi soil now, and the military situation was deteriorating. Oil prices halved in 1986 and the oil-reliant Iraqi economy continued its downward spiral (Tabaqchali 2018, p. 17). The economy of 1980s Iraq was a war economy. Military expenditures and imports related to the war effort took up a large part of the national economy. This coincided with declining oil revenues. To sustain the war, Iraq went into debt. Figure 2 shows military expenditures, oil revenues, and imports as a percentage of output.

Figure 2: Iraqi expenditures and revenues.



Source: Based on data from Alnasrawi (1994, p. 93-6).

During 1987, the U.N. passed several resolutions calling for an end to the conflict. As no agreement was reached, the West ramped up pressure to force a negotiated peace and arms sales to Iraq continued unabashedly in parallel to efforts to contain Iran via sanctions and embargoes. In early 1988, the Soviet Union and China agreed to U.N. sanctions, forcing Iran to the negotiating table. The cease-fire was signed on August 20, 1988. Iran had had little international

[9] The apparent contradiction between official negotiation position of the U.S. and its covert operations later acknowledged was likely a consequence of the desire to see Iraq victorious.

support and initially could only buy weapons from Libya. In 1982, the Soviets, Syria, North Korea, and Israel had started to supply Iran, mostly in return for oil. Iraq, on the other hand, had, as we have seen, had plenty of help from across the globe. Loans came in the form of grants, transfers, commercial lending, or covert arms deals. From 1983-93, for instance, Iraq received $2 billion in loans from the U.S. Department of Agriculture (Weiss 2011, p. 2).[10] Underpinning this was a strong geopolitical desire for Iraq not to lose the war to Iran.

The largest commercial claim in the restructuring in 2003-6 exemplifies the interconnectedness, showing how Iraq was able to maintain market access until the end of the 1980s. Between 1985 and 1990, a small Atlanta branch of the state-owned Italian bank, Banca Nazionale del Lavoro (BNL), extended loans worth $4 billion to Iraqi individuals and entities. This included $1.6 billion of loans backed by the U.S. Department of Agriculture's Commodity Credit Corporation (SSCI 1993, p. 8-9). Officially, the loans were designated for agricultural imports, but the money was used for weapons—illegally. The Department of Justice prosecuted the Atlanta branch manager, arguing he had acted without approval from BNL headquarters in Rome. However, the District Court judge, Marvin H. Shoob, wrote in an opinion that the CIA had likely known about the illegal financing of arms. He also noted that BNL Rome was not a victim, indicating that they had been aware of the loans (Stich 2005, p. 94-5). The CIA intervened and withheld certain information, triggering a Senate investigation. Recall that President Reagan had secretly put the CIA in charge of arming Iraq.[11] Thus the BNL was owned by the Italian state; received loan guarantees from the U.S. Department of Agriculture; and extended loans worth $4 billion from a small branch in Atlanta, with U.S. intelligence services involved in the court case. Regardless of whether it was officially sanctioned, two governments were

[10] The CIA (1984) suggested Iraq had spent $22 billion on weapons halfway through the war, while Iran had spent $5 billion. Schmidt (1991, p. 12) suggest total Iraqi weapons imports during the war was $63 billion (in 1990 dollars).
[11] The Senate Select Committee on Intelligence (1993) cleared the CIA of any direct knowledge of illegality.

implicitly involved.[12] Eventually, the loans were defaulted on and restructured as a commercial claim (see section 0) but the episode underscores how Iraq obtained financing in the 1980s. The loans were made to pay for a war that was supported by most of the West.

Iraq emerged from the Iran-Iraq War a country in crisis. After ten years of conflict, Iraqi external debt was a staggering $86 billion. In less than ten years, the country had gone from being a net creditor to a net debtor, with a debt-to-GDP ratio of 278%. Debt service in 1989 was more than half Iraqi oil revenues (Alnasrawi 1994, p. 93-109). Table 3 shows the breakdown of Iraqi debt at the end of 1988.

Table 3: Iraqi debt by creditor, 1988.

	Outstanding debt ($ billion)	% of GDP
Paris Club	29	95%
Gulf States	40	129%
Soviet and allies	11	36%
Reparations (non-debt)	-	-
Commercial debt	6	19%
Foreign exchange reserves	-	-
Total	**86**	**278%**

Sources: Alnasrawi (1994, p. 109, 159); Metz (1990, p. 126).

There is to this day disagreement over whether the Gulf State loans in fact constituted a grant. Iraq considered them grants, but Saddam also tried to get the loans cancelled, which is inconsistent (Jiyad 2001, p. 43). Since all debts were attempted restructured, however, I treat it as debt throughout. The overall level of debt is al murky, and timelines do not match up; Gulf States debt levels range from $30 to $60 billion in the literature (ibid, p. 42-3). Considering known debt levels three years later in 1991, approximate lending in the ensuing years, and the quality of sources, the best estimate is $40 billion. Neither contemporary nor historical sources have been able to pin down the dates and conditions of the

[12] Even if nothing sinister happened, the Department of Agriculture guaranteed loans were used for weapons.

loans, as contracts were not kept (Momani and Garrib 2010, p. 168).[13] Financing from the Gulf States mainly took place at the beginning of the war, but the exact years of the loans are an estimate. Debt to commercial creditors is estimated at $6 billion, but this obscures the role of the U.S. government. It is perhaps better thought of as quasi-bilateral loans, albeit it matters only for the distribution of creditors (see section 0).

In the mid-1980s, the first 'soft' default happened (Caron 2004, p. 131-2; Chung and Fidler 2006). The initial default can be traced to non-payments on contractual goods and services during the war, extending payments for as long as forty months. Iraq also rescheduled various loans but remained current on others (ibid). A small amount of hard currency bonds and bank loans went into default, but most of the credit extended during the Iran-Iraq War kept being serviced for the rest of the decade.[14] Interest rate payments made by Iraq during the war totalled over $24 billion (Jiyad 2001, p. 20). It allowed Iraq to maintain access to new credit, with willing political lenders standing by. Everyone could see that Iraq was insolvent, but if everyone pretended the debt would either be forgiven or rolled over, Iraq could keep borrowing to repay maturing debt. Problems began when the political and financial winds shifted.

3.2 The First Gulf War and reparations (1988-91)

The cost of war can be high, and for Iraq it was. Reconstruction costs have been estimated as high as $230 billion (Alazemi 2013, p. 98), yet the oil sector produced revenues of only $15 billion in 1989, 55% lower than in 1980. Iraq's net external debt increased by some $120 billion over the course of the war (Alnasrawi 1994, p. 106). In 1990, inflation reached 40% and cash reserves was just enough to cover three months' imports (Alexander and Rowat 2003, p. 33). Despite the economic issues, Saddam was popular—both at home and in the region—and

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[13] Hand-shake deals and covert operations did not have documents that could be traced, while some records were likely lost between the origin of the loans in the 1980s and the restructuring after a decade of sanctions in the 1990s.

[14] According to Bank of Canada's Credit Rating Assessment Group database on sovereign defaults.

Iraq did not reduce its military expenditures (Alazemi 2013, p. 97-8). Saddam saw himself as a strongman who had defeated Iran on behalf of all the Gulf States. He wanted to use the Iraqi military to bully neighbouring states, foremost Kuwait and to a lesser extent Saudi Arabia, and consolidate his power (Parasiliti 2003). Kuwait was owed $14 billion for loans during the war and refused to cancel the debt, leading to strained relations between the two countries in 1989. The price of oil fell in early 1990 and the Iraqi economy worsened. Saddam blamed Kuwait for low oil prices and accused the neighbour of attempting to drill in Iraqi oil fields. This was the pretext used for war: on August 2, 1990 Iraqi forces invaded Kuwait. Iraq quickly gained control of the territory and annexed Kuwait on August 28.[15]

Unlike the war with Iran, this time Iraq did not have the backing of the international community. The U.S. swiftly sent military support to avoid an invasion of Saudi Arabia by Iraq, and the U.N. passed Resolution 661 on August 6 (1990a) imposing economic and financial sanctions on Iraq (Warbrick 1991a, p. 482-4). The sanctions contained very few exceptions (humanitarian aid) and forbade any financial transaction with Iraq, including payments under existing contracts (Deeb 2007, p. 3). Iraq was isolated from the global economy; any new external debt would be illegal. As the sanctions did not deter Saddam, a U.S.-led military coalition authorised by the U.N. began Operation Desert Storm in January 1991. The coalition swiftly won, and Iraq signed a permanent cease-fire in April. Kuwait, however, was left with extensive damage (Warbrick 1991b, p. 970). The U.N. Security Council therefore established the United Nations Compensation Commission (UNCC) to oversee reparations payments. Reparations could be awarded to individuals, businesses, or governments for damages stemming from the illegal invasion of Kuwait. Annual claims could not exceed thirty percent of oil exports (Resolution 705, 1991) although this was reduced to five percent after the American-led invasion in 2003.[16]

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[15] For a full timeline of the invasion of Kuwait, see Warbrick (1991a, 1991b). For the geopolitical and local reasons for war, see Gause (2002) and Parasiliti (2003).
[16] UN Security Council Resolution 1483 (May 2003).

War reparations are compensation for breaches of international law and are a mainly monetary restitution; they should, however, also represent broader justice for the victims (Sandoval and Puttick 2017, p. 7-16). Reparations constitute liabilities, but are not technically debt according to the Paris Club definition (see section 0 for details).[17] For Iraq, the U.N. Compensation Fund automatically receive revenue from Iraqi oil exports to fund the payments. In total, 2.7 million claims totalling $353 billion had been made as of July 2019. $52 billion have been authorised and $48 billion have been paid out to 1.5 million claimants, with the remaining expected to be paid in the future.[18] Estimates for Iraqi liabilities in the early 1990s were higher, at around $100 billion at 1990s prices (Morrison 1992, p. 393). Enforcement of reparations payments are overseen by the U.N., which has a legal framework for ensuring payments are made, unlike unsecured government debt.[19] Reparations add substantially to the Iraqi debt burden and must be included in a fair summary of external liabilities, but given they are left out of the Paris Club definition of debt are sometimes excluded. The amounts included in are actual payments awarded by the UNCC on behalf of Iraq as of 2019, despite initial estimates being higher. Table 4 shows Iraqi debt by creditor in 1991, compared to output that had collapsed to $12.3 billion from over $50 billion before the war (Alnasrawi 1994, p. 159).[20]

[17] Paris Club is a group of (mostly) developed countries that negotiate restructurings collectively. For a history of the Paris Club, see Cheng et al. (2018).
[18] See the U.N. Compensation Commission website: https://uncc.ch/home (accessed July 16, 2019).
[19] One issue not addressed by the UNCC was, if a claim was submitted and partially awarded, would the claimant forgo the rest. Were the UNCC to use an election of remedies; one would be debarred from suing in court. This would later cause headaches for the lawyers (Buchheit 2019).
[20] Alnasrawi cites some sources that estimate output declined by as much as fifty percent after the invasion.

Table 4: Iraqi debt by creditor, 1991.

	Outstanding debt ($ billion)	% of GDP
Paris Club	18	143%
Gulf States	53	431%
Soviet and allies	11	89%
Reparations (non-debt)	52	423%
Commercial debt	9	71%
Foreign exchange reserves	-	-
Total debt (ex-reparations)	**90**	**733%**
Total liabilities	**142**	**1156%**

Sources: Paris Club; Chung and Fidler (2006); UNCC; Alnasrawi (1994, p. 109).
Note: All debts (except Gulf States) are nominal amounts restructured in 2003, i.e. minus accrued interest. Reparations are total reparations awarded as of July 2019. Table 3 and Table 4 do not reconcile because both are best estimates at each time, based on available sources.

A quick methodological note is required before continuing. After August 6, 1990, when Resolution 661 (1990a) was passed, it became impossible for Iraq to get external loans. Working backwards from the restructuring, I use nominal amounts from the Paris Club, the IMF and the UNCC (details in Section 0). This means there is a potential incoherence between tables 3 and 4, though both are the best estimates available for each year. For instance, the Gulf States debt, $53 billion, is drawn from Chung and Fidler (2006) and are amounts that the restructuring team floated in 2006. Other bilateral loans (i.e. Paris Club countries and Soviet Union in 1991) include only amounts that were restructured; if a loan was secretly written off between 1991 and 2003 it is not included. Commercial loans outstanding in 1991 are similarly the principal amount claimed in the restructuring. Therefore, the changes in debt levels from 1988 to 1991 are difficult to trace, as there are few historical sources. Jiyad (2001, p. 19-22) suggests Iraqi debt decreased after the war, but the amounts are minor compared to overall debt levels.[21] The politically motivated lending and the blurred lines between bilateral and commercial lending makes a perfect reconciliation difficult. Nonetheless, Table 4 presents a reasonably accurate snapshot of Iraqi debt as sanctions were imposed and the country withdrew from the global economy.

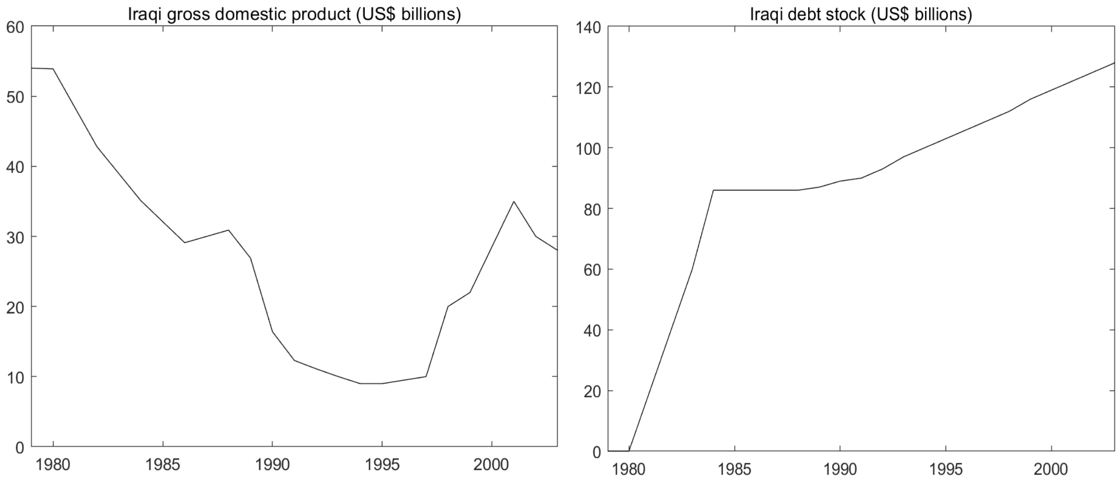
[21] Identified debt decreased by $300 million, however the overall stated debt is far lower from the actual and some scepticism is required for the numbers given.

3.3 Sanctions (1991-2003)

Following the First Gulf War, Resolution 678 (1990b) placed Iraq under sanctions from 1991. It was a terrible time for Iraqi living standards: output collapsed, society was uprooted, and personal freedoms were reduced (Sluglett 2010, p. 13-15). Oil production had already been decimated during the war, and what limited sales there was were hit by the low price of oil in the 1990s.[22] No bank, investor, or government would touch anything flowing through Iraq, as failure to comply with sanctions would lead to exclusion from international financial markets. The sanctions were meant to be short-lived and force out the government, yet Saddam's grip on power only increased, at least in Southern Iraq (Dodge 2010; Brown 1999, p. 56-104). Northern Iraq became a separate de-facto Kurdish state (King 2004, p. 12). Sanctions that had been intended to destabilize the government instead enhanced state power, which increased in every facet of daily life, especially the rationing of goods (Mazaheri 2010). Saddam wanted sanctions lifted but had to settle for the oil-for-food program, enacted in 1996, which allowed some oil sales and food imports (Sluglett 2010, p. 20-22). Consequently, Iraqi GDP—which had been falling for fifteen years—tripled from 1996 to 2003, though this barely enabled it to surpass 1988 levels (see Figure 3).

[22] Initially, no Iraqi oil sales were allowed but small exports were approved subsequently (Brown 1999, p. 56-104).

Figure 3: Iraqi GDP and debt stock (US$ billion).



Sources: Data for 1979-93 is from Alnasrawi (1994, p. 152); for 1993-2003 the source is the CIA (2004, p. 208). Debt stock data is cited in previous tables and text.
Note: Iraq was isolated; little information flowed in or out. A healthy dose of scepticism around the numbers is therefore required, especially after the sanctions period.

Various domestic debts and credits existed but no new external debt was taken on. The sanctions period devastated Iraq. Crime increased—perhaps surprisingly given Saddam's tight grip on the country—and the economy was in ruins (Sluglett 2010, p. 13-15). This meant the nominal value of Iraq's external debt—most of which was in hard currency, and mostly in dollars (see Section 4)—had neither been eroded by inflation nor outgrown by a larger economy. Iraqi debt in 2003 can be seen in Table 5. It includes all debts that were restructured by the Paris Club; old debt from the Gulf States in their nominal amounts; non-Paris Club bilateral loans that were (to some extent) restructured, commercial debt—and reparations. All amounts are before any restructuring.

Table 5: Iraqi debt by creditor, 2003.

	Outstanding debt ($ billion)	% of GDP
Paris Club	39	139%
Gulf States	53	189%
Non-Paris Club bilateral	17	60%
Reparations (non-debt)	32	114%
Commercial debt	20	70%
Foreign exchange reserves	-	-
Total debt (ex-reparations)	**128**	**458%**
Total liabilities	**160**	**573%**

Sources: Paris Club, IMF, UNCC.
Note: Paris Club, bilateral, and commercial debts are restructured amounts, with the non-Paris Club bilateral outstanding debt representing IMF debt minus Gulf State debt (the IMF does not break out by country). Reparations are what remained to be paid in 2003. By the time of the restructuring in 2003-6, the Soviet debt had been absorbed into the Paris Club debt, while a separate non-Gulf, non-Paris line of debt appeared.

The U.S. and its Coalition partners invaded Iraq on March 19, 2003.[23] From the Iraqi perspective, the sanctions period can be thought of as one long war, beginning with the First Gulf War in 1990 and ending with the invasion in 2003 (McCutcheon 2006). From the U.S. side, the attack on September 11, 2001, was a precursor for the invasions of Afghanistan and Iraq, where the Bush administration saw an opportunity for regime change, something the Republicans had wanted since the First Gulf War ended with Saddam still in power (Gompert et al. 2014).[24] Militarily, the war/invasion was quickly won and the discussion turned to reconstruction. There was a desperate need to reconstruct Iraq post-Saddam, with several moving pieces. The IMF would require a debt solution to get involved, but the Paris Club—i.e. Iraqi's creditors from the developed world—required a debt sustainability analysis from the IMF to do a restructuring deal. For the U.S. government, debt relief was seen as critical. President Bush personally advocated for a quick debt write-down and appointed a Special Envoy to deal with the matter in December 2003, having already called for a write-down within a year at the G7-meeting that September (Weiss 2011, p. 5).

[23] The Multi-National Force was led by the U.S., the U.K., Australia, Spain, and Poland.
[24] The Iraqi debt restructuring was arguably one of only two successfully executed post-invasion policies (the other being the currency exchange). It should not be forgotten that almost everything that happened in Iraq from 2003 onwards was a disaster (e.g. Kramer et al. 2005 on how the war threatens the international rule of law, or Brands and Feaver 2017 for how the mismanaged invasion lead to the rise of ISIS, but the list of failures is long).

This started the process of restructuring Iraqi debts which—as we saw in Section 3—were enormous and varied.

As Section 4 will make clear, it was not known in 2003 what the total debt level was, because: (i) the sanctions period had made it illegal to lend to Iraq; (ii) most loans were from before 1990; (iii) records were often non-existing; and (iv) Iraq had been heavily bombed, destroying many records. The debt level includes all claims made during the restructuring. Table 5 is therefore the debt level of Iraq, the most indebted nation in the world in 2003, on the eve of the invasion.[25]

4. The restructuring

The restructuring is told in detail here for the first time.[26] I have conducted interviews with people involved in the restructuring, to tell the story. The interviews are cited throughout Section 4. When information from an interview is used, I use standard citation to show where the information is retrieved. The interviews include the lawyers for Iraq, Lee Buchheit (2019) and Jeremiah Pam (2019); advisors for the commercial restructuring and banker at Citigroup, Nazareth Festekjian (2019); officials for the U.S. government: Anthony Marcus (2019); Clay Lowery (2019); and Olin Wethington (2019); and the U.K. negotiator for the Paris Club, Andrew Kilpatrick (2019).[27] I also rely on several other primary sources—documents from the restructuring, press releases, annual reports—as well as some secondary literature.

Sovereign restructurings generally follow a similar process, outlined by Buchheit et al. (2018). Debtors have three main tools to reduce indebtedness:[28]

- extension of debt maturity to provide time and reduce the net present value;

[25] According to the IMF, the most indebted nation in 2003 was Liberia, with a debt-to-GDP of 515%. IMF does not include Iraq for 2003. Per Table 5, Iraq total liabilities were 573%, making it the most indebted nation in the world.
[26] As far as the author is aware, at the time of writing (December 2019), there have been no other comprehensive accounts of the Iraqi restructuring featuring all aspects of the restructuring.
[27] Interviews were recorded and are on file with the author.
[28] Other minor efforts can be undertaken—such as buying back debt in the secondary market, if it trades below par—but they are marginal.

- principal reduction, i.e. a haircut of the nominal amount of debt; and
- coupon adjustments, to reduce the interest rate paid.

Countries usually know how much money they owe. They do not necessarily know to whom they owe money, as this depends on the type of debt. External bonds are publicly traded and can be held by anyone, while bilateral loans from other sovereign states are easier to identify.[29] Restructurings generally include one type of creditor, e.g. Paris Club members, non-Paris Club countries, or commercial creditors. Iraq, however, owed money to everyone. Even within a single group, commercial creditors for instance, the group was diverse: from government contractors and suppliers, to hedge funds, asset managers, banks, trade creditors, and state-owned entities. After sanctions started in 1990, Iraq stopped keeping track of who was owed what and records were scattered as the loans were defaulted upon. The restructuring was thus an extremely complex endeavour.

The Iraqi obligors (the debtor entities) were similarly a diverse bunch, as the line between the Iraqi government and Iraqi commercial enterprises had been blurred. The obligor included not only the government itself, but ministries, state-owned enterprises, and quasi-governmental institutions such as banks—especially Rafidain and Rasheed.[30] Coordinating between the different debtors was more complicated than in normal restructurings, as the entire public sector of Iraq was included as debtor (Deeb 2007, p. 5).[31] The central bank formally held Iraqi assets—both domestically and in foreign accounts—that could be attached by creditors, as Iraq was in default and could be sued. The U.N. Resolution 1483 (2003) immunized all Iraqi foreign assets, including assets held by the Development Fund and the Central Bank (Buchheit and Gulati 2019, p. 5). The

[29] In between external bonds (unknown) to bilateral sovereign loans (known) are commercial loans, syndicated loans, bank deposits, trade credits, supplier credits, and so on, which has known creditors to various degrees.
[30] Definitions of obligors available: http://www.eyidro.com (accessed July 22, 2019). Usually the Ministry of Finance act on behalf of the government.
[31] Most of the institutions were located outside the relative safety of the Green Zone in Baghdad, an added security risk.

Development Fund for Iraq was set up by the Coalition Provisional Authority (CPA), the interim government, to hold Iraqi assets and oil revenue; it was administered by the New York Federal Reserve. It paid wages, pensions, and was used for cash disbursements (Resolution 1483, art. 12; Wethington 2019).[32] Cash to run the government was withdrawn from the Development Fund and flown to Iraq, hundreds of million at a time (ibid).

Reparations were quickly left out of the restructuring, mainly for international political reasons. The U.S. Treasury put together some initial numbers but looked for reasons to not include reparations (Lowery 2019). Reparations had been structured by various U.N. resolutions to be paid directly out of oil revenues. A new resolution would be required to change the legal setup. Unlike sovereign debt, reparations were easy to enforce as the UNCC had been set up to take money directly from Iraqi oil revenues. The original Resolution 705 (1991) stipulated 30% of Iraqi oil revenues should go towards paying reparations. It was lowered to 25% with Resolution 1330 (2000) and to 5% with Resolution 1483 (2003). Just changing the legal status of reparations would require a political battle at the U.N., which could be vetoed by any one of the five permanent Security Council members. Even if it changed, the money would still be awarded as compensational damages to be collected by the UNCC. The Paris Club does not classify reparations as debt and there was no other forum apart from the U.N. Security Council that could intervene.[33] Reparations were therefore quickly dropped from the restructuring.

4.1 Initial steps: Immunizing Iraqi assets, reconciling debts

U.N. Resolution 1483 (2003) lifted sanctions, terminated the oil-for-food program, structured the post-invasion government, called for a debt restructuring,

[32] It was implemented in the U.S. by Executive Order 13303, on May 22, 2003, and renewed again by both Bush and Obama. It expired in 2014 (Buchheit and Gulati 2019, p. 4-5). The executive order was marred by controversy, as some argued it immunized U.S. oil companies (e.g. Kelly 2004).

[33] See http://www.clubdeparis.org/en/communications/page/definition-of-debt-treated (accessed on November 30, 2019)

and immunized Iraqi oil sales from creditor attachment. Immunizing Iraqi foreign assets from, "*any form of attachment, garnishment, or execution*," was the most important as creditors could not take possession of Iraqi assets.[34] The resolution was hotly debated, with the international community divided between the U.S. and its allies, and countries that opposed the Iraq war. The U.S. and the U.K. had circulated drafts of the resolution, which essentially legitimised the invasion. Even in the early drafts, immunizing Iraqi oil was included, although there is little evidence that it was a major point of contention.[35] It would of course protect Iraqi assets, but also enabled global oil companies, mostly American and British, to get involved without the risk of creditor judgments. I have found no evidence about the inclusion of the immunization provision, but none of the permanent members of the Security Council vetoed the resolution. From the U.S. government's point of view, reconstruction depended on getting rid of the debt overhang (Lowery 2019) and on October 16, 2003 Congress urged Paris Club creditors to get together to provide debt relief (U.S. House Resolution 198, 2003).[36] There was a political argument for debt relief, too. The White House and the Treasury could not go to Congress and ask for appropriations, only to turn around and see the money flow to other creditors on already delinquent loans, such as Saudi Arabia or China (Lowery 2019).

The Treasury appointed Olin Wethington to oversee the economy directorate at the Coalition Provisional Authority (CPA), the transitional government of Iraq, in October 2003.[37] The CPA started to explore a debt restructuring but decided not to start the formal restructuring until sovereignty formally passed back to Iraq (Pam 2019). The Trade Bank of Iraq (TBI) was established to facilitate imports and exports. It was immune from attachment, but its scope was limited

[34] As shown by Buchheit and Gulati (2019), creditors maintained their rights to not tender into a restructuring but lost any enforcement power to seize assets. All U.N. members had to enshrine the protection into domestic law, as it was passed under Chapter VII of the U.N. Charter which is legally binding on member states.
[35] See the New York Times (2003), paragraphs 12-21, governing the Development Fund. In early drafts, it was called the Iraqi Assistance Fund.
[36] See also Paris Club (2003a, 2003b).
[37] His role was, effectively, to be the interim central bank governor, with the title of Director of Economic Policy, reporting to Bremmer (Wethington 2019).

and seen by the CPA as a stopgap until debt could be restructured (Wethington 2019). The CPA believed it was untenable to only have limited immunity and the debt issue needed a quick resolution to facilitate international trade participation. As Section 3 shows, Iraq had three groups of creditors: Paris Club, non-Paris Club (including Gulf States), and commercial creditors, each having significant claims (see Table 5).

Jim Baker was appointed Special Envoy in December 2003 to lobby Iraqi creditors for debt relief in a political capacity and lay the groundwork for the restructuring. He targeted key creditors that would have to be engaged later. Three U.S. government players convened late in 2003 to deal with the issue: The Treasury (for financial matters), the State Department (diplomacy), and the National Security Council (to represent the executive).[38] Baker led a group, including the Iraqi Finance Minister and Central Bank Governor, travelling the world to obtain buy-ins for a rescheduling (Lowery 2019; Wethington 2019). Meanwhile the Treasury oversaw an initial inventory of debt, as nobody knew how much debt Iraq had (ibid).[39]

The procurement process to hire separate legal advisors for Iraq started in early 2004, with Cleary Gottlieb appointed in June 2004 (Deeb 2007, p. 4). The role of Lee Buchheit, who led the Cleary team, was to run the restructuring for Iraq and manage other financial advisors (Buchheit 2019). At the first meeting between the White House, Treasury, IMF, and Cleary, the main subject of discussion was whether Iraqi debt could be declared odious. Declaring the debt odious implied that the debt was illegitimate and would have led to a cancellation of all debt. There was talk at the highest level of the White House about declaring Iraqi debt odious, even going so far as to have Secretary of the Treasury Snow suggest it

[38] Additionally, U.S. Paris Club negotiators are jointly from the Treasury and State Department (Pam 2019; Lowery 2019).
[39] A difficult process, as explained earlier. It started by looking at records in ministries and the central bank and asking other sovereigns how much they thought they were owed.

publicly (Momani and Garrib 2010, p. 158-9). It generated lots of support and debate in the think tank world (e.g. Adams 2004) and academia, as a series of articles in the following years show (e.g. Jayachandran and Kremer 2006; Damle 2007; Gelpern 2007; Buchheit et al. 2007).[40] While the U.S. government position in public seemed to support the idea of declaring Iraqi debt odious, however, in private among the institutions directly involved—the U.S. Treasury and the IMF—the concept was not much discussed and the IMF publicly rejected the idea (Rajan 2004). They judged a standard write-down to be more efficient (Wethington 2019).

The legal advisors advocated against the doctrine of odious debts, with the IMF and the Treasury strongly supporting a standard restructuring instead (Marcus 2019). Not so much because the debt was not odious—Section 3 shows Iraq is one of the strongest cases—but because it would unnecessarily complicate the restructuring (Buchheit 2019). Many countries around the world sell goods and arms to despots on credit, and Buchheit suggested most Paris Club members would walk away from negotiations. There is no legal doctrine for odious debt (Buchheit et al. 2007), and it would have been a "*minefield of definitions*" (Buchheit 2019) as there would have been a need to set a precedent for what parts of the Iraqi debt stock was illegitimate. It was therefore decided to go for a standard restructuring, and the discussion never went to the National Security Council at the White House (Wethington 2019).[41]

Another reason against the doctrine of odious debt was that it was not in fact needed to obtain substantial debt write-offs, given the political buy-in (at least amongst the Coalition). In October 2003, the U.S. organised a conference to raise financial support for Iraqi reconstruction. Pledges as a share of outstanding debt are summarised in Table 6.

[40] References are to published articles. For the current debate see e.g. the June 2005 edition of *Finance and Development*, volume 42 (2), where the Letters to the Editor include discussions between several of the cited authors.

[41] There are somewhat differing accounts of how much support the idea had.

Table 6: Pledges at International Donors' Conference for Iraq, October 2003.

	Total pledges ($ billion)	Outstanding debt ($ billion)	Pledged assistance (% of debt)
Paris Club	25	39	65%
Gulf States	1	53	3%
Other (non-Paris Club countries)	0	17	1%
IMF	3	-	
World Bank	4	-	
Commercial debt	-	20	
Total	**34**	**128**	**27%**

Sources: Momani and Garrib (2010, p. 160); U.N.
Note: IMF and the World Bank provided a range of assistance, $1 billion each. The mid-point is shown here.

Sovereignty officially passed back to Iraq on June 28, 2004. It was decided that the Paris Club would be the best place to start restructuring negotiations.[42] Restructurings have a process but no manual: you start wherever a deal might be reached. The tactical reason for this was that every Paris Club deal comes with a comparability of treatment clause.[43] A deal would be a 'floor' beyond which no other creditors could get a better deal, meaning others would likely follow (Wethington 2019; Buchheit 2019). Paris Club members all had substantial claims on Iraq and the geopolitical alliances of the Coalition were well-represented, following the Jim Baker's initial diplomatic rounds (Pam 2019). Normally, countries undergoing restructurings do not have a lot of friends—they owe them all money. Iraq was different. Paris Club negotiations opened with the U.S. willing to stand up for Iraq, with some in the National Security Council (which represented the White House) aiming for substantial, possibly even total, debt relief (Buchheit 2019). The U.S. was keen on achieving a consensus outcome, the Paris Club was the best place to achieve it (Wethington 2019).

[42] Eighteen members participated in the Paris Club restructurings: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Italy, Japan, Korea, Netherlands, Russia, Spain, Sweden, Switzerland, U.K., and the U.S., Norway, the World Bank, UNCTAD, the European Commission, the IMF, and the OECD were observers.
[43] See: http://www.clubdeparis.org/en/communications/page/the-six-principles (accessed on July 26, 2019).

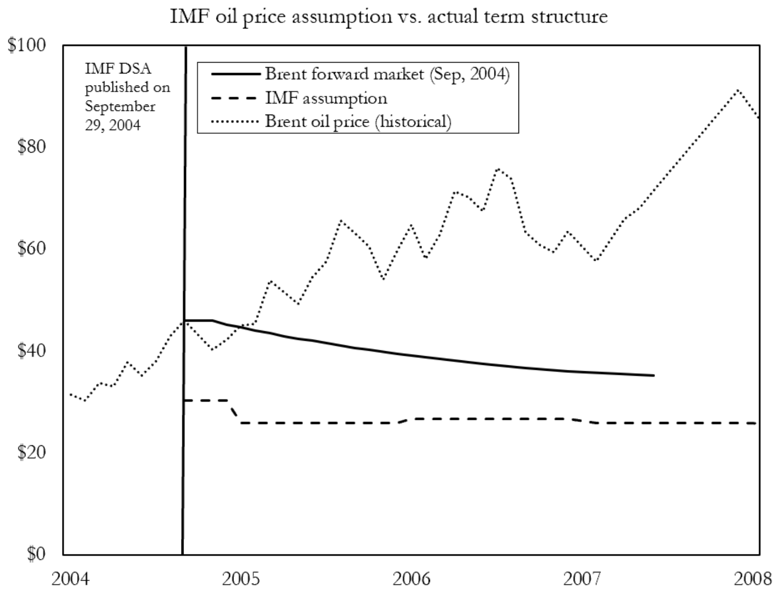
4.2 Paris Club negotiations

The Paris Club is a well-oiled machine for sovereign debt restructurings, having executed 433 deals with 90 countries since it was established in 1956.[44] Iraq required two types of debt relief: Flow treatment and reduction of the debt stock. The first was relatively easy, as Iraq was not paying its current debt. However, at the Paris Club, flow treatment usually comes before debt stock reduction. For Iraq, stock reduction came up front, which is unusual (Lowery 2019; Marcus 2019). Iraq was treated under the Evian Approach, offering "*comprehensive debt treatment*," reduction with no standard terms (ibid).[45] The approach was only approved in October 2003 and did away with economic indicators in favour of a non-standard sustainability analysis for highly indebted countries (Weiss 2011, p. 5-6). It required a debt sustainability analysis (DSA) from the IMF. The IMF had been brought in early 2003 to (i) put together a DSA for the rescheduling, and (ii) to prepare Iraq to be party to a stand-by agreement (Wethington 2019; IMF 2004).[46]

The Iraqi solvency and capacity to pay its debts would be based on the DSA, which largely depended on assumptions about oil prices and production. The Iraqi government generated all its revenue from oil sales: between 2005 and 2007, 94 percent of revenues, $96 billion in total, came from the sale of crude oil (GAO 2008, p. 2). The accuracy of the assumptions was therefore essential for debt sustainability. Because of the U.S. desire for substantial debt relief, there was political pressure from the negotiations team to reduce Iraq's capacity to service debt. The IMF (2004) assumed the price of oil would be $26 per barrel, forever. Figure 4 shows the futures market for Brent oil, as well as the oil price during negotiations. At the time of the DSA's publication, the oil price was $46 and rose throughout 2005 and 2006. The assumption did not change during the negotiations, even as the price of oil rose to over $60.

[44] http://www.clubdeparis.org/en (accessed July 12, 2019). The Club is housed at the French Treasury in Paris. For a history of the Paris Club, see Cheng et al. (2018).
[45] See also http://www.clubdeparis.org/en/communications/page/evian-approach (accessed on July 23, 2019).
[46] Meetings between the IMF and the CPA occurred throughout the spring of 2004 in Oman, Beirut, Abu-Dhabi, and London (Wethington 2019).

Figure 4: IMF oil price assumption vs. actual term structure.



Sources: Bloomberg; IMF.
Note: The historical oil price is the actual spot price of Brent, as it occurred over 2004-8. The IMF assumption is from the IMF Debt Sustainability Analysis, dated September 29, 2004.

Initial staff meetings at the Paris Club started in July 2004, with bilateral meetings in the fall. The deal was ultimately agreed in November 2004. Paris Club negotiations are generally completed within one day, and usually no more than forty-eight hours (Buchheit 2019; Marcus 2019). The Iraqi negotiations went on for over a week, with months of preparation.

At issue was a fundamental difference between the Coalition—led by the U.S. and the U.K.—and non-Coalition countries, mainly European countries and Russia. The Europeans considered the IMF's DSA a work of fiction because of how vastly its oil price assumptions differed from reality (Buchheit 2019). Iraq did not have enough cash on hand to do a cash-for-debt deal, so it would have to be a debt-for-debt. The 'bid-offer' on haircuts going into the negotiations was 95% (U.S./U.K.) and 50% (Europe/Russia).[47] However, an 80% write-down was the likely outcome from the beginning. The U.S. delegation and the head of the Paris

[47] Paul Wolfowitz pushed for 100% initially, then lowered the opening offer to 95% alongside the U.K. (Buchheit 2019; Momani and Garrib 2010, p. 162). The White House deferred the final decision to the Treasury.

Club had agreed on the number beforehand as a realistic compromise (Wethington 2019). The U.S. delegation would negotiate with everyone who wanted a complete write-off, mainly the Iraqis and parts of the U.S. government (ibid). The Paris Club secretariat would try to get the Europeans and Russians up from their 50% haircut, while the U.S. would negotiate everyone else down to 80% (Wethington 2019; Weiss 2011, p. 6).[48]

The atmosphere was tense, and the last credit holdout was Russia. The general sense was always that a reasonable compromise could be reached through diplomacy (Buchheit 2019). At the Asia-Pacific Co-operation summit (Chile, November 2004) Bush personally got involved to close the deal with Putin. Three bilateral meetings at the summit's margins were required before Putin agreed to the 80% nominal haircut (Pam 2019; Khalaf 2004).[49] In fact, the last holdout at the Paris Club was Iraq, which attempted to get 100% debt relief (Wethington 2019). All creditors met on November 21, 2004, a Sunday in Paris, expecting an agreement, but Iraq held out and only agreed a few hours after the deadline had passed (ibid).[50] The deal was struck, with the following terms outlined in the Agreed Minutes (Paris Club 2004):

- Debt reduction of 80% in three tranches:
  - 30% immediate debt cancellation, as of January 1, 2005.
  - 30% additional debt rescheduling for 23 years, with a six-year grace period, conditional on approval of a standard IMF program.
  - 20% of initial debt stock debt rescheduled after three years on similar terms, conditional on review of the IMF program (but no means testing).
- A six-year grace period for principal repayments, and a three-year grace period for (full and partial) interest rate payments.
- An interest rate of 6%.
- Voluntary debt-for-debt swaps.

[48] The U.S. helped bring 'up' several of the holdouts, too (Wethington 2019).
[49] The Russian Finance Minister had been un-responsive until then, for reasons unknown.
[50] The Iraqi negotiators were the Finance Minister (Adel Mahdi), the Central Bank Governor (Sinan Al Shabibi), and Iraq's legal advisors, Cleary Gottlieb (Lee Buchheit).

- Comparable treatment of other external creditors.
- Net present value debt reduction of 89.75%.

The deal was harsher on creditors than other restructurings during the same period. Sturzenegger and Zettelmeyer (2008) show haircuts on debt restructured between 1998 and 2005 ranged from 13% (Uruguay 2003) to 73% (Argentina 2005). Haircuts were spread out, rather than taken up-front, mostly for accounting and budgetary reasons. All countries have different accounting rules and the haircut would influence each country differently (Lowery 2019). If haircuts are spread out, losses can be booked over many years (Festekjian 2019). Several countries—Germany prominent among them—had not marked down their loans. Any write-off would hit the budget in year one, if it was front-loaded (Kelleners 2012; Lowery 2019).[51]

Lazard Frères was brought on as financial advisors to execute the deal. In December 2004, the U.S. forgave 100% of its $4.1 billion claim (Weiss 2011, p. 6) while all other Paris Club members restructured according to the initial terms.[52] Next, the focus turned to the remaining creditors. With an almost 90% net-present value reduction of debt, Iraq had the terms to offer its other creditors.

4.3 Bilateral (non-Paris Club) debt negotiations

Other bilateral creditors comprised two categories: Gulf States and countries not in the Paris Club, like China. The Gulf States were the largest creditor overall with $53 billion of debt. Iraq hired Houlihan Lokey Howard & Zukin as financial advisors, and Houlihan oversaw educating the countries on what the Paris Club deal entailed (Pam 2019). The IMF DSA had assumed comparable treatment on the rest of the creditor universe. All countries were IMF members, and this helped obtain agreements in principle from bilateral creditors. It meant that,

[51] Even though the loans had been on the books for many years and were clearly worthless; a haircut would be treated as a revenue hit.

[52] In 2011, Iraq settled with some U.S. citizens for damages during the First Gulf War (State Department 2011).

even if they did not restructure, they would not obstruct the restructuring moving forward (ibid). A key point was the 'evidence of indebtedness' clause. It meant each new loan superseded and replaced any old contracts (Deeb 2007, p. 7). Old debt would be gone, and Iraq would have a known stock of external debt.

Most of the smaller creditors settled over the following few years. The Czech Republic, Hungary, Indonesia, Malaysia, Romania, and South Africa all settled on Paris Club terms, while Bulgaria, Bosnia, Serbia, and Slovenia settled on Paris Club-like terms for debt owed to former- Yugoslavia.[53] Slovakia, Cyprus, and Malta wrote off all debt (SIGIR 2008, p. 138). Others took a bit longer: China restructured its $8.5 billion claim in 2010, having originally pledged to do so as early as 2007 (AP 2010). The UAE wrote off its $4.2 billion debt in 2012 (Dajani 2012). Egypt was difficult and did not settle until 2015, and even then, it only did so in exchange for oil shares (Aman 2015). The outstanding issue was a tie-up of worker remittances from Iraq. The remittances had been delivered to Iraqi banks but had been stolen before they could be sent to Egypt (Marcus 2019). It was unclear if the remittances could be defined as debt, which stalled negotiations. The countries which took a long time to settle all had similar outstanding issues.

The largest Gulf State creditors were Saudi Arabia ($39 billion), Kuwait ($8 billion), Qatar ($1.5 billion), and Jordan ($1.3 billion); to this date none have restructured. The Gulf States were opposed to debt relief in late 2003, having all been on the receiving end of Saddam's wars (Momani and Garrib 2010, p. 167). Several soft pledges to restructure on Paris Club terms were made at the height of the restructuring talks in late 2004, but nothing came of them. In fact, Iraq and Saudi Arabia could not even agree on how much debt was outstanding (ibid, p. 168). As of 2019, Saudi Arabia still considers it is owed money, with the Foreign Minister, Adel Al-Jubeir, denying it has written off anything (Memo 2017). The second largest creditor, Kuwait, refused to budge as well. Similarly, Qatar. Much of the Iraqi debt was incurred in its war against Kuwait, and the small

[53] They were essentially the same; some took a bit of a larger haircut to get some cash up front.

state has tied this to national recognition. There is no evidence either Kuwait or Qatar has officially restructured any debt, despite significant international pressure early on. Jordan has a large claim—having been a long-term trading partner of Iraq (Marcus 2019)—but has not provided any documentation. The claim is still outstanding. Presumably, there is a reason they have not tendered, likely to do with ineligibility.[54]

By 2008, the last phase for Paris Club write-down was complete. By 2019, 65 out of 73 sovereign creditors had restructured, with the remainder mostly consisting of Gulf State uncollected debt.[55] By late 2008, the Iraqi debt overhang was no longer a priority, with an implicit understanding that the Gulf States would not push for repayment (Lowery 2019; Marcus 2019). By 2019, the immunization of Iraqi oil has lapsed, and sovereigns rarely pursue other sovereigns.

4.4 Commercial claims

Dealing with the Paris Club and other governments was high politics, while the commercial restructuring was more operational in nature (Wethington 2019). The commercial restructuring deal-offer was given in 2005 and was fixed at Paris Club terms, with JP Morgan and Citi brought in as financial advisors to deal with the so-called London Club of large commercial creditors.[56] The structure of the deal was decided by the Iraqi government, following advice from JP Morgan, Citi, and Cleary Gottlieb (Pam 2019). The key things to decide for the structure were (i) past due interest, i.e. how much each claim had in accrued interest; (ii) whether to offer a cash-for-debt or a debt-for-debt swap; and (iii) how to reconcile claims.

[54] It could be that loans violated U.N. sanctions.
[55] Paris Club press release, December 22 (2008): *The Paris Club delivers the 3rd phase of debt reduction for Iraq*. I have been unable to find evidence that the following creditors have restructured: Brazil, Greece, Jordan, Kuwait, Pakistan, Poland, Qatar, Saudi Arabia, Turkey.
[56] Iraq is unlike most Paris Club deals where the debtor leaves wanting to escape comparability of treatment; here the clause was used to force commercial creditors to accept the deal (Buchheit 2019).

Each claim would receive 10.25% of its accrued value. All loans would accrue at a fixed interest rate from the date of default, Libor + 75bps, according to the Reconciliation Methodology which was developed by the financial advisors.[57] It did not matter if the debt had a contract that accounted for past due interest; all claims were treated equally. The French banks pushed hard for adhering to contracts when calculating the spread over Libor. This would have benefitted the banks and larger claimants at the expense of smaller ones and was dropped in favour of treating everyone equally (Buchheit 2019). Most small commercial claims were trade credits, with no interest rate specified in the contract (Festekjian 2019). The larger creditors, mostly European banks, held letters of credit or outright loans. The accrual rate was thus a good deal for all trade credit claims (ibid).[58]

The deal was a debt-for-debt swap, because Iraq did not have enough cash to pay all its creditors (ibid). Bonds were issued in return for restructured debt, but only for the largest creditors. Everyone owed more than $35 million in principal was offered a debt-for-debt deal, while smaller creditors—legally unable to hold external bonds—received cash. Issuing bonds had been preferred by JP Morgan and Citi (who make a living trading bonds) but had some backing in Iraq, too—at least officially (Chung and Fidler 2006). The lawyers advised against a debt-for-debt swap, because all bond prospectuses included risk assessment disclosures, which would not align with the propaganda coming out of the White House in 2005. For political purposes, Cleary Gottlieb suggested an all-cash offer on comparable terms to the Paris Club (Buchheit 2019). The lawyers also wanted aggregate Collective Action Clauses (CACs), even though only one bond was being swapped into a 5.8% coupon bond, maturing in 2028. The reason behind this was to make it easier for Iraq to re-open the tap or issue more bonds should it need to in the future. It ended with a compromise, as JP Morgan and Citi would only

[57] Reconciliation Methodology, exhibit C: http://www.eyidro.com/recon-method.pdf (accessed on July 23, 2019).

[58] The claims came in different currencies—mainly US dollars, Yen, and European currencies—but given the claims pre-dated the Euro's existence, a formula for converting the old currencies was worked out (Festekjian 2019).

agree to single-issue CACs, which was the market-standard at the time, rather than second-generation CACs (ibid).[59] The lawyers did not considered using first-generation CACs a deal breaker at the time and did not push (ibid).

The main issue for settling commercial claims was reconciling outstanding debt.[60] Ernst and Young (E&Y) was appointed as reconciliation manager, working out of Jordan. Debt had to meet the following definitions to be eligible:[61]

1. Evidence of written agreement.
2. Entered before sanctions (August 6, 1990).[62]
3. Fit the definition of credit.
4. Be external debt (defined as debt in all currencies except Iraqi dinars).

If the claim had not been sold and E&Y could reconcile it to available documents, it would be settled. Because the debts were so varied, they were all treated equally in terms of eligibility, regardless of governing law and currency. Nonetheless, about 817 claims (out of a total of 11,776) could not be reconciled, and a special arbitration panel was convened. From the moment a claim was submitted, the panel's decision became final, with about half of claims awarded to claimants (Buchheit 2019). In normal restructurings, creditors have Euroclear or DTCC numbers to certify their claim, which are mostly external bonds. Here, creditors turned up in Dubai and Jordan with boxes of paper (Festekjian 2019). One man from India even showed up to a creditor meeting in Dubai with an old fax, showing a claim and wanting to be paid. He was kindly asked to submit his

[59] Also called first-generation CACs, working within one bond issue rather than the whole range (see Section 2).
[60] Cleary Gottlieb knew of several precedents of how *not* to do it. In 1975, Nigeria ordered 16 million tons of cement to arrive within a year to plug a shortage, far exceeding port capacity (Marwah 2018). The result was a run-up in trade debt that needed to be settled. The government took out a newspaper ad, asking anyone it owed money, to contact them. Obviously, a lot of people did—Nigeria was inundated with claims, entangling it in a debt reconciliation nightmare. It settled only one-third of the claims (Buchheit 2019).
[61] Adopted from the Iraqi Ministry of Finance's *Memorandum for potential holders of claims, January 30,* (2008).
[62] Somewhat ironically, the statute of claims according to both New York and English law is six years, so claims had expired. As claims were made under a plethora of different legal standards, however, the offering document specified that by submitting a claim, claimants agreed to forgo the right to sue.

claim to E&Y (ibid). Another gentleman had delivered $10,000 worth of frozen chicken to the docks in Basra the morning the sanctions began (Buchheit 2019). He was not paid. Sovereign debt restructurings do not normally include such unusual claims.

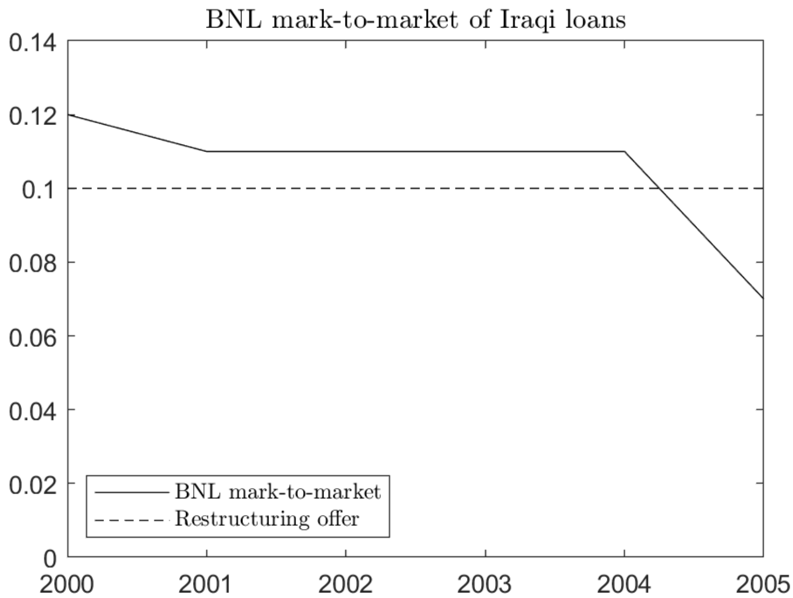
Once the parameters were set, Iraq published the commercial debt offer on July 25, 2005. JP Morgan and Citi arranged meetings with individual creditors in Dubai to market the settlement. It was a take it or leave it offer, with no creditor committee negotiations. Five creditor committees were created nonetheless, none representing all creditors. The largest, the London Club Coordinating Group, represented European and Middle East banks while the others were the Washington Club, the Iraq Creditors Club, the Korean Creditors Coordinating Committee, and the North African Trade Creditors Committee (Buchheit 2009, p. 211). Advisors took the view that negotiating individually would be fatal, as it would negate the Paris Club deal if terms were improved. The argument for equal treatment was made by the Iraqi Central Bank Governor in 2005, in a letter to one of the creditor committees. The problem raised by the Governor was not that the creditor committees made invalid points, rather that *all* had valid points. It was thus impossible to accommodate one group over another (the full letter is available in Appendix A).

The offer was considered fair by everyone. A way to evaluate the offer is to compare it to what the larger creditors had marked loans at in their books. Remember from Section 0, the largest commercial creditor was the Italian bank, BNL. BNL held $3.4 billion worth of loans (in notional and accrued interest) to Iraq and its state-owned banks, classified as non-performing loans. The loans figure in BNL annual reports from 2000, marked to their fair value.[63] They are listed explicitly in terms of accrued value and can be compared directly to the settlement offer. From 2000 to 2004, BNL valued the loans at between 10% and 12% of accrued value. In 2005, when the exchange happened, they received $683 million worth of the 2028 bonds, valuing them at $239 million in their annual report,

[63] Presumably.

with the loans moving from "non-performing" to "performing" (BNL 2005, p. 64). Figure 5 shows the restructuring offer and the BNL marks in the years leading up to the restructuring. BNL's accounting valuation would suggest the offer of 10.25% of accrued value was fair.

Figure 5: BNL mark-to-market of Iraqi loans (% of nominal and accrued).



Source: BNL annual reports (2000, 2001, 2002, 2003, 2004, 2005).

This is not to say that commercial creditors did not complain about being strong-armed; they did (Chung 2005). They also accepted the offer. The commercial debt settlement offer was made on July 26, 2005. By December, all large creditors had accepted ($14 billion), triggering the second phase of the Paris Club, the IMF stand-by agreement of January 2006, and a 30% further debt reduction (Chung and Balls 2005). The deadline for large commercial creditors to submit claims was fixed and creditors who had earlier proclaimed they would not participate showed up with boxes of claims in hand, on the day (Festekjian 2019). A year later, on July 18, 2006, the restructuring was essentially complete.[64] In total,

[64] Press releases announcing settlements and participation rates are available at the Government of Iraq Debt Reconciliation Office, run by Ernst & Young at: http://www.eyidro.com (accessed on July 12, 2019) and the Paris Club website: http://www.clubdeparis.org/en/traitements/iraq-21-11-2004/en (accessed on July 15, 2019).

11,776 individual Saddam-era claims were tendered (817 went through arbitration). Of 491 commercial claims, 96% of eligible claims (as considered by E&Y) accepted the deal, for a total of $19.7 billion, according to the Ministry of Finance.

Two facts made the commercial restructuring a lot easier than that of the Paris Club. First, the immunization of Iraqi oil assets was helpful in marketing the commercial offer (ibid). It meant potential holdouts would have to wait a long time to collect, versus up-front payment on delinquent loans now. It took away the legal options for any vulture funds, who broadly speaking did not engage (Buchheit 2019). Second, commercial creditors—as opposed to governments in the Paris Club—must mark non-performing loans down, and as shown above the offer was about fair value, or better. It did not hit anyone's profit-and-loss statement.

4.5 Future lessons and missed opportunities

The restructuring was a success, insofar as it removed the debt overhang and allowed Iraqi output to outgrow the debt stock.[65] Government debt-to-GDP in 2019 was 50%, mostly thanks to output growth rather than an outright fall in debt. The composition of the debt stock has also changed. External debt has fallen to 34% of GDP, much of it loans to the Gulf States that have been de-facto cancelled. Iraq has increased its stock of local debt (in dinars) since the restructuring, although it has also increased its foreign exchange reserves. Table 7 shows outstanding Iraqi debt.

[65] The restructuring only. Iraq cannot be considered an economic or security success.

Table 7: Iraqi debt by creditor, 2019.

	Outstanding debt ($ billion)	% of GDP
Paris Club	6	3%
Gulf States	49	22%
Non-Paris Club official	18	8%
Reparations (non-debt)	4	2%
Commercial debt	-	-
External $ bonds	5	2%
Local debt	36	16%
Foreign exchange reserves	-65	-29%
Total debt (ex-reparations)	**113**	**50%**
Total net liabilities	**53**	**23%**

Sources: IMF data for overall debt stock and GDP. Paris Club levels are based on term loans outstanding, sourced from Bloomberg; see Section 0 for Gulf States. Non-Paris Club debt is the residual and includes IMF and World Bank loans. Reparations outstanding as of December 2019 is for damages to oil-assets in Kuwait; commercial debt was restructured and therefore nil. External and local debt is the total outstanding as per the Central Bank of Iraq. Foreign exchange reserves are a negative number as they are Iraqi assets, for consistency (like Table 1).

The Iraqi debt explosion was awesome in size, when compared to any country or period in history. Few historical precedents exist in the intersection of post-conflict reconstruction, debt relief, and international political pressure.[66] Sovereign restructurings had changed a lot in the twenty years before the Iraqi case, yet oddly it stands out as going somewhat against the grain of the time. The haircut was much larger than other restructurings; there was political pressure; and laws were changed to accommodate political goals. The Evian approach—which split up heavily indebted poor countries (HIPC) and non-HIPC relief—showed how flexible the Paris Club could be, a key factor in reaching the final deal. Immunizing Iraqi foreign assets was and is largely unprecedented (Buchheit and Gulati 2019).

In that sense, the Iraqi restructuring has important lessons for the future. If oil-rich countries with lots of foreign assets need to restructure debt, it requires outside political will (an obvious example is Venezuela, as noted by Buchheit and

[66] A few were mentioned by participants in the restructuring. The closest was perhaps the German debt relief of 1953, when the London Debt Agreement cut external German debt in half, contributing to a successful reconstruction after World War II (Galofré-Vilà et al. 2019). Another is Polish debt relief in the early 1990s. Poland got a Paris Club deal that cut its debt stock in half, received IMF help from 1990-5, and turned things around in its re-entrance to the Western world (Boughton 2012, p. 438-42).

Gulati 2018). In a time when creditors can exclude countries from financial markets—because most transactions flow through London or New York—Iraq offers a template to force creditors to restructure. It requires political will, though: Any restructuring would run head-first into issues of *pari passu* and creditor lawsuits. The extent to which politics permeated every aspect of the Iraqi debt restructuring to circumvent legal issues cannot be stressed enough.

The Iraqi debt restructuring was therefore also a case of missed opportunities. The build-up of debt in the 1980s documented in Section 3 shows that all Iraqi debt was political war debt. It originated from the U.S. and its allies to support the Iraqi war effort in the 1980s. The debt was not for the people but in the name geopolitics, leaving the Iraqi people saddled with debt and an oppressive regime, which was personally enriched (Blau 2003).[67] If a doctrine of odious debt has any place in international law, a good place to start could have been BNL's loan to Iraq as described in Sections 0 and 0. There is no doubt that going to the Paris Club instead of declaring Iraqi debt odious was politically expedient, but it left unanswered who was at fault.[68] It allowed the creditors to settle debts owed without answering any uncomfortable questions of why loans were extended in the first place. Instead, the Paris Club deal, and the subsequent commercial restructuring, swept under the rug any debate about the moral of paying creditors at all.

5. Conclusion

In this paper, I showed that Iraq's entire debt stock was a consequence of the geopolitics of the Iran-Iraq War, during which Iraq benefited from American, European, and Gulf State support. The U.S., the Soviet Union and many European countries showed a willingness to disregard solvency concerns and gave loans to Iraq on non-market terms. In less than fifteen years, the war turned Iraq from a

[67] According to Blau (2003) estimates of Saddam's personal net wealth ranged from $2 to $40 billion.
[68] The U.S. also favoured the Paris Club over the Sovereign Debt Restructuring Mechanism (SDRM) proposed by the IMF (2003), an orderly legal framework to restructure sovereign debt.

net creditor in 1979 to having a government debt-to-GDP ratio of over ten. Its economy and institutions crumbled, and while Iraq was victorious militarily, it emerged from the war with Iran a failed state. As the geopolitical tide turned against Iraq after its invasion of Kuwait in 1990, Iraq was defeated and isolated by sanctions. It owed money to everyone; from Gulf States to the developed world, from banks to individuals. The Iraqi debt overhang at the time of the U.S. invasion in 2003 was devastating and restructuring it was a priority.

A problem in sovereign debt restructurings is that they are increasingly creditor friendly. Creditors sue if they are treated harshly, cutting off countries in default from the global economy. It is possible because money flows through a few concentrated financial centres, and most external debt is governed by New York or English law. The Iraqi restructuring came amid these changes yet circumvented the obstacles they represented. A unique feature is that the international community immunized Iraqi oil assets, leaving creditors with few remedies but to settle. I find the restructuring was unlike most other sovereign debt restructurings at the same time. Sovereign creditors were placed under immense political pressure by the U.S. to forgive debt, with the Paris Club deal inflicting large write-offs on Iraqi creditors. However, the Iraqi debt restructuring was a missed opportunity to set an important precedent by declaring Iraqi debt odious. Iraq had vast political backing from a U.S. hegemon, and while the deal was ultimately successful in writing off Iraqi debts, it lost out on reforming how sovereign debt is restructured.

Appendix A: letter to creditor committees

Letter from: Sinan Al Shabibi, Governor of the Central Bank of Iraq, in 2005.

To: The London Club Coordinating Group; The Washington Club; The Iraq Creditors Club; The Korean Creditors Coordinating Committee; and The North African Trade Creditors Committee.

"Over the past year, Iraq has consulted, individually and in groups, with many of [its] creditors. We have heard a common theme in these discussions. Claimants falling into each category (bilaterals, banks, contractors, suppliers, individuals, etc) have advanced plausible arguments for the proposition that—whatever Iraq's final settlement offer may be—their group should receive preferential treatment vis-a-vis other types of claimants. To give you just a flavour of these arguments:

- The bilaterals say they lent at below-market rates while commercial creditors advanced money at full market rates and took the corresponding full credit risk.
- The commercial claimants say that the bilaterals were lending to further their geopolitical or export development objectives and should therefore be subordinate to normal commercial counterparties.
- The commercial banks say that their support will be crucial in Iraq's reconstruction program and therefore they, above all others, must be treated gently in the restructuring.
- The trade suppliers say that the weight of sovereign debt restructuring precedents confirms that trade creditors should be exempted from, or treated more leniently in, any sovereign debt rearrangement program.
- The commercial companies say that they are not, like many other claimants, in the business of lending money or assessing (and bearing) sovereign credit risk.

- Construction companies ... note that they have worked on facilities that still provide critical services to the people of Iraq during this very difficult period.
- Individuals say they are individuals.
- The problem is not that these are illegitimate arguments; the problem is that they *all* have some element of legitimacy. But faced with this wide and contradictory array of positions, the Government of Iraq has concluded that the only fair and practicable course of action is to accord an even-handed treatment to all of the country's Saddam-era claimants."

Source: Buchheit (2009, p. 211).

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