The Iraq debt restructuring: A study in odious debt

Simon Hinrichsen

London School of Economics

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Motivation: Explain this

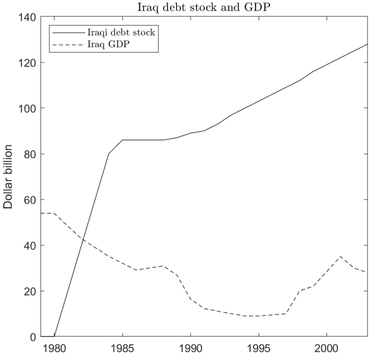

Figure 1: Iraq debt and GDP.[1]

[1] Source: See Hinrichsen (2019).

This paper

This paper finds:

- Almost all Iraqi debt was political war debt, which was defaulted on. Unlike most other cases (Shea and Poast 2018).
- Iraq most indebted nation in the world in 2003. Needed a restructuring. Problem: restructurings were creditor-friendly affairs.
- Political brute force circumvented creditors, inflicted large write-offs. Successful in the "classic" sense.
- But, missed opportunity to institute a doctrine of odious debt.

Paper tells story of the complex restructuring via primary sources, new collected data on debt, and interviews with key players (US/European officials, lawyers, bankers, academics).

Background: enforcement of sovereign debt

- There is no bankruptcy regime for sovereign debt. Largely ad-hoc affairs (Gelpern 2016; Sgard 2016).
- Before 20th century, military force was a common enforcement tool for sovereign debt. Less common since (Mitchener and Weidenmier 2010).
- Until the 1950s countries were effectively immune from legal action in case of default (Gelpern 2005).
- In 2009, almost all international bonds issued by emerging market countries were governed by New York or English law (Das et al. 2012).
- Makes debt enforceable by holdout creditors, because money flows through London/NYC (Schumacher et al. 2018). Argentina pari passu case in point (Buchheit and Gulati 2017).

Background: odious debt

- Debtors can play the game as well. CACs attempt to circumvent holdouts.
- Odious (or illegitimate) debt not really considered (Jayachandran and Kremer 2006).
- Definitions of odious debt differ (Bucchiet et al. 2007); existence in law debated (King 2016).
- Few invocations of odious debt. Exception: Ecuador in 2008 (Gelpern 2010).

Background: Iraq history

Some authors have told parts of the story (e.g. Rangwala 2013; Momani and Garrib 2010). Debt history (1979-2003) told in earlier paper (Hinrichsen 2019). In 2003:

- No one really knew the debt status in 2003 after years of sanctions, then bombings.
- No IMF Article IV consultation since early 1980s.
- All entities owed money. SOEs, banks, ministries, quickly included. Reparations left out.

Three main tools for debtors: maturity extension, haircuts, coupon adjustments.

Iraq debt in 2003

	Outstanding debt (dollar billion)	Percent 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

Figure 2: Iraqi debt by creditor, 2003.[2]

First 'soft' default in mid-1980s. Hard default since sanctions.

[2] Sources: Paris Club, IMF, UNCC.

Initial steps (2003)

U.N. Resolution 1483 governed the post-invasion:

- Lifted sanctions.
- Terminated the Food-For-Oil program.
- Structured post-invasion government (CPA).
- Set up the Development Fund for Iraq (DFI).
- Called for a debt restructuring and for members to immunized Iraqi oil sales from creditor attachment.

Iraqi assets were held at the central bank. DFI immune under U.N. privileges. The Trade Bank of Iraq (TBI) established later to facility import/exports, also immune.

Paris Club first stop (2003-04)

First stop Paris Club, normally for flow treatment. Stock reduction came first (Evian Approach). Debt sustainability largely a function of oil. The IMF DSA was...special:

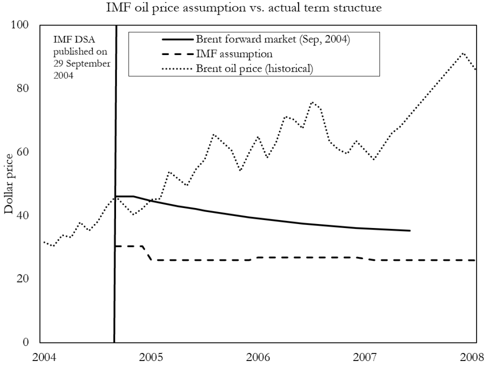

Figure 3: IMF oil price assumption vs. actual term structure.[3]

[3] Sources: Bloomberg; IMF; Paris Club.

Paris Club (2003-04)

Long, painful, political negotiations. Bush had to twist Putin's arm. The agreement was:

- 80 percent haircut on debt.
- 6 years grace period for principal repayments, 3 years for interest rate payments.
- Interest rate of 6 percent.
- Voluntary debt-for-debt swaps.
- Comparable treatment of other external creditors.
- NPV reduction of 89.75 percent.

Much harsher on creditors than other restructurings at the time.

Bilateral (non-Paris Club) creditors (2004-19)

Other bilateral creditors: Gulf States and countries not in the Paris Club (like China):

- No luck: Gulf States, with USD 53 billion of debt. Saudi Arabia (39 billion), Kuwait (8 billion), Qatar (1.5 billion), and Jordan (1.3 billion).
- Restructured: Czech Republic, Hungary, Indonesia, Malaysia, Romania, and South Africa all settled on Paris Club terms. Bulgaria, Yugoslavia, Bosnia, Serbia, and Slovenia settled on Paris Club-like terms. Slovakia, Cyprus, and Malta wrote off all debt.
- Took longer: China restructured in 2010 (amount unknown), The UAE wrote off 4.2 billion debt in 2012. Egypt was difficult and did not settle until 2015.

By 2019, 65 out of 73 sovereign creditors has restructured.

Commercial creditors (2005-06)

The offer restructuring offer was harsh in NPV-terms:

- Debt-for-debt swap fixed at Paris Club terms. First generation CACs. Cash for small claims.
- Each claim would receive 10.25 percent of its accrued value.
- All loans would accrue at a fixed interest rate from the date of default, Libor + 75bps.

Most small claims were trade credits with no interest rate specified in the contract. EY appointed reconciliation agent and had to approve all claims. No overall assertion of odious debt, but reserved the right to do so for specific claims.

Commercial creditors (2005-06)

Commercial creditors complained. A lot. They also accepted the offer. Was it fair? Broadly yes, looking at BNL's marks.

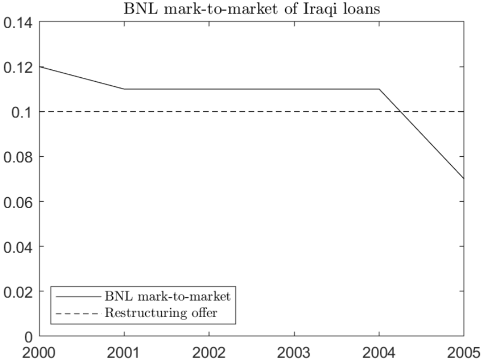

Figure 4: BNL mark-to-market of Iraqi loans.[4]

[4]Sources: Annual reports.

Results

The restructuring was big. It stands out as going somewhat against the grain of the time.

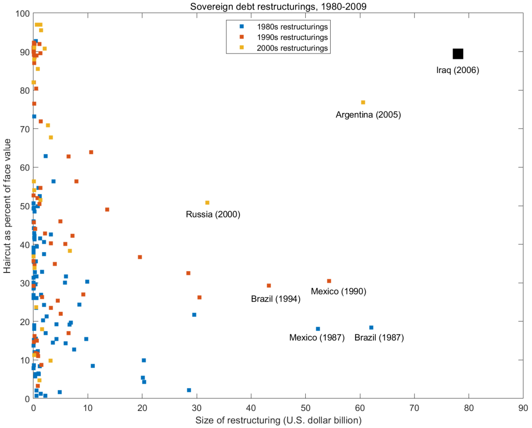

Figure 5: Haircuts and size of restructurings (1980-2009).[5]

[5]Sources: Cruces and Trebesch (2013), except Iraq data which is from this paper.

Iraqi debt in 2019

The restructuring was a success. Arguably the only thing the Coalition did well.

	Outstanding debt (dollar billion)	Percent 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

Figure 6: Iraqi debt, 2019.[6]

[6] Source: IMF; Central Bank of Iraq.

Odious debt

Hard to figure out how serious the debate around odious debt was

- The "standard" institutions were against: Treasury, IMF, lawyers, bankers.
- But support inside Iraq, outside groups ('Jubilee'), think tanks, academics, Pentagon, White House?
- Perhaps creditors wanted to avoid enshrining a doctrine of odious debt into international law, made it easier to settle.
- A good place to start would have been BNL's loan.

Paris Club was politically expedient, but it allowed creditors to settle debts owed without answering any uncomfortable questions about why loans were extended in the first place. Instead restructuring swept under the rug any debate about the morality of paying creditors at all.