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Understanding Iraq's debt: An overview of its status, outlook and origins

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Understanding Iraq’s debt: An overview of its status, outlook and origins

Ahmed Tabaqchali *

Iraq’s massive needs for reconstruction, after more than 35 years of conflict, cannot be met by its current revenues from its considerable hydrocarbon resources alone, and thus it needs to resort to debt to augment funding this reconstruction.

However, discussions within Iraq about the country’s debt are emotionally influenced by several factors, some of which are perceptions of debt as a weakness or as a burden. Perhaps the most powerful emotion is that rooted in Iraqi nationalism and the struggle against foreign occupation that sees debt as tool to hold the country hostage and ultimately to recolonize it[1].

This aversion to debt, until the Iraq-Iran war, was such that Iraq paid for goods and services on a current basis, i.e. with a minimum assumption of trade credits. Moreover, it was almost free of foreign loans apart from a number of loans extended by the ex-Soviet Union and the ex-Eastern bloc that were paid for in oil[2].

The Iraq-Iran war changed all of this as Iraq built a massive debt load to finance an eight-year war and simultaneously maintain a generous socialist system. It subsequently incurred further debts in the form of reparations for the invasion of Kuwait, and the accumulation of interest on earlier debt during the sanction years. The existence, let alone magnitude, of these debts were not known by Iraqis during the Saddam years, but featured heavily in the national discourse in the early years following 2003 when the debts were restructured, but soon took a back seat to the subsequent civil war. Ultimately, most of the focus was on the mismanagement of the country over the following years.

1. The roots of this belief can be traced to the mid 1870’s when Egypt lost control of the Suez Canal as it sold its 44% share in the “Universal Company of the Suez Maritime Canal” to Britain to pay for the massive debts incurred in modernizing the country. The Suez crises of 1956 following the nationalization of the canal by the nationalist Pan Arab regime of Nasser and the subsequent Anglo-French-Israeli assault on Egypt, only served to ingrain this in the nationalist Iraqi psyche. http://www.bbc.co.uk/history/british/modern/suez_01.shtml

2. Footnotes 23 & 24 from: https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1091&context=facpubs

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However, the signing of the IMF Stand-By Agreement (SBA) in June 2016 revived the national debate over debt, which intensified following the end of the ISIS war and the massive need for funds for reconstruction. The perceived failure[3] to raise sufficient donations from the Kuwait Conference on the reconstruction of Iraq, and thus the need for more foreign loans led to a stream of warnings in Iraqi media from politicians, economists and experts that the debts were crippling the country, burdening future generations and holding Iraq hostage to foreign powers. The public anger over mismanagement of the country, that started with countrywide demonstrations in the summer of 2015, has added this to the list of the failures of the political class.

Much of that debate is out of context, mixes loosely related facts and figures and mostly comes without an understanding of the concept of debt or debt servicing costs or debt sustainability. Much of the media coverage or analysis is jingoistic, laden with conspiracy theories and economically illiterate.

This reports's aim is to provide an understanding of Iraq's debt, its origins, developments, status and implications for the future in dealing with the challenge of reconstruction. It is not meant to be an in-depth detailed analysis of this debt, the numbers provided are approximate and rounded for ease of understanding.

The growth in debt after 2014

The double whammy of the ISIS invasion of the country in 2014 and the collapse in oil prices had a devastating effect on the economy as government finances were crushed by soaring expenses and plummeting revenues. To meet the increasing needs of the ISIS war, the government was forced to make dramatic cuts to its investment spending and resort to borrowing to fund its bloated current spending (wages, subsidies and the welfare system) [4]. The IMF Stand-By Agreement (SBA) of 2016 provided the framework for the build-up of sustainable debt provided

3. These misconceptions were addressed by the author in an article at http://www.iraq-businessnews.com/2018/02/22/its-not-the-donations-stupid-key-points-from-kuwait-conf/

4. A report by the author discusses this dynamic and the government's response at http://www.iraq-businessnews.com/2017/07/17/economic-consequences-post-mosul/. Some highlights of which are "The government maintained overall spending on salaries and pensions, but introduced new and increased existing consumption taxes on a large number of consumables while it also increased utility prices. Non-oil investments bore the brunt of the cuts as the government sharply curtailed all capital spending and investments."

an adherence by the government to the requirement to scale back the state and to encourage the development of the private sector. The regular reviews of the SBA between the IMF and Iraq set off the mechanisms of this process, while the estimates for the 2017-2022 budgets provided the basis on which Iraq and the IMF identified creditors and donors to fund the expected budget deficits. The last detailed assessment was the second review for 2017 in August 2017 (country report 17/251) which provides the foundation for this report.

The table below looks at the debt picture as of 2014, as it was the year that ended the country's relative prosperity, the current state of debt as of 2017 and its future projection for 2022.

Table 1: GDP and debt: 2014, 2017 & 2022 [5]

	2014A	2017E	2022E
GDP ($bn)	234.7	192.7	256.2
Iraqi oil prices ($/bbl)	96.5	45.3	47.1
Oil exports (mbbl/d)	2.6	3.8	4.1
Total debt % of GDP	32.0%	63.8%	52.1%
Total debt ($bn)	75.2	122.9	133.4
External debt % of GDP	24.8%	38.3%	27.9%
External debt ($bn)	58.1	73.7	71.4
Domestic debt % of GDP	7.2%	25.5%	24.2%
Domestic debt ($bn)	17.1	49.2	62.0

A = Announced, E= Estimates, $ = USD, mbbl/d =million barrels per day, bbl= barrel

5.Data based on IMF Country report 17/251 at http://www.imf.org/~/media/Files/Publications/CR/2017/cr17251.ashx.

The IMF has since then updated its GDP estimates higher, reflecting higher oil price assumptions in its World Economic Outlook (WEO) April 2018 and Regional Economic Outlook (REO) May 2018:
https://www.imf.org/en/Publications/WEO/Issues/2018/03/20/world-economic-outlook-april-2018
http://www.imf.org/en/Publications/REO/MECA/Issues/2018/04/24/mreo0518 (data only until 2019)

Updated IMF estimates are mostly high-level figures without the extensive details provided in 17/251. Crucially, they don't provide debt sustainability figures or debt composition data. Hence, figures from 17/251 are used throughout this report and to ensure consistency with other data used. Use, however, will be made of updated data to reflect the potential future variance which is essential for understanding Iraq's debt trajectory.

Debt and debt/GDP ratio in context

The important point to understand about debt is not its size per se, but its composition, the interest rate it carries, and the ability of the country to service this debt without placing undue constraints on the economy at large. This is often referred to as debt sustainability, and one of main tools used is the debt as a percentage of GDP or debt/GDP. Other essential tools that are part of the analysis are debt payments as a percentage of GDP or as percentage of exports, however, the discussion below focuses on debt/GDP as it is most often cited in Iraq's debt coverage.

While there are no ideal levels for debt/GDP, given the role of the other tools, yet a 60% debt/GDP is used as a threshold in many debt targets, while 70% is used as a risk flag. As such the specific levels of debt/GDP for current and future years not only affects Iraq's ability to assume debt, but the amount of debt raised and the interest rate it carries[6].

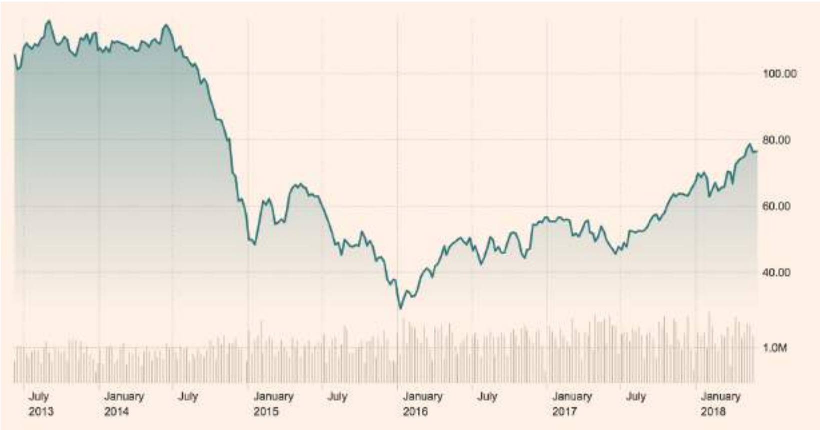
The next to understand is that the amount of debt at any given time is fixed while GDP for the current and future years is an estimate which depends on a number of variables. Moreover, the GDP used is nominal GDP, defined as the total value of a country's annual output of goods and services valued at current prices[7] for the current year and estimated prices for future years. Given oil's dominance of Iraq's economy[8], it has an oversized relevance for GDP estimates in light of the extreme variability of oil prices over the last few years (Brent price chart below) and the impossibility of accurately estimating future oil prices.

6. A brief explanation of debt/GDP is at: https://www.investopedia.com/terms/d/debtgdpratio.asp
A chart of debt/GDP for Iraq vs. other countries is at: https://tradingeconomics.com/country-list/government-debt-to-gdp

7. https://www.economist.com/economics-a-to-z/g

8. Oil exports accounted for 99% of all exports, oil revenues accounted for 87% of government revenues which in turn accounted for 32% of total GDP. Moreover, oil-GDP accounted for 38% of total GDP and indirectly accounts for the bulk of non-oil GDP as the government's orders drive non-oil GDP. Source: IMF Country Report No. 17/251, August 2017.

Figure 1: Brent Crude July 2013-May 2018



Source: The Financial Times

The effects of oil prices and export volumes on the value of GDP, and the subsequent effects of the changes of debt on debt/GDP can be seen in their evolution from 2014 to 2017. Debt grew from $75.2bn in 2014 to $122.9bn in 2017 (+63%), but debt/GDP increased, much more, from 32% to 64% (+100%). This is because GDP shrank from $234.7bn to $192.7bn (-18%), driven by the oil price decline from $96.5/bbl to $45.5/bbl (-53%), offset by oil exports increase from 2.6 mbbl/d to 3.8 mbbl/d or (+46%).

However, different prevailing assumptions at any given time can produce some dramatically different results. Table 1 was created in 2017 based on historical data for 2014 and estimates for 2017, yet creating the same table in 2013 produced very different estimates for the same two years under consideration[9]. The contrast can be appreciated by looking at the same table made in the two different years.

9. IMF Country report 13/217. Used historical data for 2012 and projections for 2014-2017 based on expected future oil prices and Iraq oil production forecasts.
https://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf

Table 2: 2014 & 2017 GDP numbers estimated in 2013 & 2017

	Estimates made in 2017		Estimates Made in 2013	
	2014A	2017E	2014E	2017E
GDP ($bn)	234.7	192.7	254.9	337.3
Iraqi oil prices ($/bbl)	96.5	45.3	97.6	88.7
Oil exports (mbbl/d)	2.6	3.8	3.1	4.3

A = Announced, E= Estimates, $ = USD, mbbl/d =million barrel per day, bbl= barrel

As can be seen that the price of oil, and the amount exported are two key variables in estimating Iraq's current and future GDP and as such have major implications when looking at debt/GDP to assess its credit worthiness.

The effect on these assumptions in assessing Iraq's credit worthiness are best illustrated at three separate points in time: the past, the recent past and the current time.

In 2013, the latest available data on debt were those at the end of 2012: external debt of $60bn and domestic debt of $14.5bn for a total of $74.5bn. Moreover, it was assumed then that oil prices would moderate but remain high, and for Iraq to dramatically increase its production and thus it was on the path of continued debt reduction. If the markets at the time were to assess its credit worthiness, they would have arrived at debt/GDP of 29% and 22% for 2014 and 2017. This would have made Iraq an extremely credit worthy nation.

While in 2017, the available data were different. Iraq's debt was seen at $122.9bn and growing, oil prices were assumed to be low yet increasing moderately in future years, and thus Iraq would continue to run fiscal deficits that needed access to more debt to fund them. All of which would have made debt/GDP of 64% for 2017 and 65% for 2018 too high for it to increase debt without a fiscal policy adjustment.

Making the same assumptions today based on updated information would yield yet another set of figures. To illustrate, average realized Iraqi oil price of $49.2/bbl and exports of 3.8[10] for 2017 imply a GDP of $197.7bn or debt/GDP of 57%

10. In 2017, Iraq exported 1.2 billion bbls or 3.3 mbbl/d according to State Oil Marketing Company (SOMO) while the KRG exported 0.55 mbbl/d until October, for a combined total of 3.8 mbbl/d.

and likely 51% for 2018[11], which is a very different proposition from that of a year earlier.

The point made is that debt/GDP, while very important, should not be used without an understanding of the numbers and assumptions used in deriving it or of its sensitivity to changes in these underlying assumptions- especially for Iraq given its high oil dependence. Until Iraq diversifies its economy, the price of oil will continue to have an oversized effect on debt/GDP and thus on its ability to assume debt.

The status and composition of debt as at the end of 2017

As table 1 shows, current estimates of debt are $122.9bn, made up of external debt of $73.7bn and domestic debt of $49.2bn. These are projected to increase to $133.4bn by 2022, made up of external debt of $71.4bn and domestic debt of $62bn.

External debt

The external debt estimates of $73.7bn for 2017 are made of four basic blocs. The first is $41bn to the non-Paris Club group of creditors (mostly to the GCC) that were accumulated by the pre-2003 regime during the Iraq-Iran war. They are still outstanding yet have been frozen in time since 2003 without accumulating any interest, and neither Iraq making nor its creditors demanding repayments. The IMF assumes that these would be cut by 90% along the same lines as those of the Paris Club debt.

The second is $6bn of restructured Paris Club debt. This was about $40bn in 2003 but restructured and cut by 90%. It carries an effective interest rate of 3% and payable over a period of 28 years.

The third is $4.7bn in Eurobonds, of which $3.7bn are Iraq's only external debt

http://somooil.gov.iq/index.php/2015-11-14-05-40-7/46-2017-02-23-07-48-01
https://auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018.pdf Page 9

11. Iraqi Ministry of Finance (MoF) data for 2017 show a surplus of $1.6bn vs IMF estimates of a deficit of $9.8bn that was to be funded by debt. Therefore, debt would be $9.8bn lower. The updated GDP figures of $197.7bn and $272.2bn are from the IMF's WEO for April 2018. A recent piece by the author looks at this in greater detaill at: www.iraq-businessnews.com/2018-06-15-forget-the-donations-stupid-new-dynamics-in-funding-reconstruction/

at truly commercial terms. They are made up of three bonds: A $2.7bn bond issued in 2006, due in 2028 with a 5.8% interest rate; a $1bn bond issued in 2017, due in 2022, guaranteed 100% by the U.S. government, with a 2.1% interest rate; and a $1.0bn bond issued in 2017, due in 2023 with a 6.5% interest rate.

Finally, the fourth bloc is $22bn in borrowings incurred after 2014 mostly from the IMF, the World Bank and bilateral creditors. Most of these were provided in the form of aid and support to fund the budget deficits and thus are at generous interest rates and repayment terms. A small amount of this figure, about $3bn are arrears to trade counterparties including those to International Oil Companies (IOC's).

For all practical purposes most of the $41bn in debt to non-Paris Club creditors will not be repaid and could very well, as the IMF assumes, be restructured with a 90% hair-cut and or be eliminated entirely as a part of a grand bargain with the GCC depending on the nature of the future relationship. This was the subject of discussions over a number of years with the UAE forgiving its $7b in debt in 2008, but the others held back due to the turbulent relations between Iraq and the GCC over the 2006-2014 period.

The IMF notes in 2017 that, excluding this debt of $41bn, the rest of the external debt is highly concessional with over 70% of that being official loans with an effective interest rate of 3% in 2017, average time to maturity or time until full repayment is due, was 8.5 years and with an effective maturity of 30 years. Indeed, the last available full year data were those for 2016 which show: that this concessional debt (excluding the $41bn in debt and the $4.7 in Eurobonds) was $20.6bn; interest payments were $0.5bn; debt repayments were $0.8bn for a total debt servicing of $1.3bn. This was equal to 0.8% of 2016's GDP and 1.2% of exports. The upshot is that foreign debt servicing is very low relative to the size of Iraq's GDP while interest rates and repayment terms are extremely generous[12].

Domestic debt

The domestic debt of $49.2bn in 2017 is made up mostly of Treasury Bills (T-Bills) bought primarily by Rafidain Bank, Rasheed Bank and the Trade Bank of

12. IMF Country report 17/251
MoF "Quarterly Public Debt Bulletin, Q2 2017" at:
http://www.mof.gov.iq/obs/ar/Documents/2 نشرة الدين العام الفصلية.pdf
MoF "Medium Term Debt Management Strategy (MoF 2016)" at https://goo.gl/Ty6Kih

Iraq (TBI). The Central Bank of Iraq (CBI)[13] became a major holder of government debt from 2014 onwards, as it effectively bought all the T-Bills issued since then. The Ministry of Finance (MoF)[14] noted in 2016 that the effective interest rate on domestic debt was 2.6%. While most of these T-Bills are short term paper and subject to increases in rates, the majority are automatically rolled over by agreement with the MoF.

About $10.6bn of domestic debt by end 2016 were government loans with Rafidain Bank, Rasheed Bank and the TBI- of which $2.5bn were Ministry of Electricity loans and $8.1bn were loans by State Owned Enterprises (SOE's) guaranteed by the government. Finally, about $6.3bn of domestic debt by end of 2016 was arrears to domestic creditors[15] which do not carry interest.

It is worth highlighting that domestic government debt is held mostly by publicly owned entities, i.e. Rafidain Bank, Rasheed Bank, the TBI and the CBI (MoF notes they held 59% of all domestic debt by end of 2016). While these banks are independent of the government, yet would deal with it at much more advantageous terms to it than those extended by any outside entity.

Outlook for debt growth to 2022

The projected growth in debt from $122.9bn in 2017 to $133.4 in 2022 is based on expectations that budget deficits would continue until 2020 turning to small surpluses in 2021 and 2022. These in turn are based on Iraqi oil price assumptions of $45.3/bbl in 2017 increasing to $47.1/bbl in 2022, and for exports of 3.8 mbbl/d increasing to 4.1 mbbl/d.

However, the changed oil price dynamics imply that these assumptions are too conservative given the current outlook for the world economy. As such using less conservative oil price assumptions as outlined in the table below yields a very different outlook for revenues, deficits and the future debt levels.

13. T-Bills are bought by state banks, Rafidain Bank, Rasheed Bank and the Trade Bank of Iraq (TBI) and then sold, at a discount to the Central Bank of Iraq. This is what is referred to as indirect monetary operations by the CBI to finance the budget deficit and was one of the main reasons behind the decline in the CBI foreign reserves.

14. Medium Term Debt Management Strategy (MoF 2016) at https://goo.gl/Ty6Kih

15. IMF Iraq Country Report No. 17/251, page 17-18.

Table 3: Budgets for 2017-2022 under different assumptions

Year	2017E	2018E	2019E	2020E	2021E	2022E
Original assumptions (August 2017)						
Government revenue ($bn)	69.2	73.9	75.6	77.6	80.7	84.5
Government expenditure ($bn)	79.0	83.4	79.0	78.7	79.3	79.7
Budget balance ($bn)	-9.8	-9.5	-3.4	-1.1	1.4	4.9
Exports (mbbl/d)	3.8	3.9	3.9	4.0	4.0	4.1
Iraq oil prices ($/bbl)	45.3	45.4	44.9	45.2	45.9	47.1
Updated assumptions (June 2018)						
Government revenue ($bn)	65.3	103.6	98.0	96.8	94.4	95.6
Government expenditure ($bn)	63.9	86.3	88.7	89.8	88.9	88.6
Budget balance ($bn)	1.5	17.3	9.3	6.9	5.5	7.0
Exports (mbbl/d)	3.8	3.9	3.9	4.0	4.0	4.1
Iraq oil prices ($/bbl)	49.2	63.5	59.0	56.0	54.0	53.0

A = Announced, E = Estimates, $ = USD, mbbl/d = million barrels per day, bbl = barrel

Sources, assumptions see footnote[16]

The updated assumptions change the shape of the original projected deficits for 2017-2022 significantly in that the government would be running budget surpluses throughout the period. The significance is that this would turn a projected cumulative deficit of $17.6bn to a cumulative surplus of $47.4bn.

Assuming that the government would use the accumulated surplus to fund the reconstruction of the country following the culmination of the ISIS conflict, then the overall debt should not increase from the current levels unless the government assumes more debt to fund further reconstruction.

Given that Iraq and the IMF as part of the 2016 SBA agreement had secured

16. Assumptions:

- Updated figures for 2017 are from MoF which show revenues and expenditures for 2017 excluding those for the KRG. However, MoF and IMF estimates and planed budget include those of the KRG.
- Iraqi oil price averaged $49.2 for 2017, $63.5 for Jan-Jun 2018, is used as an estimate for full year 2018. Estimates for 2019-2022 assume gradual oil price declines. Oil revenues are based on these oil price assumptions and on original oil export estimates.
- Non-oil revenues are assumed to be at 13% of total revenues for 2018 increasing to 17% by 2022 in-line with the 2016 SBA. Supporting this assumption is that non-oil GDP is assumed higher by the IMF in its May's REO to +4.4%/+5% for 2018/2019 up from 2.4%/3.7% driven by the contribution form reconstruction.
- Updated Expenditures, while based on updated IMF's estimates, also reflect expectations that the government will ease back on its tight fiscal consolidation, however, they might very well be off-set by the historical tendency for lower budget executions.

Sources: IMF Iraq Country Report No. 17/251, IMF World Economic Outlook (WEO) April 2018 database, IMF Regional Economic Outlook (REO) statistical appendix, Iraqi Ministry of Finance (MoF).

about $9.8bn[17] in loans by mid-2017 to fund its expected deficit for that year, then the debt by end of 2017 would be $113.1bn instead of the earlier assumed $122.9bn. Assuming no increase in debt to further fund reconstruction, then debt/GDP would be 57% for 2017 decreasing to 42% for 2022 on an updated GDP estimate of $272.2 bn.

Moreover, assuming that the $41bn of external debt to non-Paris club members would be restructured along the same lines as those of the Paris Club debt or cut by 90%, then total debt would be $76.2bn for debt/GDP of 28% for 2022.

Granted that these are simplistic assumptions and not used or assumed by the IMF or other international bodies, yet they serve to demonstrate that positive changes in assumptions, based on the current changed environment, can have large positive implications on Iraq's debt load. Moreover, the implication extends beyond the debate on debt into Iraq's ability to borrow to fund its reconstruction drive[18].

17. The IMF (Country Report No. 17/251 P: 28) notes "The program is fully financed through the next twelve months, but there is a financing gap of $7.1bn in late 2018 and 2019. The authorities have contacted one donor to fill the 2018–19 financing gap, for which there is good prospect". This implies that Iraq has achieved full financing for 2017's $9.8bn deficit, and given that actual budget achieved a surplus, then Iraq has borrowed $9.8bn to fund a deficit that did not materialize and so the funds would likely not be drawn which would lower the overall debt.

18. This is explored by the author in recent report at: http://marshtomountain.com/forget-the-donations-stupid-new-dynamics-in-funding-the-reconstruction-of-iraq/

The origins of Iraq's debt[19]

The Iraq-Iran war from 1980 to 1988, transformed[20] Iraq from a creditor nation with over $35bn in foreign reserves to a debtor nation with debts of up to $80bn.

Expecting the that war would be short, Iraq pursued a policy of waging the war while maintaining public sector spending and embarking on a major national economic development. That and the increased military spending were initially funded by its foreign reserves with help of about $5bn in support from the Gulf Corporation Council (GCC). The drop in oil exports by 60% in 1981 from the destruction of export terminals, and the further drop in 1982 with the closure of

19. Many of the sources cited here on Iraq's debt were made at different points in time, they stated the debt at time of their publication. Some were of the original debt only, while others were original debt and accumulated interest and as such the figures are accurate at the time of publication. Also, these figures will change at later dates as interest accumulates or the debt is serviced. Finally, many of the sources used approximations of the debt at the time for these same reasons.

Complicating matters were that Iraq's external debt fell into a number of overlapping categories depending on the type of lender, i.e. an ex-Communist country or a Western country. Other categories were the type of loan and the terms of the loan and so forth. Some of the private commercial debt was treated as a country debt especially as applies to ex-Communist countries. Finally, the Iraqi government at the time did not publish official debt figures.

The sources below were used for the material in this section:

https://digitallibrary.un.org/record/114667/files/S_22661-EN.pdf
https://www.nytimes.com/1991/02/11/world/war-in-the-gulf-financing-us-has-received-50-billion-in-pledges-for-war.html
https://www.upi.com/Archives/1991/02/04/Whatever-outcome-of-war-Iraq-in-deep-financial-trouble/4240580333159/
https://www.ft.com/content/b94bccb4-14e7-11db-b391-0000779e2340
https://fas.org/sgp/crs/mideast/RS21765.pdf
https://www.economist.com/node/3429194
http://www.mafhoum.com/press5/142E17.htm
https://www.euromoney.com/article/b1320r9njx37n2/seeking-forgiveness-of-saddam-era-debt
http://www.arts.uwaterloo.ca/~bmomani/Documents/WLU-IraqiDebtNegotiations_000.pdf
https://scholarship.law.berkeley.edu/cgi/viewcontent.cgi?article=1091&context=facpubs

IMF Country Reports including the ones below:
https://www.imf.org/external/pubs/ft/scr/2004/cr04325.pdf
http://www.imf.org/external/pubs/ft/scr/2005/cr05294.pdf
https://www.imf.org/external/pubs/ft/scr/2006/cr0615.pdf
https://www.imf.org/external/pubs/ft/scr/2016/cr16379.pdf
http://www.imf.org/~/media/Files/Publications/CR/2017/cr17251.ashx

20. The deeper transformation of the country as a result of the Iraq-Iran war is discussed in further detail in the appendix at the end of the report.

the Syrian oil pipeline led to the depletion of its foreign reserves. Thereafter the GCC countries provided financial support and oil sales on behalf of Iraq. This ultimately led to the GCC's claims of debts of $49bn, but which Iraq argued were supplied as assistance rather than loans to help defend them in the war against Iran. Complicating matters is that much of that amount was not contractual as it was in the form of transfers, and a number were such that neither party kept formal agreements or written records of the amounts.

With the collapse in oil prices in the mid-1980s (chart 2) the GCC countries were no longer able to continue this support, and Iraq turned towards sovereign international creditors such as Western nations, the ex-Soviet Union, the ex-Eastern bloc nations and to private international creditors such as banks. These took the forms of government loans, credit export guarantees and bank loans. This ultimately became the Paris Club of loans of $40bn (including interest by 2003, but originally were $21bn), other non-Paris Cub of loans of $16bn (including interest by 2003) and the banks' loans portion of the commercial/private sector debt of $15bn (including interest by 2003).

Finally, Iraq began to accumulate indirect debt in the form of arrears to its international trade counter parties and suppliers of foreign goods and services as it was no longer able to pay for its needs in time. This ultimately became the trade creditors' portion of the commercial/private sector debt of $15bn (including interest by 2003).

There are many different publicly available figures of Iraq's debt by the end of the Iraq-Iran war, but they can be estimated to be around $80bn[21]. Iraq reported that its total external debt and obligations were $42bn by end of 1990 in a letter to the UN Secretary General. This figure would not have included its debts to the GCC nations given that Iraq did not consider them to be loans but grants, and so it is logical to conclude that its debts by the end of the war in 1988 were around $80bn.

The invasion of Kuwait in 1990 and the subsequent sanctions regime over the next 14 years brought a new set of obligations in the form of war reparations (details below) and the build-up of significant overdue interest on the accumulated debt that it was not able to service[22]. However, due to the sanctions it was not able to

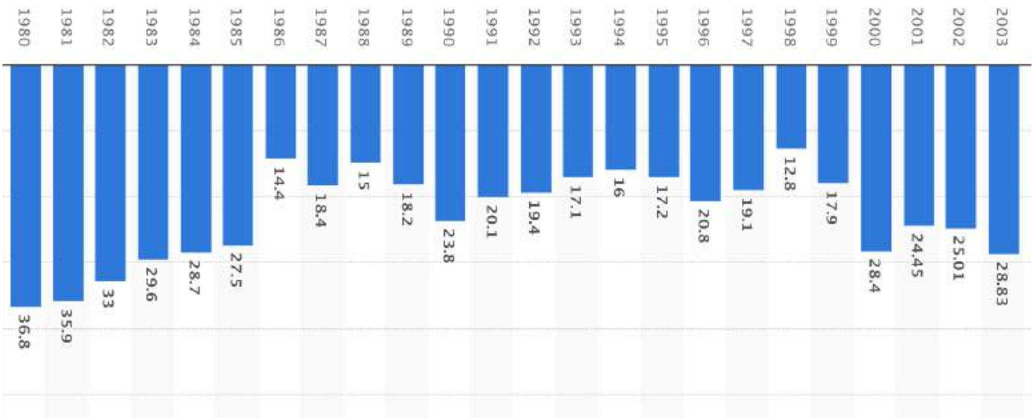
21. The total costs of the Iraq-Iran war to Iraq are discussed in further detail in the appendix at the end of the report.

22. The total costs of the invasion of Kuwait and the 14 years of sanctions to to Iraq are discussed in further detail in the appendix at the end of the report.

assume any further external debt.

An indirect cost that would play a significant role after 2003 regarding the forgiveness of Iraq's debt by the GCC, is the costs that the GCC assumed, in addition to those incurred during the Iraq-Iran war. The first of these were pledges of $16.8bn by Saudi Arabia and $16bn by Kuwait to the US for the cost of the Gulf War. The second were pledges of $9.5bn by Saudi Arabia and Kuwait as part of the US's commitments of $14.3bn in financial aid to economically hard-hit countries in the Middle East as a result of the Gulf War. A full fulfilment of these pledges would have added $42.3bn to the GCC's earlier costs of $49bn for a total of over $90 bn- the largest portion of these were borne by Saudi Arabia and Kuwait.

Chart 2: Average Brent prices 1980-2003.



Source: Statista-The Statistics Portal[23]

By 2003 total debts were about $120bn[24] made up of three major blocs. The first was $40bn to Paris Club group of creditors, of which $21bn was original debt, and $19bn in overdue interest. This was reduced in 3 stages by 90%[25] and was at $6bn

23. https://www.statista.com/statistics/262860/uk-brent-crude-oil-price-changes-since-1976/

24. Figures are rounded for simplicity and to allow an understanding of the position.

25. The use of 90% haircut in this report is an over-simplification. During the negotiations the US forgave 100% of its $4bn in debt, while the rest cut it by 80% over three stages of 30%, 30% and 20% with the residual

by the end of 2017.

The second was $65bn to the non-Paris club group of creditors. A portion of this amount at $49bn was to the GCC countries. There were efforts to renegotiate these along the same lines as those of the Paris Club debts. However, the obstacles were requirements to link these to national reconciliation in Iraq, the poor relationship between the GCC and successive Iraqi governments, and possibly the reluctance of the GCC to provide Iraq with assistance as Iraq was pivoting towards Iran. The other portion was $16bn, including interest, to China, Turkey and ex-communist European countries. This $65bn currently stands at $41bn after a number of cancelations such as $8.5bn by China in 2007, $7bn by the UAE in 2008.

Finally, the third bloc was $15bn in debt to commercial/private creditors (trade creditors, corporations, banks). This became known as the London Club Coordinating Group that settled on the same terms as those of the Paris Club. The bulk was restructured in a debt-for-debt exchange by issuing Iraqi government bonds, namely the $2.7bn Eurobond issued in 2006, due in 2028 with 5.8% interest rate[26].

War Reparations

The United Nations Compensation Commission (UNCC) was established in 1991 to process claims and pay compensation where appropriate for losses resulting from Iraq's invasion and occupation of Kuwait (1990-91)[27].

About 2.7 million claims were submitted seeking about $350bn in

20% to be paid over a number of years up to 28 years. Therefore, the net-present value (NPV) of the debt is equivalent to 10.25% of the original debt. Therefore, the use of 90% (89.75% to be precise) hair cut glosses over these details in order to simplify the conclusion in that ultimately the remaining debt by Iraq is 10.25% of the original debt as of the current time.

26. Small creditors were given cash settlements of 10.24% of their outstanding loans while the rest received 10% of the value of their loans (principal and interest) in the form of bonds.

27. In paragraph 16 of the UN Security Council Resolution 687 (1991) the Security Council reaffirmed that "... Iraq, without prejudice to the debts and obligations of Iraq arising prior to 2 August 1990, which will be addressed through the normal mechanisms, is liable under international law for any direct loss, damage, including environmental damage and the depletion of natural resources, or injury to foreign Governments, nationals and corporations, as a result of Iraq's unlawful invasion and occupation of Kuwait."

compensation[28], however not all were accepted as legitimate. Of these about 1.5 million claims, or 56% of all claims, were accepted which represented a compensation of about $52bn or 15% of all amounts claimed.

Iraq started paying[29] these soon after the start of the oil for food programme so that by 2003 the UNCC paid out about $24bn. It continued to make payments and by 2017 the total payments made were about $48bn. The final portion of $4.6bn is expected to be paid in 2019.

While the reparations were not included in Iraq's total debt figures, they nevertheless affected the country's credit rating as they were substantial liabilities.

Conclusion

With the closure of the reparations chapter in 2019, and the end of the ISIS conflict, Iraq is in a position to capitalize on the window of opportunity offered by the higher oil prices to reposition its debt profile. With the proper positioning and adhering to the IMF programme from the SBA, the country can tap into the debt markets to fund productive investments in its infrastructure that would enable it to rebuild and to grow.

Moreover, this debt profile is nowhere near as large as feared in the national discussion on debt, and more importantly neither the debt nor its servicing are a burden on the country or on its future generations. However, the national discussion should shift to focus on the real burden placed on future generations from an unsustainable ever-expanding socialist legacy.

Most of the country's oil revenues are spent on expanding the public payroll and social security spending, in the process depleting the country's wealth without building its infrastructure. Very little of the oil revenues are going towards reconstructing and building the country's physical capital, which is what would create economic sustainability and drive the country's diversification away from oil.

28. https://www.uncc.ch/

29. Initially in 1991, 30% of revenues from the sale of Iraqi oil was to be channelled through the UNCC to pay for these claims and for its operations; this was reduced to 25% in 2000 and finally to 5% in 2003.

The result of overspending on expanding the public-payroll and underspending on infrastructure is an economy dependent on imports of goods and services, stunted private sector and a labour market skewed towards public employment. The consequences of which are continued high oil dependence which makes the country vulnerable to external shocks such as the collapse in oil prices.

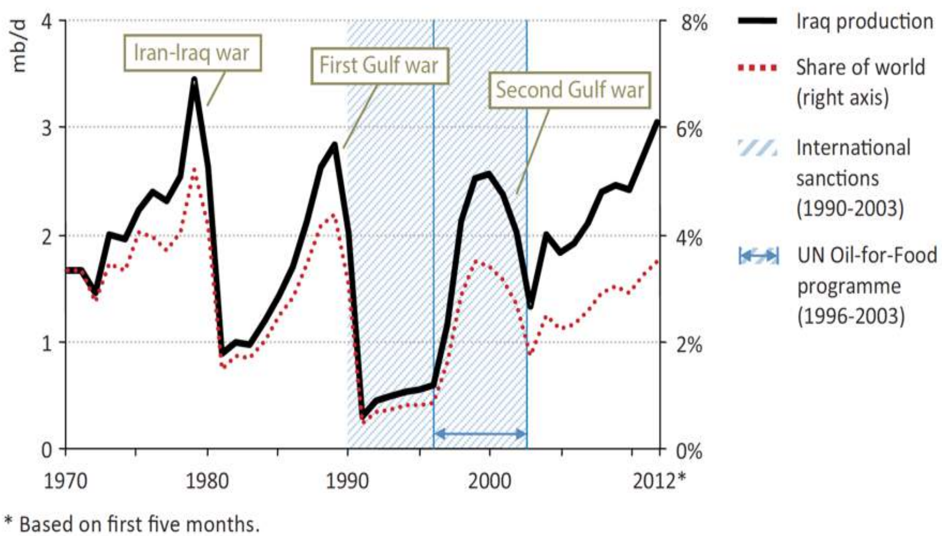
Ultimately this pattern of misspending would create the conditions for a future financial crisis. Even with an optimistic scenario for expanding oil production and for continued high oil prices, the government's revenues will not able to meet the high demands of Iraq's young, large and rapidly growing population.

Appendix: **On the costs of conflict**

The section on the origins of Iraq debts discussesd how the Iraq-Iran war, the invasion of Kuwait, and the 14 years of sanctions lead to the build-up of significant debt. However, what it did not discuss was the much larger non-direct debt cost to the country, of which the loss of oil income is but one component.

As discussed in the origins of Iraq's debt, the Iraq-Iran war transformed Iraq from a creditor nation with over $35bn in foreign reserves to a debtor nation with debts of around $80bn by end of the war. However, the transformation was far more fundamental than that. The economy was booming led by increased oil production paced by rising oil prices following the Arab oil embargo in the wake of the Arab-Israel war of 1973.

Chart A: Iraq-Oil Production 1970-2012



Source: https://www.iea.org/publications/freepublications/publication/WEO_2012_Iraq_Energy_OutlookFINAL.pdfy

In the years immediately before the war the government was running annual budget surpluses of up $10bn or about 20% of GDP. These were invested in the country's infrastructure and led to the rise of Iraq's then considerable foreign reserves. The war's immediate effect was the loss of income from the destruction of productive assets and in particular the loss of oil income from the damage to oil export facilities. This was compounded by the reversal of the budget surpluses into deficits- the damages of which were magnified by the associated losses of not transforming these surpluses into investments in the country's infrastructure.

Less understood is the damaging long-term effects of the diversion of productive capacity in industry and agriculture into the war effort, thereby increasing the country's reliance on foreign imports. Added to this should be the damage to human capital from loss of life and ultimately the loss of human productive capacity.

To appreciate a portion of these unaccounted-for costs, consider the following estimates by different sources on the costs of the Iraq-Iran war: -

A 1987 study by the Japanese Institute of Middle Eastern Economies estimated total Iraqi war losses from 1980 to 1985 at $226bn. This is made up of (1) $120.8bn in GDP lost in the oil sector, and $64bn in GDP lost in the non-oil sector, (2) $33bn lost in destroyed materiel, and (4) $8.2bn lost in damage to non-oil sector fixed capital investment. Lost oil income of $65bn is included within oil GDP losses, while the lost opportunity was $43.4bn in unrealized fixed capital investment. http://www.dtic.mil/dtic/tr/fulltext/u2/a224269.pdf page 123

A 2002 report estimates that the total cost to Iraq of the 8-year war at $450bn which would be about 10 times the pre-war GDP in 1980 http://www.nber.org/papers/w9361.pdf page 4. The report uses data from a major study on the economic consequences of this war: (The Economic Consequences of the Gulf War 1st Edition, by Kamran Mofid) at: https://www.amazon.com/Economic-Consequences-Gulf-War-ebook/dp/B000Q35WTK/ref=sr_1_fkmr0_1?s=digital-text&ie=UTF8&qid=1528542102&sr=1-1-fkmr0&keywords=Kamran+Mofid%2C+The+Economic+Consequences+of+the+Gulf+War%2C+Routledge%2C+London%2C+1990

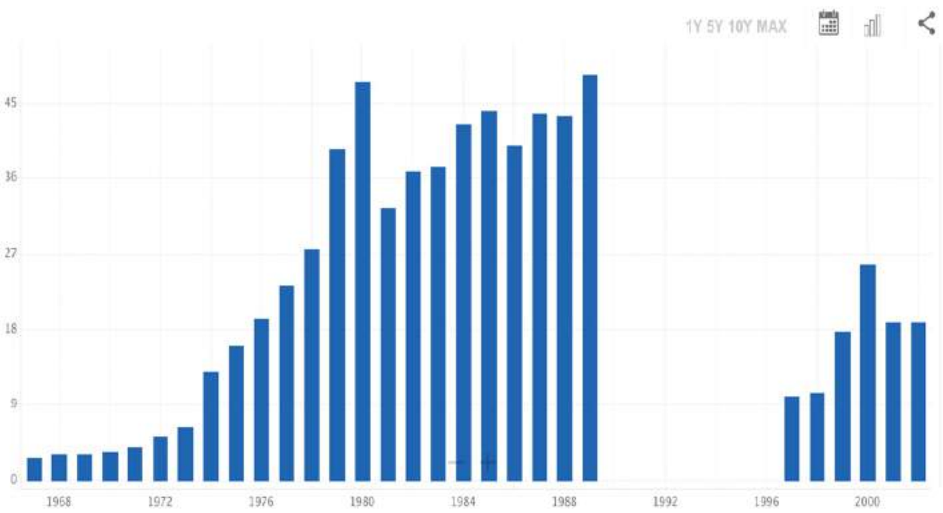
Added to the amounts of these studies should be the damage to the country's human capital, its capacity to function, as well as the loss of the $35bn in foreign reserves and the assumption of around $80bn in debt.

The costs of the invasion of Kuwait and the subsequent 14 years of sanctions to Iraq's economy, however, are larger than those of the Iraq-Iran war by orders of magnitude - as they add the significant destruction of the country's human and capital stock in addition to the degradations of all aspects of the economy due to Iraq's isolation from the world during these years.

Some estimates of the cost of the Gulf war and the sanctions made in 2002 are: $230bn of infrastructure was destroyed in the war, oil production under the sanctions regime 1991-2002 averaged 1.4 mbbl/d vs. pre-war peak of 2.85mbbl/d in 1989, then the difference or lost export income is about $150bn, which is over 3 years of GDP based on the last available GDP figure of $48.4bn for 1989 (there are no available figures for GDP between 1990-1996). Once again, these don't include the damage to the country's human capital, its capacity to function as well as the increase in debt to about $120bn from the accumulation of interest on the Iraq-Iran war debt of $80bn, and the assumption of war reparations of $52bn.

The growth of Iraq's GDP from the 1970's and the subsequent decline as a result of conflict can be seen from the chart below.

Chart B: Iraq's GDP 1967-2002

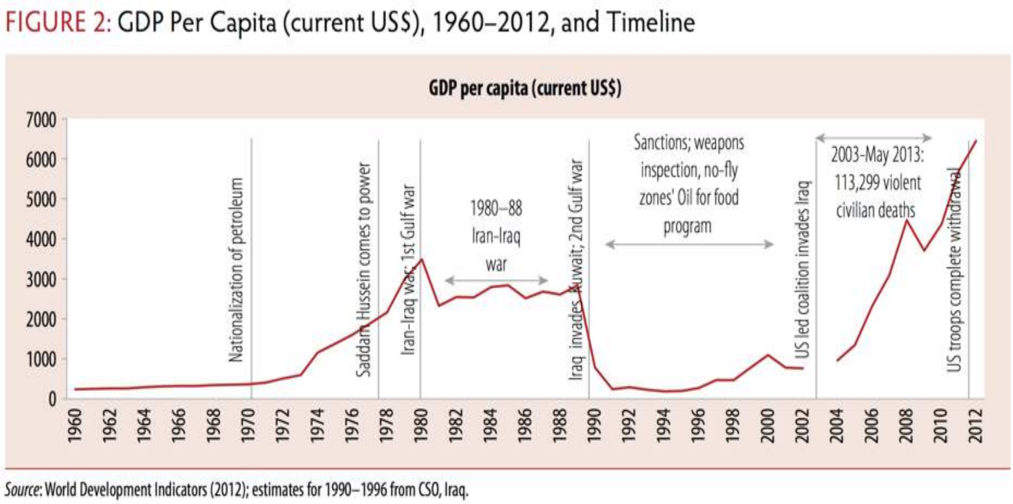


(source: (https://ieconomics.com/iraq-gdp)

However, the same effects of the above translated into the living standards can be appreciated by using GDP per-capita as a proxy for living standards from 1960-2012 as in the chart below.

As can be seen the rapid raise in living standards of the 1970's came to and with the start of the Iraq-Iran war. The decline in living standards was off-set somewhat by the continued socialist spending and the national development drive but that eventually contributed led to the growth of debt. The invasion of Kuwait and the subsequent sanctions had a devastating impact on living standards that erased over 20 years of progress.

Chart C: Iraq's GDP per capita 1960-2012



Source : http://documents.worldbank.org/curated/en/204911468044383593/pdf/926810v10ESW0P0C0disclosed020110150.pdf. Page 4. Data based using estimates from Iraq's Central Statistical Office (CSO) for 1960-1996 and World Bank figures afterwards.

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