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The Right Way To Ease Iraq's Debt Burden

Should the new government of Iraq be required to pay in full the external debts accumulated principally by Saddam Hussein's late regime? No. It would be economically, politically and morally misguided to expect Iraq to pay all its accumulated external obligations. But it would be equally misguided simply to write it off at a stroke.

Iraq's external debt may be at least Dollars 350bn, including foreign debt, compensation claims and pending contracts. Conventional foreign debt alone is somewhere between Dollars 60bn and Dollars 120bn, depending on how much past due interest is included and the status of claims associated with the Iran-Iraq war. Based on estimated export earnings of Dollars 20bn a year, a maximum debt-service ratio of 25 per cent and an estimated interest rate of 6 per cent, the new Iraq might reasonably be expected to service the interest on debt of Dollars 80bn.

With the exception of individual and family compensation claims arising from the Gulf war, Iraq has not been servicing most of its external obligations for more than a decade. Most of these can wait a little longer. The only arrears that should be paid off promptly are its overdue obligations to international financial institutions, such as the International Monetary Fund and the World Bank, which amount to less than Dollars 200m. This would enable

Iraq to draw fully on IMF and World Bank resources to rebuild its society and government.

US calls for government creditors to forgive immediately Iraq's external obligations - a line that has been taken by Paul Wolfowitz, deputy defence secretary, in the case of France, Germany and Russia - are rash. Established multilateral mechanisms are available to address this complex subject at the appropriate time. The United Nations Compensation Commission should eventually address the non-individual and non-family claims arising from the Gulf war. It is reasonable to expect it will reduce the remaining, principally governmental, claims by more than if the Hussein regime had not fallen. We know from history that burdensome reparations payments are a recipe for resentment, instability and international friction.

It is impossible to make considered judgments about Iraq's ability to pay at this point because of the paucity of information about its economy. However, it may well be necessary to write down further the Gulf war claims by individuals and families that have been adjudicated already but not yet paid: these amount to about Dollars 25bn and are currently being serviced with 25 per cent of Iraq's oil exports.

Most of Iraq's remaining obligations are government-to-government. The Paris Club of such creditors will deal with them once an IMF-backed economic

programme is in place. In this case, the deliberations will have to go beyond the club's traditional members and include creditors in eastern Europe, Russia and especially the Middle East, which hold about 75 per cent of Iraq debt. Drawing these countries into multilateral discussions is one channel for building political, financial and economic stability in the region. If a creditor country chooses not to participate, that will be its choice, although Iraq will be required not to discriminate against non-participants and private sector creditors.

The US government is owed very little by the Iraqi government, reportedly about Dollars 2bn. So when members of the administration call unilaterally for the substantial elimination of inter-governmental claims on Iraq, the US can justly be accused of seeking to spend other people's money. The motive appears to be concern about the costs of reconstructing Iraq and a desire to reduce contingent claims on US taxpayers. Iraq's external obligations will indeed have to be reduced in line with its ability to pay - but that ability should be established through multilateral mechanisms on the basis of established criteria.

Should Iraq become the first country to benefit from the doctrine of "odious debt"? No. This controversial doctrine holds that the external obligations incurred by repugnant regimes should not be passed on to their more attractive and deserving

successors. However, to seek to apply it to Iraq's case would be a mistake.

First, some of Iraq's creditors are themselves being forced to pay odious debt - for example, Russia on behalf of the former Soviet Union. Second, the Iraq case is complicated because it involves Gulf war compensation claims. Third, any changes in the treatment of Iraq's debt will be felt most deeply in the Middle East; western appeals to the doctrine of odious debt may again amount to spending others' money. Finally, many other countries - Indonesia, Nigeria and South Africa, for example - would immediately apply to use the Iraq precedent to wipe out their own odious debt.

A case can be made for establishing international standards for the treatment of post-conflict and post-dictatorship debt. This is not an easy task; it should be addressed calmly and deliberately. The result might be improved incentives not to make debt contracts with such regimes.

Meanwhile, established multilateral mechanisms are more than sufficient to lighten Iraq's debt burden and ease its passage to economic and political recovery.

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