Note: Dealing with Iraq's Foreign Indebtedness

Wajeeh Elali

EXECUTIVE SUMMARY

Iraq now faces a growing economic crisis, which is impoverishing the country and threatening its basic social fabric. The crisis is partly the result of decades of mismanagement on the part of the Iraqi government. It is also the result of massive overspending and foreign borrowing during the Iran–Iraq War and the Gulf War. This article investigates Iraq's debt crisis and attempts to devise a pragmatic debt-management strategy, which could possibly lead to solving this acute problem. The four-pillar strategy introduced here, if well implemented, would not only obliterate the debt, but could more importantly set the scene for Iraq's return to its place in the international community with a renewed political and economic stability. © 2000 John Wiley & Sons, Inc.

INTRODUCTION

Who would ever have thought that a once-affluent country such as Iraq, with the world's second-largest oil deposits and an excellent infrastructure, would become a shadow of the prosperous nation it once was. During the 1970s, Iraq was emerging as one of the richest countries in the Middle East with its vast natural and human resources. It had achieved a high level of economic and social development, which placed it in the World Bank category of upper middle-income countries along with Greece, Venezuela, and Czechoslovakia. Its devastating war with Iran, its invasion of Kuwait, along with the UN economic sanctions ultimately bankrupted the country and, in a matter of years, have transformed it into a pocket of deprivation rivaling the worst black spots of the Third World. The latest US-led missile bombardment of December 1998 also did nothing to alleviate Iraq's crisis. It has only exacerbated the effect of the sanctions and worsened what UN reports described as "near apocalyptic" conditions within the country.

Wajeeh Elali, Ph.D., is a Professor of Finance at McGill University where he teaches Applied Corporate Finance and Treasury Management. From 1981–1982, he was a visiting professor at Harvard Business School. His current research focuses on Corporate Finance, Business Performance, and International Debt Problems.

Thunderbird International Business Review, Vol. 42(1) 65–83 • January–February 2000
CCC 1096-4762/00/010065-19
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Recent studies reveal that Iraq's real GDP has plummeted by 75% since the 1991 Gulf War and is now estimated to resemble its GDP of the forties, prior to the oil boom and the modernization of the country (Alnasrawi, 1994; CESR, 1996; Elali, 1997; Cordesman & Hashim, 1997). As a result, Iraq's *per capita* income and caloric intake have plunged from upper Third World levels to the ranks of "Fourth World" states like Rwanda, Haiti, Zaire, and Somalia. By mid-1995, some independent sources warned that the overall situation throughout the country was catastrophic for the vast majority of the people (*Christian Science Monitor*, 1995). In 1997, extensive surveys conducted by UNICEF, the World Food Programme (WFP), and the Food and Agricultural Organization (FAO) also confirmed that the Iraqi population was living in a state of extreme poverty, with minimal provision of health care, nutrition, education, water, sanitation, or other basic services. Moreover, humanitarian agencies stated that food, medicine, and equipment would remain in short supply despite the oil-for-food agreement between the UN secretariat and the government of Iraq (EIU, 1998; Cortright & Lopez, 1998).

To add fuel to the fire, Iraq's most valuable assets, as well as its basic social and economic infrastructure, have been squandered, eroded, or irrevocably destroyed

That is not all. Reports indicate that not only is the economy in a state of ruin, but the situation has also greatly demoralized its people. Crime has never been so widespread. A wave of lawlessness, unemployment, and corruption has undermined society values. To add fuel to the fire, Iraq's most valuable assets, as well as its basic social and economic infrastructure, have been squandered, eroded, or irrevocably destroyed. Its best-educated people have fled and its national currency (the dinar) has continued to depreciate, driving prices ever upward. The Economist Intelligence Unit (EIU, 1998) predicts that inflation in Iraq will remain endemic in 1999 as the government continues to finance its spending commitments by printing money.

To make matters worse, Iraq's official foreign reserves (estimated between US$35–40 billion at the beginning of the 1980s) have either been totally depleted or misallocated. The country has also experienced near total diplomatic, political, and economic isolation since its army marched into neighboring Kuwait in 1990. Iraq, furthermore, has been deemed by the EIU to be the riskiest country in the world to do business with. On top of all this, the country is sinking in a mire of foreign debt, war reparations, and other financial obligations that are certain to keep it in economic shambles for decades to come.

THE SIZE OF THE PROBLEM

In spite of the heroic efforts of the EIU's statisticians, World Bank experts, OECD specialists, and other institutional researchers, nobody seems to know in detail what actually constitutes Iraq's foreign debt or exactly how much Iraq originally borrowed on the international market. This should come as no surprise. In Iraq, statistics are hard to come by because of the obsessive secrecy of the regime that views statistical and economic data on Iraq as state secrets. It is also among the few countries in the world that do not report their debt statistics to the World Bank Debtor Reporting System (DRS). The Iraqi government has not been forthcoming with statistics on its economy since 1980 and may well be unable to provide any accurate statistics. Abbas Alnasrawi (1994), a prominent professor at the University of Vermont, has written extensively about the economy of Iraq. He made the following statement about this nonavailability of suitable data: "Although there are no precise figures on Iraq's foreign obligations or an agreement on what constitutes [external] debt, there are reliable estimates of magnitudes."

In early 1989, the Export–Import Bank of the United States reported that Iraq was facing a severe debt crisis that oil revenues could not rectify. According to that report, in 1989 Iraq owed nearly US$27 billion to Western creditors and another US$50 billion to the Gulf states, including US$10 billion to Kuwait (Karabell, 1995). Furthermore, on April 29, 1991, the Iraqi government, on one of its very rare occasions, explicitly indicated in a memorandum submitted to the UN Secretary-General Boutrus Boutrus Gali that, as of December 31, 1990, its external debt obligations were the equivalent of US$42.1 billion. This excluded interest payments due and grants from the Arab states (MEES, 1991). The importance of this memorandum goes beyond the fact that it is one of the most detailed financial statements made public by the Iraqi government. It shows that the Iraqi government continues to insist that the funds it received during the war with Iran (estimated between $30 and $50 billion) from the rich Arab states — mainly Kuwait, Saudi Arabia, and the United Arab Emirates — were grants, while these states classify them as debts.

As recently as 1992, the World Bank classified Iraq among the Severely Indebted Middle-Income Countries (SIMICs) such as Argentina, Brazil, Mexico, Morocco, Poland, and others. Moreover, the most recent data released by the EIU in 1998 shows another rather depressing picture. According to this source, Iraq's total external

indebtedness (comprised primarily of bilateral, official, or government-to-government loans) has reached and surpassed the shocking level of 100 billion US dollars.

The same statistics further show that Iraq's foreign indebtedness has dramatically escalated over the last two decades. Between 1980 and 1997, its total debt stock soared from US$2.5 billion to US$119.3 billion — an increase of almost forty-seven fold. The debt accumulated at a rate of 25.53% annually while its GDP and exports of goods and services both plunged by a cumulative −5.07 and −8.77%, respectively.

Compared to other indebted countries, Iraq comes out very badly. Alongside other Middle Eastern and North African countries, Iraq remains the largest borrower, holding more than 30% of the region's outstanding debt, which was estimated at the end of 1997 to be $386 billion (EIU, World Outlook 1998). Table 1 furthers this comparison of Iraq's indebtedness on the international scene. With its external debt stock at about US$119.3 billion in 1997, Iraq ranked seventh (below the total for Indonesia, but above that for Argentina).

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Table 1. Debt Indicators for the Highest Indebted Countries, 1997

Country	Debt ($bn)	XGS ($bn)	GDP ($bn)	D/XGS[a] (%)	D/GDP[b] (%)	Debt per Capita ($)
Brazil	182.1	52.9	758.4	344	24	1138
Mexico	177.5	109.1	409.2	162	43	1829
China	159.2	181.2	937.8	87	16	129
South Korea	141.3	139.0	468.0	101	30	3071
Russia	130.2	87.4	448.6	148	29	885
Indonesia	123.3	52.4	211.6	235	58	619
Iraq	**119.3**	**5.6**	**22.3**	**2130**	**534**	**5187**
Argentina	110.2	25.0	322.1	440	34	3148
Thailand	98.2	56.6	159.6	173	61	1583
India	92.2	34.8	383.7	264	24	94
Turkey	81.2	33.0	197.1	246	41	1268
Greece	46.2	11.0	116.3	420	39	4200
Philippines	43.9	25.3	79.3	173	55	618
Poland	42.1	26.5	133.8	158	31	1079
Malaysia	39.8	75.4	85.7	52	46	1877

[a] D/XGS = debt-to-exports ratio.
[b] D/GDP = debt-to-GDP ratio.
Source: EIU, World Outlook 1998 and author's computations.

SEVERITY OF THE PROBLEM

The severity of a country's external debt can also be measured by a variety of debt indicators referred to as debt ratios. Since the absolute figures of the total debt of a nation do not always tell us very much, researchers, as well as politicians, have had to turn to relative measures such as Debt–Export ratios and Debt–GDP ratios to provide a more accurate indication of the severity of a country's debt. Needless to say, neither of these measures is infallible so they must not be used in isolation from one another. Discussion here will, however, be confined to the following two ratios: Debt-to-GDP ratio and Debt-to-Exports ratio.

Debt-to-GDP Ratio

This ratio relates total external debt to the debtor's GDP. It is thus viewed by most analysts as a useful measure of the current burden of debt on the economy, or to put it another way, of how much national output would be needed to pay off the debt. The higher the ratio, the more indebted the country, and, accordingly, the heavier the burden in terms of output forgone.

The slide of Iraq into troubled debtor status began in 1982–1983, well before the imposition of the UN sanctions in 1990. Its total external debt-to-GDP increased almost continuously from 4.6% in 1980 to 143% in 1988, peaking at 791% in 1991 before falling to 534% in 1997. The true culprit of this burgeoning debt was the Iraqi government's imprudent macroeconomic policies and its massive borrowing in the 1980s, which, as a whole, allowed debt to grow at much faster rates than the economy was growing. In 1983, for example, Iraq's GDP fell by 6.88% while its external indebtedness grew by 32.66%. A similar deterioration can also be traced in subsequent years.

Another culprit in the dramatic increase in the debt-to-GDP ratio was the UN oil and trade embargo. The sanctioning of exports substantially reduced aggregate growth and output, thus exacerbating the debt situation. As a consequence, the debt-to-GDP ratio deteriorated greatly in the 1990s.

In 1997, Iraq's debt-to-GDP ratio appeared extremely high in comparison with all other heavily indebted economies. Table 1 shows that, at that time, the debt burdens carried by Iraq were much heavier than any developing country in the world. Brazil, for example, had the largest external outstanding debt among the developing countries, amounting to US$182.1 billion at the end of 1997, but it was

only 24% of its GDP. However, this was only a tiny burden compared to Iraq's external debt, which was equivalent to a hefty 534% of its GDP that same year.

Debt-to-Exports Ratio

This ratio is, in effect, an indicator of how close the debtor country is to bankruptcy. It can be shown empirically that any country with outstanding debt worth more than 200 percent of its exports on a present value basis is in real trouble (World Bank, 1995). Statistics show that Iraq's debt-to-exports ratio rose incredibly from 9.4% in 1980 to 1077% in 1986; it had then declined to 582% by 1989 before jumping in the 1990s to a horrendous five-digit figure — a percentage value that even among the most severely indebted countries is hard to find. This jump was mainly due to a massive, if not total, collapse in Iraq's oil exports because of the UN oil and trade embargo imposed on Iraq when it invaded Kuwait in August 1990.

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The statistics also indicate that, up to 1983, Iraq was not in a particularly heavily indebted position. Its debt-to-exports ratio stood at 231%, a little above the critical threshold of 200% associated with a severe debt problem, but still well below the unsustainable levels of 300 to 500% that characterized most heavily indebted countries in Latin America and Africa during the 1980s. Nevertheless, the prolonged war with Iran, which ended in late 1988, along with the UN sanctions, which started shortly after in 1990, dramatically altered the debt-to-exports ratio so much that it rose to an unprecedented level.

All the figures regarding Iraq's debt profile are so alarming that, if the seriousness of Iraq's foreign debt situation is not fully acknowledged and a fast workable strategy found to alleviate it, the living conditions of its citizens and the prospects for its development will only become more and more bleak. This huge external debt burden is not only hampering Iraq's economic development and damaging its long-range productivity, but is also threatening its future ability to prosper and have sustainable growth in the years to come. As yet, however, there has been no instant rescue from this financial adversity. On the contrary, the Iraqi government contemptuously rejected several offers (such as the UNSC Resolution 986) proposed by the international community to deal with this or other related problems on the grounds that to do so would "infringe on Iraq's sovereignty and independence" and would be "insulting."

WHO IS TO BLAME?

The current external debt problem in Iraq is the result of a complex interaction of many varied endogenous and exogenous factors. Although it is hard to quantify, it can be said that each has contributed its fair share in bringing this crisis to its present level.

The Endogenous Factors

These factors stem from imprudent government policies, which have wasted resources, wreaked havoc with living standards, and stunted development over the course of the past three decades. Following are the most notable endogenous factors, which have given Iraq's debt crisis its peculiar characteristics.

Massive military expenditures. These expenditures absorbed between 40–75% of Iraq's GDP during the 1980s — an extremely high ratio by world standards (Alnasrawi, 1994; Cordesman & Hashim, 1997). For example, in 1980, Iraq's military spending swallowed up a good 77% of the country's oil income for that year. In subsequent years the Iraqi government didn't hesitate to spend double or even triple the amount of the country's oil revenue. Between 1981 and 1985, Iraq's military spending amounted to US$119.9 billion while in the same period its oil revenue amounted to just $48.4 billion, a net cash outflow or deficit of $71.5 billion. The question, though, is how did the Iraqi government finance this huge deficit? Actually, it was financed through a combination of massive international borrowing, the abandonment of development projects, and the curtailment of civilian imports and social services as well as the reduction of foreign reserves. What better recipe for a national disaster!

The Profligacy of Saddam Hussein's Regime. This regime has been accused of corruption and mismanagement of resources on a grand scale. Over 78 luxury palaces around Iraq have been built for the sole use of Saddam, his family, or close supporters (one of them is about five times the size of the White House and one and a half times the size of Versailles). Monuments have been erected. Lavish guesthouses with high vacancy rates and huge government centers have been developed, and the biggest and most costly mosque in the world was also constructed. All these and tens of other "white elephant" megaprojects have exhausted valuable resources. However, they have no real economic value except to be spectacular showcases to commemorate Saddam and his regime.

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The Guns and Butter Policy. This policy led to Iraq's imports expanding far beyond the country's financial capacity. In spite of a serious setback in export earnings shortly after the breakup of the war with Iran, the amount of imported goods and services continued to rise. Statistics show that Iraq's total nonmilitary imports increased from $13.5 billion in 1980 to $20.7 billion in 1981 (an increase of 53.3%), while its total export revenue plummeted from a record high of $27.9 billion to $10.6 billion (a decline of 62%) during the same period. Similar trends were observed in 1982: Exports went further down to $10 billion while nonmilitary imports went up even further to a record high of $21.5 billion, and military imports accelerated to $6.4 billion. These horrendous mistakes eventually brought about, first, the decline of foreign reserves and, second, the accumulation of foreign indebtedness to a level unprecedented in the history of Iraq. The two wars have cost Iraq both its guns and much of its butter!

Imprudent Macroeconomic Policies. These policies manifest themselves in a chronically large budget deficit, overvalued exchange rates, highly elevated government fees and taxes, skyrocketing inflation rates, an economy isolated from international competition, insufficient domestic savings, and continued capital flight. Just as it has been in the past, the Iraqi government has been highly incompetent in dealing with economic matters in the 1990s. It has attempted to deal with far too many problems through such approaches as "economics by fiat," "economics by repression," and/or "managing by intimidation." These imbalanced policies brought about an overall lack of confidence in the system, which in turn engendered a massive exodus of financial as well as human resources.

Lack of a Cohesive Debt-Management Strategy. There is a complete lack of a cohesive debt-management strategy for the country as a whole, as no such strategy has ever been developed to solve this dire problem. The absence of such a strategy obviously prevents the country from being able to control effectively its external indebtedness and to keep its burden at an acceptable level. There is also an acute shortage of well-trained negotiators and specialists in debt management at the regional and international levels.

The Exogenous Factors

As serious as the endogenous factors were, they should not be viewed as the only causes for the deterioration of Iraq's financial situation and thus the increase of its international indebtedness, which climbed

from next to nothing in 1975 to almost US$120 billion in 1997. Of course there also were some unfavorable exogenous shocks that helped to contribute to its debt crisis. Iraq was, in part, the victim of a number of developments beyond its control. Three of these deserve special attention.

The continued decline in oil prices combined with the reduction in Iraq's oil export capacity (due to the closure of its export outlets on the Persian Gulf and Syria) further caused serious deterioration in Iraq's oil revenues, . . .

The Collapse in the World Price of Oil. Having reached a peak of US$34 per barrel in 1982, the price of oil collapsed to as low as US$7 per barrel in 1986. The continued decline in oil prices combined with the reduction in Iraq's oil export capacity (due to the closure of its export outlets on the Persian Gulf and Syria) further caused serious deterioration in Iraq's oil revenues, hence deepening its financial crises. As Alnasrawi (1994) noted, the fall in oil prices along with the war-caused decline in oil exports played a major role in causing a US$19.4 billion decline in the purchasing power of Iraqi exports between 1980 and 1986.

Imprudent Lending Practices. The behavior of some Western creditors and some Arab states in the Persian Gulf can also be blamed for their imprudent lending practices, which added more fuel to the debt inferno. In the beginning years of the Iraq–Iran war in the 1980s, the American, British, French, Italian, and Soviet governments agreed and/or supported the extending of credits worth some US$40 billion to the Iraqi government and continued to provide it with huge financial facilities until its invasion of Kuwait in August 1990. Saudi Arabia, Kuwait, the United Arab Emirates, and Qatar opened their coffers as well, literally pouring billions of dollars into Iraq to the tune of an estimated US$50 billion (Karabell, 1995).

The United Nations Sanctions. The insistence of some members in the UN Security Council (in particular the United States and the United Kingdom) to maintain and prolong the economic sanctions against Iraq until it complied with a wide range of UNSC resolutions regarding weapons of mass destruction and other matters greatly accelerated the collapse of Iraq's economy and exacerbated its financial difficulties. However, this stance finally converted Iraq's international debt problem from a fairly manageable short-term liquidity to absolute unsustainability. Moreover, Iraq lost approximately $130 billion worth of oil revenues since the imposition of the UN oil and trade embargo in August 1990, which could have partially been utilized to alleviate its debt burden. Without a doubt, the sanctions, to the detriment of Iraq, continue to stand despite their declining utility as a coercive tool to contain the regime of Saddam Hussein.

THE SEARCH FOR REPRIEVE

Over the last ten years or so, the international community has recognized that there was a need for far more aggressive and comprehensive plans to deal with the so-called developing countries debt crisis. It thus proposed a number of plans and initiatives such as the 1988 Toronto Terms, The 1989 Brady Plan, The 1994 Naples Terms, as well as The 1996 HIPC Debt Initiative (Cline, 1995; Boote & Thugge, 1997; Iqbal & Kanbur, 1997). All of these called for a substantial easing of the terms, a cancellation of the stock of debt where appropriate, and for more concessional resources or greater concessionality to help heavily indebted countries obtain some reprieve from their unsustainable debt situation within a reasonable time horizon.

Likewise, some of the indebted countries have also tackled this complex problem by means of containment, austerity, macroeconomic adjustment and structural reforms, rescheduling of debts via creditors' clubs such as the Paris Club and the London Club, as well as other ingenious debt relief mechanisms. Some of these countries have succeeded while others have been doomed to failure (Abbott, 1993; George, 1996).

Although the issue of debt forgiveness received its first support among official institutions and political circles as early as 1987 (Fischer, 1987), it was not considered an option on the agenda until 1989. In March of that year, US Treasury Secretary Nicholas Brady hinted in his initiative at the possibility of debt cancellation, although it was restricted to a very modest 20 percent. From 1990 on, this issue received even further support as both economists and international institutions seemed to have abandoned the pretense of believing that sooner or later the LDCs' loans would be entirely repaid.

Today, the principle of debt-stock forgiveness and the positive contribution it makes towards debt reduction and the development of heavily indebted poor countries (HIPCs) has been widely recognized (e.g. Naples Terms in 1994, and HIPC Debt Initiative in 1996). Large numbers of international debt experts concur that debt forgiveness is a necessary step towards overcoming the debt trap and restoring the growth prospects in many LDCs. It is clear, though, that the debt cancellation must be much higher than that provided in the Brady Plan and the Toronto menu. As professor Gianni Vaggi (1993) suggested, a 50–70% write-off, or even total

cancellation in some cases, would be a realistic scenario. The argument put forward here is that sufficient debt reduction in the debt stock or debt servicing would result in an immediate free foreign exchange from lower debt service payments. If the free cash flows were used to finance sound economic policies and income-generating projects, future payoffs would be substantial and the debtor country would be put on the road to acceptable and sustainable economic growth and development.

In the case of Iraq, even though one can argue that debt forgiveness is undoubtedly an important factor, it would do little towards returning the country to a normal situation (i.e., letting it regain normal access to the international capital markets as well as restoring growth and promoting sustainable development). Hypothetically, if Iraq did happen to achieve a 100% write-off in its debt volume and debt servicing, but the underlying economic policies and management practices remained unchanged, the reduction of the debt stock alone could not possibly benefit Iraq's prospects for economic recovery and prosperity. Sooner or later Iraq, with its government's long-standing reputation of irrationality and imprudence, would find itself in the midst of another debt crisis despite any cancellation of its debt.

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It is exactly for this reason that a viable and more realistic strategy for resolving Iraq's external indebtedness must be more than the combination of debt rescheduling and cancellation. It must rather be a combination of four complementary components:

- debt relief;
- new financing;
- structural reforms; and
- peace, political stability, as well as regional cooperation.

Each of these four components must be viewed as links on a chain as each one is as important as the other is and so is an integral part of the whole. Moreover, this debt-management strategy is not intended to be a separate activity or to replace Iraq's overall macroeconomic strategy. It is only meant to be integrated with it or to operate alongside it. As important as this debt strategy is, it can by no means solve all of Iraq's financial problems. At best, if it is implemented fully and correctly, it may be the first necessary step in the removal of Iraq's many impediments so that the country may reestablish the necessary conditions for its sustainable growth and development.

THE FOUR-PILLAR STRATEGY

Given Iraq's peculiar economic, social, and political conditions, its development priorities, its financial needs, as well as the scale and complexity of its debt problem, it is incredibly difficult to develop an effective strategy that could possibly remedy Iraq's foreign indebtedness problem. However, in my opinion, the closest one could come to such a scenario would be by the proposed four-pillar strategy. This comprehensive debt strategy is designed to achieve a number of objectives, which are two-fold and interrelated:

- The short-term objectives are to reduce immediately Iraq's debt burden to a sustainable level as well as to provide a high degree of liquid resources so that any reconstruction or rehabilitation programs would not be curtailed for lack of external funding.
- The long-term objectives are to improve Iraq's chances of economic recovery, political stability, reintegration into the international community, and long-term sustainable development and prosperity.

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The four pillars combined together could pave the way to Iraq's achieving these multiple objectives.

Pillar I: Debt Relief

Reducing Iraq's outstanding stock of debt to a sustainable level is probably the most direct means of eliminating its debt overhang. In my opinion, only a cancellation of 80% or more of Iraq's external debt would make sense, as that would allow the country to reach a sustainable debt situation. Without such a reduction, Iraq's debt overhang would not only be perpetuated, but both domestic and foreign investment would completely disappear so that its economic growth and reforms would be greatly hindered.

Debt forgiveness would thus be the major source of any debt reduction and could be negotiated bilaterally with the creditors. Iraq would have to engage in and intensify various bilateral initiatives with all its official and commercial bank creditors. This would not be an easy task, as it would require a lot of hard bargaining, patience, diplomacy, and above all negotiation skills, which Iraq might lack, but it would be worth the effort.

The amount of debt cancellation that Iraq could expect to receive from its creditors would be determined by a complex mixture of the

prevailing economic and political conditions in the country on the one hand, and the political stalemate between Iraq and the UNSC on the other. At present, under the UNSC's resolutions, the government of Iraq is required to demonstrate its peaceful intentions by meeting a series of obligations. Some of the major ones are as follows: Iraq must end its weapons of mass destruction programs, recognize its borders with its neighbors, refrain from aggression and end its support of terrorism, return stolen property and account for Kuwait POW/MIAs, and, last but not least, it must stop brutalizing its citizens. In simple terms, the government of Saddam Hussein must totally change its behavior and prove its peaceful intentions towards its people and its neighbors in order to be considered for any debt relief by its creditors.

The bad news, though, is that there is more and more overwhelming evidence that Saddam Hussein's true intentions can never be peaceful — as US Secretary of State Madeleine Albright pointed out in her remarks at Georgetown University on March 26, 1997. This was also reiterated by her, as well as by others, during the intensive bombing campaign (Desert Fox Operation) which took place in late December 1998. If this is the case, Iraq will never be eligible for debt relief. Nevertheless, the good news is that the international community, including the United States, would be willing to change their policies towards Iraq once a change in the existing regime occurs.

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As further suggested by Mrs. Albright, should Saddam Hussein's regime be replaced by a representative and responsible government that would return Iraq to the community of nations, Iraq could expect some leniency from its major creditors as a gesture of goodwill. This opinion is widely shared by a number of prominent politicians, scholars, and diplomats all over the world. In a recent article published by *Foreign Affairs* (May/June 1997), Zbigniew Brzezinski, Brent Scowcroft, and Richard Murphy all came to the same conclusion and added that, "the United States should consult with interested parties about whether a postSaddam regime should be offered relief from Iraq's enormous debts or Gulf War reparations. Such a gesture would be a sensible way to deal with the problems of Iraqi reconstruction. It might even help induce aspiring successors to step forward." If Saddam's regime was replaced by a responsible and freely elected government, Iraq could then benefit, for instance, from military debt forgiveness or peace dividends similar to what many other countries have already taken advantage of — Egypt for its participation in the 1991 Gulf War, Poland for its pioneering role in the

political transition of Eastern Europe from communism, and Jordan for accepting the peace treaty with Israel. All these may offer an encouraging precedent.

Furthermore, the cancellation of a large portion of Iraq's foreign debt could also be justified based on humanitarian grounds, as it would alleviate the long suffering of the Iraqi people. The two successive wars, along with the ongoing UN sanctions, have inflicted disproportionate damage on a population that has no voice in the policies of either its own government or the international community at large. The humanitarian issue in Iraq is very real and raises questions about how much an entire nation can be punished for the actions of an authoritarian regime. As correctly stated by CESR (1996), "the international community should not impose massive and collective suffering on innocent civilians for the sins of their government." Outside governments should not be indifferent to the very real suffering the Iraqi people experience due to the cumulative impact of the UN sanctions and Saddam's quarter of a century of warmongering, selfishness, and incompetence (Cordesman & Hashim, 1997).

Pillar II: New Financing

Ensuring adequate new external financing is the second element in this strategy. It is important that Iraq not lose the possibility for further borrowing, either for purposes of economic reconstruction and modernization or for the reduction of its existing debts. An injection of fresh money would provide immediate liquidity relief and could be linked directly to the support of policy reforms that would help to revive and drive the economy towards a new sustainable growth and development. Needless to say, it would be in the region's best interest to see Iraq not only implement reforms, but keep them on track so that a healthy, well-functioning, and competitive market could evolve. This would be out of reach without significant investment at both the regional and international levels.

This fresh financing would have to be offered on highly concessional or grant terms so that it would not add to Iraq's debt overhang, but help resolve it. Donor countries, commercial banks, export credit agencies, international lenders, the IMF, and the World Bank would be expected to provide new funding. Some Arab states in the Persian Gulf and other friendly governments around the globe wishing to have new, long-term economic relations with Iraq could do likewise.

Foreign direct investment (FDI) and the repatriation of flight capital could also participate in the new capital inflow, provided that

Iraq could give the necessary incentives to attract both domestic and foreign investors. Oil and gas, agriculture, and tourism might stand as the most attractive sectors for foreign investors especially from the USA, Canada, Europe, China, Japan, and South Korea. As with other indebted countries, FDI might be more promising as it provides resources in a manner that shares the risk between the host country (Iraq) and the country of origin. It also has the potential of bringing with it foreign technology and management skills. Furthermore, as Iraq's capital markets deepen, equity investment would play a greater role in financing development and growth.

It must be said, though, that any influx of capital would have to be backed by a system of sanctions in order to ensure that undertakings were honored, resources used effectively and productively, and schemes administered fairly and efficiently. It is quite plausible that Iraq would have to make a binding commitment to use the resources for the purposes for which they were intended. On their part, the creditors, including international institutions, would have the authority to exercise surveillance over the whole scheme, and/or in the final analysis, to impose some sort of sanctions for noncompliance.

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Pillar III: Structural Reforms
Implementing major political, social, legal, and economic reform is the central element of this debt strategy as this would reduce macroeconomic imbalances, promote democracy and political stability, facilitate long-term growth, and reduce poverty and social inequality among the people of Iraq. Policy reforms should include, among other things:

- diversifying and expanding product bases, thus becoming less dependent on oil revenue;
- building a strong agriculture sector that would provide both food crops and renewable sources of energy;
- deregulating the economy, improving the financial system, promoting private initiatives, and selling off money-losing, state-owned enterprises to the private sector;
- adopting policies to encourage the repatriation of flight capital and foreign direct investment;
- encouraging greater competitiveness by creating and promoting a dynamic export base and permitting imports;
- cutting back military expenditure to an acceptable proportion of GDP and diverting resources from defense to education, health care, social welfare, and agriculture;

- doing away with administrative corruption and the further abuse and misallocation of resources;
- making the Central Bank of Iraq fully independent and holding it accountable for cutting inflation, price stability, and full employment;
- improving productivity and making the economy more internationally competitive;
- rebuilding civil society within which human and property rights could clearly be defined and protected;
- pressing ahead with important legal, judicial, and political reforms; and
- promoting and creating a responsible and an elected accountable government.

Pillar IV: Peace, Stability, and Regional Cooperation

The regional political and economic climate is a particularly important factor in the case of Iraq. Peace, political stability, and regional cooperation are the key prerequisites for economic stability and prosperity in the Middle East. Wars, hostilities, political instability, antimarket policies, and excessive red tape all constitute obstacles to any rational investor. As aptly stated by John Gavin, US Ambassador to Mexico, "Potential investors don't want flexibility, they want fixed rules of the game." Without being able to have reasonable confidence in the country's long-term stability and economic viability, no one would even consider investing in Iraq.

Thanks to Saddam Hussein, Iraq has distinguished itself for its aggressive behavior not only towards its neighbors, but also towards its own people. This must be changed. Iraq needs to return to its normal position as a civilized and effective member in the region. To achieve this, Iraq must make and maintain a comprehensive peace settlement as well as build bridges of trust and mutual respect with all its neighbors. This would involve Iraq's not only recognizing each country's right to existence, but also its ceasing from all forms of terrorism, war, and violence. At the same time, the West must develop tighter controls on the transfer to Iraq of both conventional military technology and that of mass destruction. The West must also take every step to pressure Iraq into joining international and regional arms control regimes that can bring stability to the region.

Furthermore, Iraq must also remove trade barriers, ease government regulations, continue the privatization process, which must include privatizing financial institutions, allowing for investment openings, encouraging regional joint projects and production partnerships, and

accelerating the process of regional economic cooperation and integration (the proposed Middle East Common Market). By making new alliances and other cooperative agreements, Iraq's local companies could quickly update their technology, coming more in line with international standards in terms of quality, productivity, and performance.

Last, but not least, Iraq has to demonstrate that it has learned from its past mistakes by adopting more civilized approaches to solving its domestic and regional problems and disputes. All these have to be the new ingredients that constitute the "new" Iraq within the "new" Middle East and should be a sign of potential political and economic stability in the whole region.

CONCLUSION

While the international community regards Saddam Hussien as the root of Iraq's financial and economic crisis, the only solution put forward inflicts horrendous poverty and deprivation on the Iraqi people. They have already suffered enough through two wars and eight-year sanctions with no hope of reprieve. One thing is definitely clear — if the UN attempts to enforce all of its current demands on Iraq in terms of sanctions, war reparations, and loan repayments, it may end in creating the kind of "peace" the allies forced on Germany after World War I. This was a peace which John M. Keynes, the famous English economist and monetary expert, quite correctly warned could only lead to chaos and a second war. A revisionist plan is what is called for. Iraq's rich natural resources should be used to rebuild and rehabilitate the country, not to pay punitive damages to be shouldered by the next generation. To quote Cordesman and Hashim (1997), "Iraq may have a loathsome, guilty, and incompetent regime, but a Carthaginian peace can only contribute to Iraqi revanchism for years to come."

Without a doubt, the external debt burden in Iraq is a problem that can be managed once its government has the willingness and the vision to do so. The Iraqi government must act quickly and promptly to develop and implement a foolproof solution to put an early end to the country's economic and financial drift.

This article has attempted to render a workable strategy to alleviate Iraq's acute foreign indebtedness and kick start its economy. Any successful strategy must not only be able to bring Iraq out of its seemingly financial and economic impasse and fully reintegrate into the international community, but it must also prepare the country to

play a better and more constructive role on the world stage in the new millennium.

Appendix

IRAQ'S EXTERNAL DEBT SUSTAINABILITY
(A SIMPLIFIED ASSESSMENT)

Assumptions:

1. The two key indicators of external debt sustainability are the stock of external debt-to-exports ratio and the external debt service-to-exports ratio with target levels below 200 and 20 percent, respectively.
2. The overall UN sanctions imposed on Iraq in 1990 should be lifted, which means that Iraq's political and diplomatic isolation would end, allowing the country to once more enjoy normal economic interaction with the rest of the world.
3. Iraq would be allowed by other OPEC member countries to recapture the market position it held prior to its invasion of Kuwait in 1990, which implies that Iraq's oil export would be in the neighbourhood of 3 million barrels per day.
4. Iraq's external debt at the beginning of 1998 amounted to US$120 billion, of which 35% or $42 billion was in interest free loans from Arab countries, mainly Kuwait, Saudi Arabia, and UAE.
5. The interest charge would be 8 percent on the outstanding balance and no debt repayment would be required during 1998. Also, there would be no voluntary inflows of foreign capital in the form of grants or other assistance.
6. Oil would be Iraq's only exportable commodity with an estimated price of US$14 per barrel.
7. The $220 billion claims filed by the victims of the 1991 Gulf War against Iraq for losses directly resulting from its invasion of Kuwait in August 1990 should be eliminated.

	Outstanding Debt ($bn)	Annual Debt Service ($bn)	Annual Export Earnings ($bn)	D/X	DS/X	POSITION
1st Scenario: Zero Debt Cancellation	120	6.24[a]	15[b]	800%	41.6%	Unsustainable
2nd Scenario: 25% Debt Cancellation	90	4.68[c]	15	600%	31.2%	Unsustainable
3rd Scenario: 50% Debt Cancellation	60	3.12[d]	15	400%	20.8%	Unsustainable
4th Scenario: 75% Debt Cancellation	30	1.56[e]	15	200%	10.4%	Unsustainable
5th Scenario: 80% Debt Cancellation	24	1.25[f]	15	160%	8.3%	Sustainable

D/X=Debt to Exports Ratio; DS/X=Debt Service to Exports Ratio.

[a] $120 billion x .65 x 8% = $6.24 billion
[b] 3 million barrel x $14 x 360 days = $15.12 billion
[c] $90 billion x .65 x 8% = $4.68 billion
[d] $60 billion x .65 x 8% = $3.12 billion
[e] $30 billion x .65 x 8% = $1.56 billion
[f] $24 billion x .65 x 8% = $1.248 billion

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