Restructuring Iraq's Foreign Debt – Let's Hope This "Baker Plan" is More Successful

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December 5, 2003

On December 5, 2003, President George W. Bush announced that he is appointing **James A. Baker III** to be his "debt envoy," in charge of renegotiating Iraq's huge foreign debt. To many, this appears to be a welcome move -- Baker is a savvy, affable fellow with strong diplomatic skills and multilateralist inclinations, which this administration sorely needs. And Iraq's debt now stands at $128-$200 billion or more, depending on whose claims are recognized (See below.) Since this is several times the country's entire national income, a debt restructuring is certainly long over due.

In fact, as I've argued **elsewhere**, if Iraq's foreign debt had been restructured in the early 1990s, when Baker was Secretary of State, many of our difficulties with Iraq, including Saddam's 1990 invasion of Kuwait, and, *a fortiori*, our own recent invasion of Iraq, might well have been avoided entirely.

Those who are old enough to remember James Baker's terms as Secretary of the Treasury from January 1985 to August 1988 and Secretary of State from January 1989 to August 1992 may be struck by several ironies.

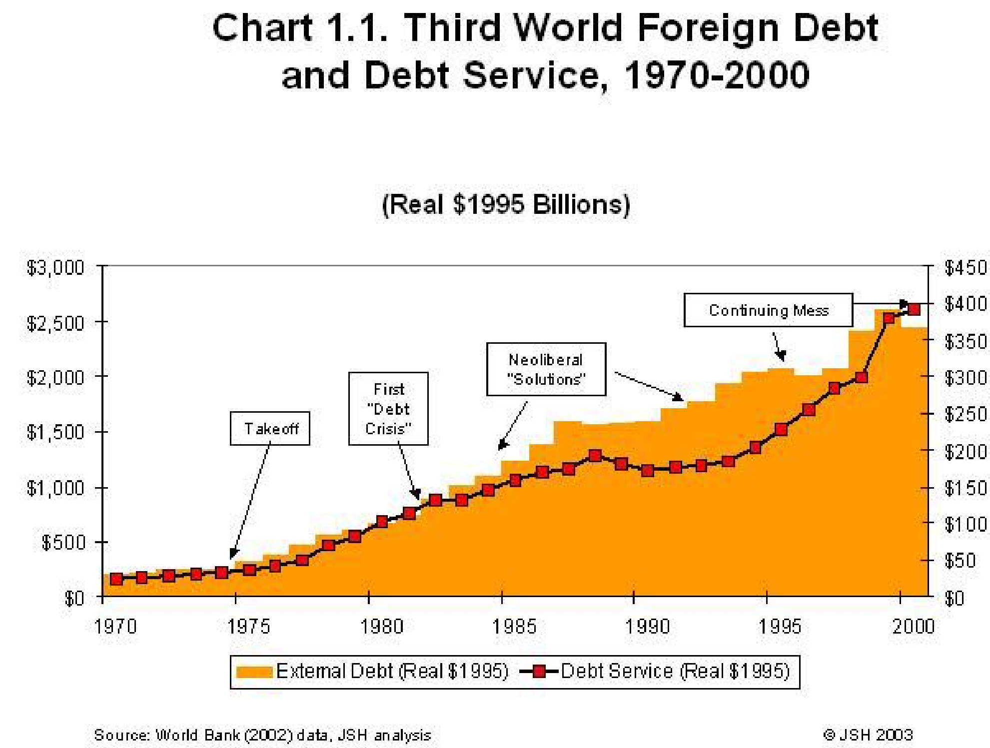
As we'll remind ourselves below, not only did his "Baker Plan" utterly fail to reduce the Third World debt, but when he was Secretary of State, he actually ***encouraged the US Department of Agriculture and leading US and foreign banks to lending billions of dollars to Iraq*** -- despite its evident credit unworthiness. His motive back then was evidently to insure that Saddam could continue to import weapons from abroad and enhance his ability to manufacture even nastier weapons at home. It seemed like a good idea at the time.

So, in a sense, this appointment shows that our policies have come full circle. It must be profoundly satisfying for 73-year old Jim Baker. His last hurrah in government may finally be to successfully restructure a Third World country's debts – indeed, the same country whose debts he helped to increase substantially fifteen years ago. We may not be able to find Bin Laden, but we may have located another enemy, Pogo…….

THE BAKER PLAN'S TRACK RECORD

To begin with, Jim Baker's credibility in debt restructuring is not exactly unsullied. In 1985, as President Reagan's second Treasury Secretary, he launched his so-called "Baker Plan," the first of several attempts by the US Government to tackle the exploding Third World debt problem. It was managed on a day-to-day by Baker's close associate, former Undersecretary of the Treasury **Dr. David C. Mulford**, who later became **Chairman of Credit Suisse First Boston's International Group**, and just last month was **designated** by President Bush II as the new **US Ambassador to India**.

The "Baker Plan," which relied heavily on a combination of tougher IMF/World Bank conditions in exchange for a modest amount of new loans, basically assumed that with the right policies, developing countries could grow themselves out of their excessive debts. Unfortunately this assumption proved to be wrong – with disastrous consequences, mainly for the countries. The Baker Plan, together with its successor, Treasury Secretary **Nicholas Brady**'s so-called "market-oriented," voluntaristic approach to debt reduction, were utter flops. The conditions that were imposed on debtor countries threw them into even deep recessions, provoking bloody riots (Venezuela, 1989) and debt moratoria (Brazil, 1987; Argentina, 1988). And by the year 2000, the real level of Third World debt was 150 percent higher than it had been in 1985. **(See Chart 1.1)**



However, the Baker Plan, the Brady Plan, and other such "market-based" approaches to debt reduction that succeeded them did at least have one beneficial effect. They provided lots of opportunities for leading First World investment banks -- like Mulford's former employer **Credit Suisse First Boston,** and Nick Brady's investment bank **Darby Overseas Investments Ltd.,** but unlike Baker's own **Carlyle Group,** which has generally avoided developing countries **--** to make a ton of money by structuring and syndicating all the many privatizations and debt swaps that resulted from them, and by advising developing countries on all the complexities of how these plans really worked. (See **my book** for more juicy details -- including Dr. Mulford's involvement in Argentina's 2001-02 debt debacle.)

THE ORIGINS OF IRAQ'S DEBT AND THE KUWAIT INVASION

In announcing Jim Baker's new appointment, President Bush **explained** that "the future of the Iraqi people should not be mortgaged to the enormous burden of debt incurred to ***enrich Saddam Hussein's*** regime." It is hard to quarrel with that statement – *up until* the last five words. If Mr. Bush had actually bothered to examine the origins of Iraq's foreign debt, he would have quickly realized that "enriching Saddam" was a very minor part of the story.

Indeed, the vast bulk of Iraq's foreign debt today is supposedly "owed" to **Kuwait, Saudi Arabia, and the Gulf States**. Most of this was incurred to help fight the Iran-Iraq War and defend the autocratic dynasties that rule these oil emirates against the Ayatollah Khomeini's populist fundamentalism in the 1980s.

One of the main reasons why Saddam invaded **Kuwait** in August 1990, in fact, was that **Kuwait and Saudi Arabia** refused to restructure these "Iraqi debts" – at the same time they were accelerating oil production, driving oil prices down. By 1989, coming out of an eight-year war, Iraq's economy was a complete mess, with hundreds of thousands of war casualties, more than a million soldiers under arms, declining oil revenues, and this huge war debt. Yet for reasons that are still very unclear to this delay, the Kuwaitis and the Saudis insisted on being repaid in full, and actually accelerated their oil production.

If James A. Baker III, the Secretary of State at that point, had really wanted to avoid Iraq's subsequent invasion of Kuwait, he (and Mulford/ Brady) might have exerted pressure on these US allies – who were completely dependent on the military for their protection -- to restructure these excessive debts back then, not wait until 2003 to do so. Instead, Baker adopted what might be termed a "Weimar" strategy with respect to Saddam's debts. It was nothing less than a throwback to the hard-hearted policy that the US, France, and the UK adopted with respect to Germany's reparations debts after World War I – with similar consequences.

But please don't take my word for it. Instead, examine the detailed history of the "lessons learned" from the Iran-Iraq war that was published in December 1990 by the US Army War College's Strategic Studies Institute, a few months after Saddam invaded Kuwait. On the subject of why he had done so, the study had this to say:

> *Conventional wisdom maintains that Iraq always was covetous of Kuwait, and that, indeed, the nature of the Ba'athists is to be expansionists; in invading, the Iraqis were merely following their instincts. This explanation does not hold water. Why, for example, if they desired territory, didn't they seize Khuzestan at the end of the war when Iran was prostrate? Why did they not at least insure themselves control of the Shatt Al Arab? By withdrawing completely from Iran, and turning the issue over to the UN for settlement, the Iraqis behaved as a responsible member of the world community.*
>
> *Nor does it seem reasonable to argue that Iraq invaded Kuwait because it thought it could get away with it. Throughout the war, the Iraqis had ample evidence of the importance of Kuwait to the superpowers….**Taking all this into account, it seems obvious that Iraq invaded its neighbors because it was desperate.** (Emphasis added.) It had a million man army that it could not demobilize, because it had not jobs to send the men home to. It had no jobs because its economy had been ruined by the war. It could not get its*

> *economy going again until it demobilized. Thus the Iraqi leadership saw itself in a vicious dilemma. At the same time, Kuwait was fabulously wealthy, and Iraq – by seizing it – could hope to exploit its wealth to resolve its economic problems….The lesson would appear to be, never make war until you have assessed the potential of your opponent. Iraq's initial mistake in attacking Iran was in failing to appreciate the vast human potential that Tehran could exploit…And in the end, although it emerged "victorious," it practically bankrupted itself.*[i]

In this view, Saddam was not so much a crazed madman, an expansionist bent on regional domination, or even an undeterrable, diehard anti-Zionist, as much as he was a desperate bungler, driven into the corner by his country's own economic situation.

THE COSTS OF NOT RESTRUCTURING

Was this view correct? We may never know. What is clear is that the cost of not bothering to find out has been enormous – especially compared with the cost of the mere $27 billion settlement that Iraq proposed and Kuwait rejected in July 1990, on the eve of the war.

Among the subsequent costs of failing to restructure Saddam's debts" back then, we can include:

- **The costs of the 1991 Kuwait invasion** -- at least **$100 billion** of damage to non-oil infrastructure in Kuwait and **$50 billion** in Iraq, plus **$61 billion** of direct military expenses for the US-led coalition forces, an estimated **$600 billion** in longer-term reductions of the region's gross domestic product; 2500 to 3500 civilians, 50,000 to 100,000 Iraqi soldiers, and 350 coalition forces killed; about 111,000 indirect civilian deaths, including 70,000 children, due to a breakdown in sanitation, the spread of infectious diseases, the disruption of hospital care caused by power outages, and the side-effects of more than 300 tons of depleted uranium ordinance used by the coalition in southern Iraq; up to 25,000 coalition troops who complained after the war of "Gulf War" syndrome, a mysterious "illness" that many believed might have been caused by exposure to chemical weapons; nearly 700 oil wells that were set afire, burned for a year, and caused an environmental disaster and another $20 billion of damage; and 11,000,000 barrels of oil that were released into the Persian Gulf, about twenty times the size of the 1989 Exxon Valdez spill.[ii]

- **Compensation Claims for Gulf War Damage.** As a result of the 1991 war, Iraq was also saddled with UN sanctions, plus $320 billion in claims for damage compensation, which it was supposed to pay out of oil revenues, channeled through the UN under the terms imposed by the coalition. [iii] These claims included $117 billion claimed by Kuwait's Public Authority for Assessment of Compensation, even apart from lost oil revenue.

By 2003, $148 billion of those Gulf War claims had been settled for about $.30 on the dollar, or $43 billion. Assuming conservatively that the remaining claims will be settled for a (present value) of $.20 cents on the dollar, the remaining claims might be worth $36 billion. At that rate, Iraq will ultimately have paid **$79 billion** for Gulf War damage -- on top of its foreign debt, and roughly the same amount as its entire Iran-Iraq war debts.

In the wake of the 2003 US invasion, Kuwait has apparently indicated that it may be willing to exchange a portion of these claims and debts for a stake in Iraq's new oil concessions. Throughout the decade, Iraq protested to no avail that many of Kuwait's claims were spurious, amounting to yet another forced transfer of oil revenues to wealthy Kuwaitis while its own citizens were starving – for example, the case of one Kuwaiti who complained to the UN in 2003 about losing his thoroughbreds, jewelry, and art collection, and received $4 million in compensation.[iv]

Sanctions. There was also the enormous cost of the trade sanctions that banned all imports of Iraqi goods that the UN imposed on Iraq four days after the invasion, and maintained for 13 years, until May 2003, after the US-led invasion. This was one of the most comprehensive economic blockades in history – way beyond the effort maintained, for example, against South Africa in the 1980s. However, even these sanctions failed to get Saddam out of Kuwait, topple him from power, or force him to cough up his purported "weapons of mass destruction."

But what they did do was to create what can only be described as a catastrophe for Iraq's people – despite the fact that they were much responsible for their dictator's behavior than the international community that had helped bring him to power in the 1960s, armed him, and encouraged his war-like behavior throughout the 1980s.

The sanctions created havoc in Iraq's public health, sanitation, and hospital systems, by interrupting the supply of imported medicines, hospital equipment, chlorine and pipes for water treatment plants, pollution control gear for the country's oil refineries, and many other imported necessities. UNICEF has estimated that the 1990s sanctions alone were responsible for boosting Iraq's infant mortality from 25 per 1000 births in 1990 to 92 per 1000 in 1995, and causing a one-third reduction in per capita caloric intake by 1996. In 1996 the UN Oil-for-Food program was introduced to moderate these effects, but aid experts estimated that for the decade as a whole, the sanctions on Iraq probably claimed at least **60,000 to 100,000 victims per year** – half of them children.[v] In addition, the sanctions also imposed heavy costs on neighboring states like Turkey, which estimated that it lost at least **$80 to $100 billion** in trade revenues with Iraq because of the border's closure.[vi]

Meanwhile, the one group of Iraqis that were the least affected by sanctions was of course Saddam's Ba'athist Party itself. A 2002 study by the GAO found that, while the UN Oil for Food program handled $51 billion of Iraq oil revenues from 1997 to 2001, another $6 billion of illicit income was generated through illegal oil exports and surcharges levied by key officials in exchange for contracts.[vii] It speculated that much of this income ended up in the usual places – bank accounts in offshore havens like Switzerland, Lebanon, and Cyprus.

Of course the sanctions also provided the occasion for the well-known remark by US Secretary of State Madeleine Albright in 1996. When asked by reporter Leslie Stahl whether this policy was worth the deaths of 500,000 Iraqi children, she replied, "I think this is a very hard choice, but we think the price is worth it." Many others did not agree. Two successive senior UN humanitarian program coordinators and the head of the World Food Program resigned from the program in 1998 and 2000, describing what was being done to the people of Iraq as "intolerable." As one commented, "How long should the civilian population of Iraq be exposed to such punishment for something they have never done?" [viii]

The Clinton Administration's answer -- like that of President George H.W. Bush I and James A. Baker III way back in 1991-92 -- was that, from the standpoint of its own selfish interests, this brutilitarian policy was preferable to the full-scale invasion that would have been needed to take Saddam out. In fact, but for the events of September 11th 2001, and the opportunity that it presented to conflate Saddam's regime with other "Islamic terrorists," President Bush II would probably have reached the same conclusion.

All this is even before accounting for the costs of the 2003 US-led invasion – so far, more than $100 billion -- and the reconstruction required by that – so far, an estimated $20-$30 billion a year. All told, the failure to head off Saddam's adventurous attempt to solve his "debt problem" by invading Kuwait has easily had an economic price tag – even apart from all the suffering that it caused – of at least $800 billion to $1 trillion.

This makes Iraq's foreign debt – whatever it is – pale by comparison. And it should also make us all a wee bit curious to know whether negotiating a debt-and-oil-price settlement with Saddam was ever seriously considered by James Baker way back in the late 1980s, before all these bloody chickens came home to roost?

IRAQ'S FOREIGN DEBT – WHO'S OWED WHAT NOW?

As for Iraq's foreign debt now, who is owed what, and with whom, therefore, will 'debt envoy" Baker have to negotiate? The estimates of the debt's size vary widely, partly because different measuring rods and time periods are used by different analysts. But by all measures, the accumulated debt burden was already very heavy by the end of the 1980s -- and most of it was due to the Iran-Iraq War, which had lasted from October 1980 until July 1988, when Iran finally accepted a ceasefire. Since the US and its allies, including Kuwait and Saudi Arabia, actively encouraged that war, and provided assistance to both sides in the interests of perpetuating it, there is a strong moral argument that the portion of the Iraqi debt that pertains to it should indeed be these allies' responsibility.

Iraq's own official estimate of its foreign debt as of December 31, 1990 was just $42.1 billion. But this left out a huge amount of "quasi-loans" that it had obtained from neighbors like **Kuwait, Saudi Arabia, and the Gulf States** -- all of which informed Saddam after the war was over that they were never intended these funds as "grants," but as loans, which they expected to be repaid. As noted, this became a crucial bone of contention in the events leading up to the Kuwait invasion.

Since Iraq was embargoed throughout the 1990s, except for UN-approved "Oil-for-Food" transactions, it did not contract any new loans after August 1990. The World Bank/ Bank of International Settlements estimated in 2001 that as of 1998, Iraq's foreign debt totaled **$127.7 billion**.

However, this included about $47 billion of interest that had accrued during the 1990s. Since this was a period when Iraq was subject to sanctions that arguably prevented it from doing any debt restructuring, it is questionable whether it is really fair to charge Iraq for all this imputed interest (calculated by the World Bank at a 7 percent a year.)

Netting out this interest, the World Bank's estimate implies that Iraq's foreign debt was $80.7 billion in August 1990, just before the Gulf War – including all the disputed finance from the Gulf States. That already made Iraq's debt-to-national income ratio about 1.1, or $4600 of foreign debt per capita – not quite as high as the debt burdens of some other Third World countries (like Nicaragua), but about as high as the typical "heavily-indebted country."

Of this $81 billion total, **fully $47 billion** was "owed" to Arab kingdoms, including **$17 billion to Kuwait, $20 billion to Saudi Arabia**, and $300 million from Jordan and Morocco. (If interest is included, this adds **another $30 billion** the $47 billion.) Most of the $47 billion was provided during the first three years of the Iran-Iraq war, when these countries were most afraid that Iraq might lose the war to Khomeini. A US intelligence estimate says that Kuwait and the Gulf emirates provided Iraq at least $1 billion a month from October 1980 through the end of 1984, in order to sponsor this war effort.

Another $13.5 billion was provided by the Soviet Bloc, including **$12 billion from the USSR** (including about $7 billion for arms), $1 billion from **Bulgaria**, and $500 million from **Poland,** in the form of export credits. Another **$800 million** was loaned by Iraq's good neighbor to the north, **Turkey**. (Iraq also received the whopping sum of $50 million in foreign aid from the Soviets and Western Europe during this period.)

Finally, about **$19 billion** of Iraq's foreign debt came from **First World Western** sources, including $13.5 billion of bilateral and government-guaranteed export credits from the 16 members of the "Paris Club." These were also mainly used to finance Iraq's arms imports. The leading providers were **France's COFACE,** which loaned $ 3.75 billion of export credits outstanding for arms and $4.3 billion for other goods; **Japan's JEXIM** and leading trading houses, which loaned Iraq 700 billion yen ($5.8 billion); the **UK's ECGD**, which provided more than $1 billion in credits, and became Iraq's "paramount favored creditor;" and **Germany's HERMES, Austria's OeKB, Canada's EDC, and Australia's EFIC**.

While these government agencies provided the loan guarantees, a whole army of private banks got involved in delivering these guaranteed credits, and some also provided their own credits to Iraq. Among the most important private banks involved in Iraq lending during the 1980s were Germany's **Commerzbank, JP Morgan, Chase, Gironzentrale (Austria), First City Bank of Houston, and Gulf International Bank (Bahrain.)** In the early 1980s, JPMorgan also made several rather unusual, life-saving loans to a Brazilian arms company, **Engesa**, which became one of Iraqi's principal arms suppliers.

All told, therefore, when James Baker looks around to see who will have to "eat the losses" on Iraq's foreign debt, he will quickly learn that it not just our Old European rivals, the French and the Germans, or even the fair-weather Russians, but the original "hard ball" players from 1991, Kuwait and Saudi Arabia. Let's hope that he has more success negotiating a debt reduction for Iraq with them than Saddam did.

IRAQ'S FOREIGN DEBT – BAKER'S OWN INVOLVEMENT

The other interesting fact to know about James Baker's experience with Iraq's foreign debt is that he was deeply involved in making it larger. While he was Secretary of State from 1988-92, our very own **US Department of Agriculture's Commodity Credit (CCC) Program** loaned Saddam nearly $5 billion, with James A. Baker III's knowledge and active encouragement.

Under the **US Department of Agriculture's "GSM-102"** export credit program, the CCC underwrote private loans that were extended by US banks to foreign banks or US exporters, supposedly for purchasing US commodities like wheat and rice. The DOA had approved Iraq's participation in the "GSM-102" program early in the Reagan Administration, in December 1982. In 1983 the CCC guarantee $385 million in Iraqi credits to import American grain, the first in a long series of such guarantees. By 1990, these CCC credit guarantees were being issued to Iraq at the rate of $1 billion per year, and accounted for more than 20 percent of the entire GSM-102 program.

These loans were made, not just to feed Iraq's people and support US farmers, or surely not because Iraq had good credit, but as part of an effort to cultivate a close relationship with Saddam's regime -- and especially in the late 1980s, at a point when his oil revenues were collapsing and no one else would lend him any more money, in order to help him continue buying arms.

In June 1989, for example, US Secretary of State James A. Baker III wrote to the US Secretary of Agriculture, **Clayton Yeutter**, asking him to boost the CCC's loan guarantee program to Iraq to $1 billion a year. Yeuter promptly did so. Even September 1989, when a major scandal surfaced that involved lending to Saddam by Italy's largest state-owned bank (since privatized in 1998), **Banco Nazionale del Lavoro (BNL)**, the record shows that Baker lobbied hard to continue this lending, with the State Department commenting in February 1990 that "the CCC program is a key component of the (Iraq) relationship….we need to move quickly to repair the damage to the US-Iraqi relationship by getting this critical program on track."

Many prominent US and foreign banks helped to arrange these Iraqi credits under the CCC program, including **BNL, JPMorgan, Midland Bank, Chase, First City Bank of Houston, Bank of New York, DG Bank (Germany), Bank of America, Arab Banking Corp. (Bahrain), Gulf International Bank (Bahrain), Girozentrale (Austria), and UBAF**. All told, from 1983 to 1990, the USDA's CCC program extended more than $5.5 billion of credits to Iraq – of which $2 billion was still outstanding when it invaded Kuwait in August 1990.

For a country with just 18 million people at that time, this was an enormous trade credit. But we now know from sources in Iraq and Jordan that much of the grain that these loans were supposed to have purchased never even reached Iraq. Much of it was traded by **Saddam's intermediaries in Jordan**, Turkey, and the then-Soviet Union for munitions, spare parts, chemical and other military supplies.

Most of this story has never been fully investigated. The rather morally-obtuse Clinton Administration decided that it had better things to do than chase down "Iraq-

Gate" after it won the 1992 election, and the current installment of the Bush Dynasty certainly has no interest in doing so. Fortunately for Mr. James A. Baker III, the appointment to his new "debt envoy" position doesn't require Senate confirmation.…..

The historian can always dream, however, of being able to ask Baker a few tough questions about what really happened way back then, and what he thinks might have been possible with a little more aggressive, more timely, if perhaps less "voluntaristic," approach to debt restructuring.

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[i] See Dr. Stephen C. Pelletiere and Lt. Col. Douglas V. Johnson II, "Epilogue: Iraq and Kuwait," in Lessons Learned: The Iran-Iraq War. Vol. I. Fleet Marine Force Reference Publication (FMFRP 3-203), (Quantico, Va: US Marine Corps Combat Development Command), December 10, 1990. Other students of Saddam Hussein's career have also argued that he was not an aggressive expansionist but a "ruthless pragmatist." See Efrain Karsh and Inari Rautsi, Saddam Hussein: A Political Biograpphy. (London: Brassey's, 1991.)

[ii] For the costs of the 1991 Gulf War, see John T. Haldane, "Rebuilding Kuwait," Trade and Finance, April 1991, avaialble at **www.washington-report.org/backissues/0491/9104081.htm**; Mervat Tallawy, UN Social and Economic Commission, "UN Agency: Iraq war losses expected to top $400 billion," abs-cbn.com, April 15, 2003; Dr. Eric Hoskins, "Public Health and the Gulf War," in Dr. Victor Sidel and Dr. Barry Levy, ed., (International Physicians for the Prevention of Nuclear War), War and Public Health. (Cambridge: Oxford U. Press, 2000); Melissa Krupa, "Environmental and Economic Repercussions of the Persian Gulf War on Kuwait," ICE Case Studies #9, May 1997, available at **www.american.edu/projects**.

[iii] For a summary of compensation claims against Iraq, see CSIS, "A Wiser Peace: An Action Strategy for a Post-Conflict Iraq," Supplement I: Background Information on Iraq's Financial Obligations," January 23, 2003, Center for Strategic and International Studies, available at **www.csis.org**.

[iv] See "UN Pays $863.7 million in Claims Against Iraq," Reuters, April 8, 2003.

[v] See Bruce Bartlett, "Sanctions Don't Work," National Review, March 19, 2003; "Iraqui refiners say pollution cost of UN sanctions is "Astronomical,"" News and Observer, April 27, 1998; Mary Deibel, "Administration Takes on Rebuilding Iraq's Economy," **www.knoxnews.com**, April 10, 2003; Rahul Mahajan, "The Unending War in Iraq," Resist, September 2000, available at **www.thirdworldtraveler.com**

[vi] See Xinhua News Agency, "Turkey Suffers Heavy Economic Cost," August 3, 2000.

[vii] See US Government Accounting Office, "Weapons of Mass Destruction: UN Confronts Significant Challenges in Implementing Sanctions in Iraq," (Washington, D.C: GAO, May 2002.

[viii] Hans von Sponeck, former UN Humanitarian Program Coordinator for Iraq, February 13, 2000.