‘It’s not the donations, stupid’: Key points from the Kuwait conference

Ahmed Tabaqchali
21 February 2018

With a few exceptions, the coverage of the “Kuwait International Conference for the Reconstruction of Iraq”[1] has been confusing at best, ranging from those who thought it was a failure for raising far less than needed to those who thought that that it was a reasonable success for raising a third of what was needed[2]. These thoughts were not helped by an Iraqi delegation that was focused on presenting a shopping list of projects that would need $88bn[3] in financing. In the end, it was reported that Iraq received pledges of $30bn[4] in loans and guarantees, just over a third of the required total.

Lost in all of this is the significant document “Reconstruction & Development Framework”[5] that the World Bank Group (WBG) prepared with the Iraqi Ministry of Planning (MoP), as well as the IMF’s work on Iraq and its presentation[6] at the conference. The first is a comprehensive analysis of the reconstruction requirements across all sectors of the country and provides plans for short, medium and long-term reconstruction needs within the framework of a long-term recovery for the country. In combination with the second, they provide the structure for funding the reconstruction effort.

The key takeaway is that the Government of Iraq (GoI) is realistic in its expectations that external sources of financings will be small, and therefore it expects to utilize its own resources over the next five years for the required reconstruction. However, given the high existing demands on its budget, it will augment its public investment budget with new financing approaches that are attractive enough to bring in syndicated bank loans, institutional investors and international stakeholders. These financing approaches were developed with the WBG and thus are based on a thorough analysis of the country’s capabilities and challenges, as well as being in-line with the IMF guidelines set in the Standby Agreement (SBA) of June 2016. The IMF’s presentation argues that this is feasible and consistent with macroeconomic stability, which means that the reconstruction should contribute to sustainable economic growth.

The IMF argues that the GoI can contribute $77bn over the next five years from the required reconstruction bill of $88bn. This contribution would be made of $50bn from oil revenues and $27bn of debt from raising bonds in capital markets and borrowing from International Finance Institutions (IFI’s) and in investments. Crucially GoI’s contributions are bound by requirements that Iraq’s foreign currency reserves remain at the current $50bn level and that total debt as a percentage of GDP is about 50%.

Therefore, Iraq would need to be able to access debt capital markets or bank lending markets for $27bn and donations of $11bn, or a total raise of $38bn. Investments, depending on their type, would fit into either category. The $30bn pledged goes a long way towards filling the financing gap of $38bn and not towards the $88bn total. The amounts pledged are roughly spilt between investments and export credits/loans.

Sovereign loans and guarantees come with lower interest rates and easier terms than commercial loans or bonds and therefore result in a lower repayment burden on Iraq. While Investments by their very nature are made with expectations of attractive rates of return and thus, given Iraq’s needs, will most likely be in productive ventures that either fill a need or contribute to economic growth. Sovereign export guarantees, while beneficial to the sovereign’s own domestic companies, yet by lowering their risk exposure would encourage these very companies to expand in Iraq. Ultimately, investments and guarantees are far more important and sustainable than donations as they are beneficial to both parties: they benefit the home companies as they seek higher growth in Iraq than in slowing mature home markets, yet for Iraq their presence is needed, and they contribute to overall economic growth.

The assumptions made by the IMF are provided in the table below taken from its presentation.

Iraq: Selected Economic and Financial Indicators, 2017–23

	2017 Est.	2018	2019	2020 Proj.	2021	2022	2023	Total
Iraq oil export prices (US$ per barrel)	49	60	56	53	51	51	51	
Total government debt (in percent of GDP)	58	53	53	52	51	50	49	
Debt service (in percent of exports of goods and services)	3	5	7	10	12	15	16	
Gross reserves (in US$ billion)	48	62	70	70	65	57	50	
Financing gap (US$ billion)	0	2	5	6	7	6	10	36
Sensitivity of oil revenue per 1$ of oil price change (in US$ billion)	1.4	1.4	1.5	1.5	1.5	1.5	1.5	

Sources: Iraqi authorities; and Fund staff estimates and projections.

The future price assumptions of Iraqi oil prices[7] are conservative and are derived from the futures markets. Based on prior IMF projections, they would assume that Iraq would not increase its current oil production or exports over the next five years. Moreover, they would assume that Iraq would still be bound by its OPEC production cut throughout 2018. Yet, Iraq has been exceeding these, leaving room for revenue upside in 2018.

Debt, current and new, at around 50% of GDP ensures that debt is below the threshold of 60% used in many debt targets. While debt service, on current and new debt, ensures that debt repayments are sustainable, and with the requirement of maintaining $50bn in reserves that no undue pressure will be exerted on the US $ peg of the Iraqi Dinar (ID). The IMF noted that to ensure that Iraq maintains $50bn in reserves that it, towards the end of the five-year period, would need to refinance some of the maturing debt and thus total financing need is $36bn.

It's worth noting that $41bn out of Iraq's $68bn in external debt at the end of 2017 is in the form of unresolved arrears to non-Paris Club creditors that were accumulated under the pre-2003 regime. This could be cut down by 90% if current negations with these creditors lead to the same debt relief terms accepted by the Paris Club creditors. Were this to happen, total debt as a percentage of GDP would be much lower than 50% giving Iraq greater flexibility to assume more debt while expanding its investment capital spending.

However, the crucial requirement is that Iraq must adhere to the prudent fiscal policy set by the IMF SBA agreement of June 2016 which is not only long overdue but essential to reduce the role of the state in the economy in order to diversify away from oil and for the development of private sector as the main driver of the economy.

The reconstruction needs and funding framework as articulated by the MoP, WBG and IMF fits with the thesis presented by the author in a recent study on Iraq's Economy Post ISIS[8] which concluded that "*Guided by the IMF following the signing of the Stand-By Arrangement (SBA) in June 2016, the Iraqi government can embark on the long process of decentralizing the state by reducing its role in the economy, encouraging the* *development of the private sector in agricultural and industrial production, and stimulating private sector employment. The straight jacket of the low oil price environment, the absence of financial buffers and sovereign wealth funds, plus the need for reconstruction will ensure that the government continues on this path, builds upon it, and ultimately ensures its eventual success.*"

In conclusion, the Kuwait conference was not about raising donations for Iraq but a strategic meeting on how to rebuild Iraq properly. Or as reported by one of the informed reports *"… conference in Kuwait was different, in that it moved from being a pledging event to a strategic meeting on how to rebuild Iraq. Private sector representatives joined ministers from key countries with a stake in strengthening Iraq. And the requirement was mainly for investment and credit lines to encourage the private sector to develop commerce rather than continuing the cycle of handouts, both promised and actual.*"[9]

Disclaimer
Ahmed Tabaqchali's comments, opinions and analyses are personal views and are intended to be for informational purposes and general interest only and should not be construed as individual investment advice or a recommendation or solicitation to buy, sell or hold any fund or security or to adopt any investment strategy. It does not constitute legal or tax or investment advice. The information provided in this material is compiled from sources that are believed to be reliable, but no guarantee is made of its correctness, is rendered as at publication date and may change without notice and it is not intended as a complete analysis of every material fact regarding Iraq, the region, market or investment.

---

[1] http://news.kuwaittimes.net/website/kuwait-international-conference-for-reconstruction-of-iraq-kicks-off-today/

[2] *This thread on Twitter highlights the main thrust of the conference lost among the confusion.*
https://twitter.com/dickinsonbeth/status/963728625207054336

[3] *Part 3 "Investment Opportunities & Reforms"*
https://view.publitas.com/1692ac51-faf7-464f-a9c2-1784ed1da647/iraq-reconstruction-and-investment-part-3-investment-opportunities-and-reforms/page/1

[4] https://uk.reuters.com/article/mideast-crisis-iraq-reconstruction/factbox-pledges-made-for-iraqs-reconstruction-in-kuwait-idUKL8N1Q55RY

[5] *Part 1 "Reconstruction & Development Framework" of "Iraq Reconstruction & Investment"*
http://www.cabinet.iq/uploads/Iraq Reconstruction/Iraq Recons & Inves.pdf

[6] *Session 3 after clicking on pdf of presentation. Presentation starts at minute 8.20 on the youtube link.*
https://view.publitas.com/1692ac51-faf7-464f-a9c2-1784ed1da647/iraq-reconstruction-and-investment-part-3-investment-opportunities-and-reforms/page/1

[7] *Iraqi oil tends to sell at a blended discount of $5 to Brent crude.*

[8] http://auis.edu.krd/iris/latest-iris/iraqs-economy-after-isis-investors-perspective

[9] https://www.thenational.ae/opinion/comment/reconstruction-isn-t-just-about-rebuilding-iraq-it-is-an-exercise-in-nation-building-too-1.705753