

Chapter 2

Background

Iraq's payment default

2.1 The committee's reference stems from a debt incurred when the then Australian Wheat Board (AWB) sold wheat on credit terms to the Iraqi government.¹ Following the conflict arising out of Iraq's invasion of Kuwait in 1990 and the subsequent imposition of United Nations (UN) economic sanctions on the Iraqi regime, the Iraqi government defaulted on payments owing to its creditors. The overwhelming majority of Iraq's debt to Australia relates to contracts between AWB and the Iraqi government. A small amount of debt is owed to other exporters to Iraq.²

2.2 The debt relates to wheat sales made over the period 1987-1990, affecting the relevant individual seasons' wheat pools as follows:

- 1987-88: US\$0.36/tonne
- 1988-89: US\$3.21/tonne
- 1989-90: US\$4.06/tonne

2.3 The debt outstanding averages out to \$2.68 per tonne for growers that contributed to each of the three seasons' pools.³

2.4 In their joint submission to the inquiry, the Department of Foreign Affairs and Trade and the Department of Agriculture, Fisheries and Forestry⁴ calculated that as at 31 December 2004 AWB Ltd is owed US\$1.027 billion by Iraq, including interest. Of this, US\$211.9 million is the uninsured component.⁵

1 The Australian Wheat Board moved from being a statutory marketing authority to a grower controlled corporation (AWB Ltd) in July 1999. Further detail is included at paragraph 2.6.

2 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 5. Other companies, namely Bonlac Food Ltd, Kraft Foods Ltd, John Shearer Ltd, Westpac/Australis Irrigation Pty/Ltd and National Australia bank/Anchor Foods Ltd were owed US\$18.9 million when Iraq defaulted on its debts, of which US\$2.6 million was uninsured.

3 AWB Ltd, *Submission 4*, p. 8

4 This joint submission is simply referred to as the 'joint submission' for the remainder of the report.

5 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 6

2.5 This chapter will examine the insurance payout and the Commonwealth ex-gratia payment AWB received following Iraq's default, as well as the recent agreement between the Paris Club group of creditor nations to forgive the majority of Iraq's debt and schedule a timetable for repayments of the remaining debt.

AWB's EFIC Cover

2.6 Throughout the 1987-1990 period, the Australian Wheat Board operated as a statutory marketing authority, granted sole responsibility for the marketing and export of Australian wheat under the *Wheat Marketing Act 1984* and then the *Wheat Marketing Act 1989*.⁶ This regulated marketing arrangement is referred to as the single desk system. Today, the functions of the former AWB are undertaken by AWB Ltd,⁷ a publicly listed company with a dual class share structure that retains grower control. In July 1999, AWB became a grower owned and controlled corporation, and in 2001 AWB Ltd was publicly floated with the listing of B-class shares on the Australian stock exchange.⁸ In this report, the organisation is referred to as both AWB and AWB Ltd, depending on the time period being discussed.

2.7 AWB's sales to higher risk credit markets during the late 1980's were insured by the Export Finance and Insurance Commission (EFIC) on their National Insurance Account (NIA). This effectively meant that they were underwritten by the Australian government when a purchaser of AWB wheat on credit defaulted on payments.⁹

2.8 Under the NIA arrangement, EFIC undertook to pay out an agreed percentage of the debt to AWB in the event of a payment default, for distribution amongst the affected farmers. Depending on market conditions and the size of particular contracts, this ranged from 70 to 80 per cent of the value of sales during the relevant period.¹⁰ Australia's single desk wheat marketing arrangements dictate that all growers participating in the relevant seasons' wheat pool were equally affected per tonne of wheat sold to AWB.

2.9 AWB indicated that NIA cover was necessary as commercial credit insurance markets could not accommodate their insurance requirements due to the size of the contracts and the length of payment terms.¹¹

6 The Wheat Marketing Act 1989 came into effect on 1 July 1989. The new provisions deregulated the domestic market and established an industry fund imposing compulsory levies on growers.

7 AWB Ltd is the parent company of AWB International, which is solely responsible for the marketing of Australian wheat to overseas markets.

8 AWB Ltd, *Submission 4*, p. 3

9 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 5

10 AWB Ltd, *Submission 4*, p. 6

11 AWB Ltd, *Submission 4*, p. 6

2.10 In the years leading up to 1990, the terms of EFIC's insurance cover were becoming less favourable to AWB. In late 1987 EFIC reduced its credit insurance cover from 95 per cent to 80 per cent of sales.¹² Insurance premiums over the affected pool years had also risen, from \$10.1 million in 1987-88, to \$17.5 million in 1988-89 and \$23.3 million in 1989-90.¹³ Nonetheless, AWB still felt the arrangements were commercially beneficial:

They put us through the wringer on an annual basis under the national interest account and invariably we had to run through the corridors of Canberra but they supported us at that time and [we are] very grateful for that support. Without credit cover, we would not have sold the volumes that we sold to Iraq.¹⁴

Although the extent of the NIA cover had been reduced, AWB concluded that the cost of seeking commercial insurance cover for the residual 20 per cent was prohibitive.¹⁵

2.11 During the 1980's, Iraq was an important market for Australian wheat growers. AWB informed the committee that Iraq was our largest grain customer; approximately twelve per cent of our wheat exports,¹⁶ while DFAT submitted that in the three affected pool seasons Australia supplied 35 per cent, 49 per cent and 41 per cent (respectively) of Iraq's import requirement.¹⁷

2.12 According to AWB, Iraq's importance to Australia was enhanced by weak prices due to high production levels worldwide, the strength of Australia's currency and subsidies for US and EU wheat producers.¹⁸ Selling on wheat credit was deemed to be an essential strategy for accessing the Iraq market, which in turn required the coverage provided through the NIA. According to AWB Ltd:

You could not do business with Iraq at that time unless you could put credit on the table.¹⁹

2.13 Between February 1991 and December 1992 EFIC paid growers (via AWB) \$US381.2 million, AWB's full entitlement under their insurance arrangement.²⁰ This sum equates to approximately 80 per cent of the value of the contracts Iraq defaulted on during 1987 to 1990.

12 AWB Annual Report 1987-1988, p. 13

13 AWB Annual Report 1988-1989, p. 16 and AWB Annual Report 1989-90, p. 10

14 AWB Ltd, *Transcript of Evidence*, Canberra, 23 February 2005, p. 7

15 AWB Ltd, *Submission 4*, p. 6

16 AWB Ltd, *Submission 4*, p. 5

17 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 7

18 AWB Ltd, *Submission 4*, p. 5

19 AWB Ltd, *Transcript of Evidence*, Canberra, 23 February 2005, p. 7

20 AWB Ltd, *Submission 4*, p. 6

2.14 These insurance payments were not distinguished from ordinary payments to growers from contract sales in AWB's Pool Realisation Statements, which provide information to growers on AWB's financial activities for each seasons' pools.

2.15 The uninsurable portion owing to wheat growers, originally US\$98.1 million,²¹ is the debt of interest to the committee.

2.16 During the inquiry, some confusion arose as to the ownership of Iraq's debt following their payment default. Under normal insurance arrangements, once a claim has been paid by the insurer, the insurer then takes ownership of the debt. However, there was conflicting evidence as to whether EFIC actually took ownership of the debt at the time they paid out AWB's claim, or at a later date.

2.17 AWB Ltd maintained that the debt had transferred in 1991, though some administrative tasks may have been incomplete:

[We] assume that paperwork was outstanding as a result of their wanting to put the debt to the Paris Club. They wanted an extra piece of paper to demonstrate that they had the debt, but, as far as I was concerned, under the terms of the insurance policy, which were very clear, when they paid out the money in 1991 the entire debt went to them.²²

2.18 The Department of Foreign Affairs and Trade told the committee that:

... when the insured portion of the debt was paid, the legal responsibility for the rest of the money, if you like, was transferred to EFIC. It was decided before negotiations began in the Paris Club last year to do the last formality; ... Our understanding is that EFIC thought it would be useful at that stage formally to assign the rights.²³

2.19 In correspondence with the committee, EFIC indicated that under the terms of the insurance policy AWB was required to assign the debt 'upon request'. This request was not forthcoming when AWB's claim was paid out, but many years later in 2004. EFIC stated that although the rights and obligations attached to the debt transferred from AWB to EFIC upon payment of the claim:

EFIC obtained a legal assignment of the debt in May 2004. The assignment of the debt was not completed until 2004 because between the payment of claims in the early 1990s and the fall of the Iraqi Government, sanctions were in place precluding formal negotiation of recoveries between EFIC and Iraq. The Deed of Assignment was signed once sanctions were lifted and recoveries were in prospect through the processes of the Paris Club.²⁴

21 AWB Ltd, *Submission 4*, p. 8

22 AWB Ltd, *Transcript of Evidence*, Canberra, 23 February 2005, p. 6

23 Department of Foreign Affairs and Trade, *Transcript of Evidence*, Canberra, 23 February 2005, p. 15

24 EFIC correspondence dated 23 May 2005

2.20 Consequently, during the period between the payment of claims (over 1991 and 1992) and the assignment of the debt in 2004, the status of the Iraq debt was as follows:

- The rights and obligations attached to the debt belonged to EFIC;
- In accordance with UN sanctions, EFIC was precluded from negotiating recovery of the debt during this period; and
- Under AWB's EFIC insurance policy, money recovered by AWB, 'whether from the buyer or any other source', was to be remitted to EFIC and then divided in proportion to the loss borne.²⁵

2.21 In spite of the information provided by EFIC, the committee is still unclear as to whether the delay in formally assigning the debt was due to poor administrative practice or a belief that, until the Paris Club agreement, AWB (and subsequently AWB Ltd) was better positioned to pursue the debt in the context of ongoing sanctions, or a combination of both.

2.22 Regardless of the intent, the committee is of the view that such administrative practices have not assisted in preventing false expectations to arise, a matter discussed further in Chapter Four.

Commonwealth ex-gratia payment

2.23 Following the imposition of UN sanctions against Iraq in 1990, wheat shipments already in transit were diverted to alternative markets. This resulted in AWB incurring financial losses from the forced sale of goods to lower paying markets and increased shipping costs associated with diverting the cargo. DFAT submitted that:

The Government agreed that the grains industry should not bear the full burden of meeting these losses and compensated the exporters for the losses they incurred in the Iraq market from the imposition of UN sanctions ...²⁶

2.24 The then AWB received A\$31.03 million in compensation in the period from October 1991 until April 1992.²⁷ AWB Ltd informed the committee that the entire sum was distributed to growers.²⁸

25 EFIC correspondence dated 23 May 2005

26 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 8

27 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 8. Ricegrowers' Co-operative Ltd, Bergerco and WA Meat Exports also received payments with a combined total of almost \$1.9 million.

28 AWB Ltd, *Transcript of Evidence*, Canberra, 23 February 2005, p. 8

2.25 On 14 October 1991 the then Minister for Primary Industries and Energy informed the Parliament that the ex-gratia payments:

... fully meet the Prime Minister's undertaking to the Grains Council of Australia that the Government would not expect the grains industry to bear the full burden of the United Nations sanctions on Iraq. All of the claimants have accepted the payments as full and final settlement with the Government for their losses.²⁹

The Paris Club Agreement

2.26 In November 2004, the federal government announced that it would forgive US\$22.1 billion of Iraq's debt (measured from 1 January 2005), as part of an agreement negotiated between Iraq and the Paris Club group of creditor nations.³⁰ This reflected an international effort to forgive 80 per cent of the US\$38.9 billion owed to these countries. Iraq's debt to Australia stemmed predominantly from wheat imports (see paragraphs 2.1-2.4).

2.27 The joint submission stated that:

The Australian Government, in consultation with the grains industry, believes that the interests of wheat growers are best served by assisting Iraq's recovery. Relieved of much of its debt, Iraq has the potential to be a stable and solvent partner for Australia in the Middle East to enable it to service any remaining debt and provide a more financially viable export destination.³¹

2.28 Under the Paris Club agreement Iraq is to start repaying the 20 per cent unforgiven debt from 2011, for government distribution to the industry and/or growers. In accordance with the proportion of debt that was uninsured by AWB, AWB Ltd will be entitled to 20 per cent of this figure. DFAT officers explained the arrangements as follows:

Given that the original exporters as a whole have already received from taxpayers approximately 80 per cent of the value of their original contracts, fulfilling commitments under the insurance arrangements, the Government's view is that they would as a group be entitled to receive just over 20 per cent of any future recoveries (including in particular 19.9 per cent to AWB Ltd). The remaining 80 per cent or so of any recoveries would be retained

29 Hon. Simon Crean, *House of Representatives Hansard*, 14 October 1991, p. 1803

30 The Paris Club is comprised of 19 nations that meet to find solutions to debtor nations' debt problems. Its members are Australia, Austria, Belgium, Canada, Denmark, France, Finland, Germany, Ireland, Italy, Japan, the Netherlands, Norway, Russia, Spain, Sweden, Switzerland, United Kingdom and the USA. South Korea also participated in the agreement with Iraq.

31 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 1

by the government as a recovery against the taxpayer-funded insurance payments.³²

2.29 The committee was advised that the Paris Club agreement provides for AWB Ltd to receive 34 payments of US\$1.2 million plus interest over seventeen years, totalling approximately US\$42 million. Providing Iraq is able to fulfil its obligations under the agreement these payments will commence in 2011, with some interest to be paid prior to that date.³³

2.30 Significantly, debt forgiveness is extended to Iraq under the Paris Club agreement on the condition that Iraq does not undertake to repay other creditors on terms more favourable than that agreed to with Paris Club creditor nations.³⁴

2.31 In light of apparent confusion regarding the financial consequences of the Paris Club decision, the committee reiterates that the burden of debt forgiveness will be equally shared by AWB Ltd and its insurer, EFIC. That is, AWB Ltd and EFIC will receive a 20-80 split of monies paid by Iraq under the agreement, matching on a pro rata basis the financial loss suffered when Iraq defaulted. This means that growers will receive approximately 20 per cent of the original 20 per cent debt outstanding following EFIC's payout. In effect, the government has applied the consequences of the Paris Club decision equally to the growers (AWB Ltd) and the taxpayers (EFIC), both of whom have forgone 80 per cent of their Iraq debt entitlement.

2.32 In evidence to the committee, AWB Ltd confirmed the extent of their future entitlement:

... if, ultimately, the government is successful in getting repayment of money from the Iraqis, our portion of that payment will be 20 per cent of the debt recovered.³⁵

2.33 This equitable division will occur despite EFIC legally owning the debt owed by Iraq.³⁶

2.34 In mathematical terms, after AWB's insurance payout in 1991 and 1992 and their prospective repayments under the Paris Club up until 2028, AWB will have been

32 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 6

33 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 7

34 Department of Foreign Affairs and Trade and Department of Agriculture, Fisheries and Forestry, *Submission 5*, p. 3

35 AWB Ltd, *Transcript of Evidence*, Canberra, 23 February 2005, p. 9

36 Entitlement to the debt owed under the contract is not legally divisible, so could therefore not be proportionally split, as a legal entitlement, between AWB and EFIC. However, as part of the terms of AWB's agreement with EFIC, EFIC agreed to pass to AWB 20 per cent of any debt recovered.

paid approximately 84 per cent of the value of their defaulted contracts with Iraq over the relevant pool years.