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Iraq: Economy Under Siege [redacted]

Iraq's war of attrition with Iran is strangling its economy. With major oil export facilities inoperable and Damascus refusing to allow oil deliveries through the Iraq-Syria pipeline, Iraq's oil revenues have plummeted to less than one-third of prewar levels. The Iraqis have virtually shelved their development program, and Baghdad has been forced to slash imports this year for the first time since the war began in 1980. [redacted]

The next year will be critical for Iraq. We do not believe Baghdad will be able to obtain the amount of financial assistance in 1984 that it received this year, and the private sector, particularly consumers, will bear the brunt of new austerity measures. Some slowdown in military spending might also be required. Under these circumstances, the Iraqis will feel increasingly compelled to carry the war to Iran. An attack on Iran's oil facilities could easily lead to an escalation of the war throughout the region, putting Gulf oil exports at risk. [redacted]

Tightening Financial Squeeze

We estimate that Iraqi oil revenues will plunge to about $7 billion in 1983 compared with more than $9 billion last year and a peak of $26 billion in 1980. The loss of its Persian Gulf oil export terminals at the outset of the war and the closure of the oil pipeline across Syria in April 1982 leaves Baghdad with the 700,000 b/d pipeline across Turkey as its sole route for oil exports. Moreover, a $5 barrel price cut to meet OPEC guidelines last March is costing Iraq $100 million a month in lost oil revenue [redacted]

Iraq is taking steps to increase oil sales. Expansion of the Turkish pipeline—by about 200,000 b/d—is scheduled for completion in early 1984, according to press reports. Iraq also is arranging for the transport of small amounts of oil by truck. [redacted]

Table 1
Iraq: Oil Exports and Revenues

Quarter	Net Exports [a]	Revenue [b]
1980		
First	3,183	8.2
Second	3,083	8.3
Third	2,883	8.6
Fourth	125	0.4
1981		
First	569	1.9
Second	803	2.7
Third	903	3.1
Fourth	903	3.1
1982		
First	1,278	4.0
Second	578	1.8
Third	578	1.8
Fourth	578	1.8
1983		
First	552	1.6
Second	552	1.0

[a] Thousand barrels per day.
[b] Billion US $.
[c] Estimated.

[redacted]

More importantly, Baghdad is arranging oil barter deals involving Saudi Arabia and Kuwait who in turn are selling their oil on Iraqi account. These oil sales to Iraq's customers probably will average up to 400,000 b/d for the year, worth about $3-4 billion. [redacted]

We believe that declining revenues will force Iraq to reduce import spending this year to $14-16 billion, as compared with $19 billion last year. Early 1983 trade data for some of Iraq's most important trading partners indicate that imports of heavy industrial machinery, electrical equipment, and construction materials are well off last year's pace. Imports of most consumer goods and raw materials for the light industrial sector are also being reduced. Imports of consumer goods from Japan, Iraq's second-largest trading partner, were down 85 percent during first-half 1983 from the same period last year. The regime has constrained private-sector imports by delaying import licenses and cutting total value to 30 percent of 1982 levels. [redacted]

We estimate Iraqi imports from the West in 1983 will reach only some $10-11 billion compared with $14 billion in 1982. OECD trade data indicate that Iraq's imports from the West fell by over one-half—to $3.5 billion—in the first six months of 1983 from the same period last year. The big losers were Japan, West Germany, and France, which accounted for 60 percent of the drop. [redacted]

Oil barter deals, however, probably will allow an increase in imports in second-half 1983. France and the USSR—Iraq's two largest arms suppliers—have agreed to take oil to help pay for about $1 billion owed each country for military hardware this year. Saudi Arabia is providing oil to the Soviets on Iraqi account. Iraq also is striking oil barter arrangements with civilian trading partners, including Japanese trading companies. [redacted]

Imports from the USSR this year probably will approach last year's $1.4 billion despite a slow start. Soviet deliveries to Iraq plummeted to $75 million in first-quarter 1983 compared with about $580 million for first-quarter 1982, [redacted] The drop probably resulted from a temporary difference between Moscow and Baghdad over a payments scheme for Soviet military deliveries. The USSR is Iraq's most important arms supplier; last year Baghdad signed arms deals with Moscow valued at about $3 billion. [redacted]

We believe Iraq will have a roughly $14 billion deficit on its current account this year, down only slightly from the levels of the last two years. The trade deficit will reach $7-9 billion and other foreign exchange outflows will total about $6 billion—most of it in remittances by Iraq's still sizable foreign labor force. With the labor market already tight because of draft callups—approximately 600,000 men are in the regular armed forces and tens of thousands more in militia and security units—Iraq has not been able to significantly reduce its foreign labor force [redacted]

Covering the Current Account Shortfall

Iraq is closing the current account gap with deferred payments, Gulf aid, and reserve drawdowns. We project it will negotiate deferred payments—or simply be late in paying—some $5-6 billion owed foreign companies for project-related and other imports in 1983. Iraq generally is demanding that payments begin in 1985 with interest rates below commercial levels. Many firms are under tremendous pressure to come to terms with Iraq to protect their investments. Prospects for participation in postwar development also motivate the companies to accede to Iraq's demands. To avoid piling up its own debt, Baghdad is requiring foreign firms to find their own financing for the deferred payments. [redacted]

So far, Iraq has obtained a $1 billion credit to cover the deferral of payments due French civilian contractors this year, according to press reports, and is negotiating with other foreign firms, including Japanese, West German, Italian, and British companies. We estimate the Iraqi 1983 obligation to firms from these five countries alone is at least $3 billion. We believe other OECD countries will follow suit, and several Third World countries, including Jordan and Turkey, also are deferring payments due this year. [redacted]

We estimate Gulf state aid—including oil sales on Iraq's behalf—will contribute approximately $4-5 billion to Baghdad's foreign exchange needs, compared with $5.5 billion in direct financial assistance last year. As they cope with their own revenue problems because of the soft oil market, the Gulf states are unlikely to increase direct aid much above the $1.2 billion they already have provided this year. [redacted]

Commerical loans from the international banking community in 1983 probably will not substantially exceed the present level of about $900 million. In our

Table 2
Iraq: Current Account Balance and Financing Arrangements

Billion US $

	1981	1982 [a]	1983 [b]		1984 [b]	
			Scenario A	Scenario B	Scenario A	Scenario B
Trade balance	−9.1	−9.7	−7.0	−9.0	−3.7	−3.7
Exports (f.o.b.)	11.0	9.7	7.0	7.0	7.3	9.3
Oil	10.8	9.5	6.7	6.7	7.0	9.0 [c]
Nonoil	0.2	0.2	0.3	0.3	0.3	0.3
Imports (c.i.f.)	20.1	19.4	14.0	16.0	11.0	13.0
Net services and private transfers	−6.1	−7.1	−6.0	−6.0	−4.3	−5.3
Freight and insurance	−4.0	−3.5	−2.6	−2.7	−1.5	−2.1
Investment income	3.2	1.6	0.6	0.7	0.3	0.3
Other	−5.2	−5.2	−4.0	−4.0	−3.1	−3.5
Grants	−2.0	−1.0	0	0	0	0
Current account balance	−17.1	−17.8	−13.0	−15.0	−8.0	−9.0
Financing the current account	18.0	18.5	13.0	15.0	8.0	9.0
Gulf state aid	8.0	5.5	1.2	1.2	1.0	1.0
Saudi and Kuwaiti oil sales	0	NEGL	3.0	3.5	2.0	3.0
Commercial loans	0	0	1.0	1.0	0.5	0.5
Arrearages	0	0	4.8	5.8	2.0	3.0
Reserves	10.0	13.0	3.0	3.5	2.5	1.5

[a] Estimated.
[b] Alternative scenarios for import spending and current account balances depend on our assumed levels of foreign assistance and reserve drawdowns.
[c] Assumes Trukish pipeline expansion completed in early 1984.
[d] Represents earnings on official foreign assets only.

judgment, many Western banks, already concerned about their overexposure in other LDCs, will be reluctant to lend to Iraq until the war is over. Arab financial institutions—which may be more willing—probably have fewer funds available than in the past because other OPEC countries are withdrawing deposits to cover their own financial needs.

We estimate Iraqi foreign exchange reserve drawdowns could reach $4-5 billion in 1983 assuming no other assistance is forthcoming. The reserve position has deteriorated markedly in the last few years. Foreign exchange assets amounted to about $35 billion before the war; they were only $8 billion at yearend 1982. Underscoring the severity of Iraq's financial condition, the government is conducting a "voluntary" drive to collect gold from the citizenry.

Domestic Impact

The war has been responsible for a sharp slowdown in the economy. Agricultural and industrial production are stagnating or falling because of the shortages of equipment and raw materials, and the government has virtually abandoned its economic development program. Baghdad has canceled almost all new contracts

Table 3
Iraqi Official Foreign Exchange Assets [a]

Year	Assets [b]
1974	4
1975	3
1976	5
1977	8
1978	10
1979	19
1980	31
1981	21
1982	8
1983	4-5 [c]

[a] Billion US $.
[b] End of year.
[c] Estimated.

This table is Secret

not related to the military effort or the petroleum sector and postponed work on several nonessential projects already under way. These developments represent a sharp reversal from the guns and butter approach the government maintained during the first two years of the war.

The Iraqi consumer is increasingly feeling the effects of the import cuts. Imported staples, especially fresh food and luxury goods, are either in short supply or available only at exorbitant prices. The shortage of imported goods has fueled an inflation rate that we estimate is as high as 50 percent and has encouraged black-market activity.

Outlook

We believe the remainder of this year and 1984 will be a critical period for the Iraqi economy. A possible source of short-term relief to Iraq's financial problems is a resumption of exports through the Iraq-Syria pipeline. Baghdad and Damascus recently have been discussing the issue. Reopening the pipeline, however, would be a major shift in policy by Syria, which has supported Iran for much of the war.

Substantial additional oil income would reduce the pressures on Iraq to intensify the war in the Gulf. Even if only the Syrian part of the pipeline were opened—there is also a spur ending in Tripoli, Lebanon—Iraq's earnings could be increased by some 50 percent from the current level of $7 billion annually.

Prospects for substantial increases in oil export revenue remains bleak, however. Increased exports through the expanded Turkish pipeline could add as much as $2 billion to revenues in 1984, but Saudi Arabia and Kuwait may reduce their oil sales accordingly to keep Iraq within its OPEC production guideline. The Iraqis are unlikely to be able to resume exports from the Gulf as long as the war continues.

As a result, Baghdad faces the prospects of obtaining foreign financing for another large current account deficit in 1984—on the order of $9 billion—even if it makes additional sharp import cuts. The Gulf states' oil sales are not likely to recover enough in 1984 to prompt them to increase their aid to Iraq; they may even cut back. Commercial banks probably will refrain from giving major loans to Iraq while the war continues. Moreover, foreign exchange reserves will, at best, allow a drawdown at the 1983 rate.

Iraq thus will have to defer again a sizable share of 1984 payments—probably including some 1982-83 payments—or slash imports. Should Baghdad renege on deferred payments due in 1984, bank financing for essential commodity purchases also is likely to be adversely affected. Moreover, Baghdad probably will encounter greater resistance from foreign contractors and suppliers who are less able or willing to finance delayed Iraqi payments. Several West German firms, for example, have stated they anticipate serious obstacles to financing in 1984, according to the press.

The Iraqi populace will tolerate the stoppage of the development program—few Iraqis directly feel the effect—but a substantial reduction in imports of food and other basic commodities probably will heighten discontent. Iraq depends on imports for about one-half of its grain consumption alone [redacted] To ease the burden on the population, the government may attempt to reduce defense-related spending. Military contracts signed last year for nearly $5 billion, however, ensure continued high levels of arms spending. [redacted]

Implications of the Conflict With Iran

The tightening economic vise is forcing Baghdad to seriously consider desperate measures to bring an end to the war with Iran. Iraq's efforts to acquire French Super Etendard aircraft armed with Exocet antiship missiles and public threats to use them against oil tankers servicing Iran in the Gulf represent a major attempt to break the economic stranglehold. The Iraqis could well make good their threat in the hope that it would cut off Iranian oil exports and force Iran into negotiations to end the war. More realistically, however, the Iraqis probably would count on major Western powers to intervene and enable Iraq to resume exporting oil out of the Gulf. [redacted]

Meanwhile, Baghdad's threats also serve as a form of blackmail to force the Gulf states to increase substantially their subsidies to Iraq. If this coercion works, the Iraqis might hold off military escalation. [redacted]

Iranian retaliation for an Iraqi attack on Tehran's oil export facilities could have a profound impact on world oil supplies and the world economy. A successful Iranian attack on Gulf state oil facilities or the mining of the Straits of Hormuz, for example, would sharply reduce Free World oil supplies. [redacted]

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