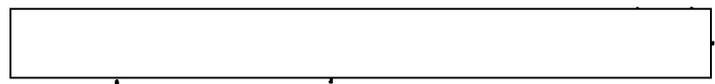




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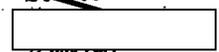


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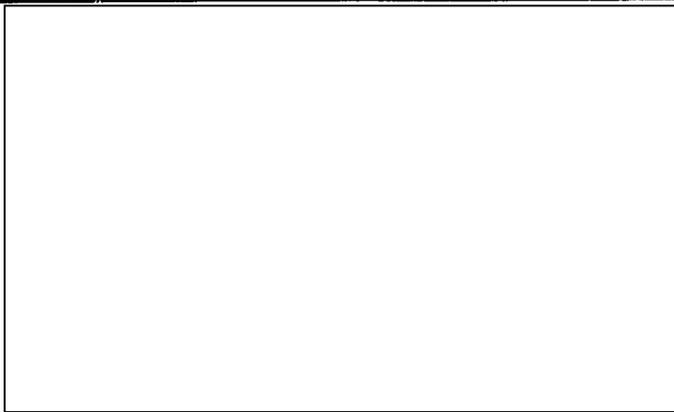
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Articles



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The foreign exchange crisis afflicting Iraq, Jordan's major export customer, is braking the growth of Jordan's domestic economy, aggravating its foreign exchange shortage, and cutting into government revenues at a time when Jordan's other sources of economic growth are stagnating.

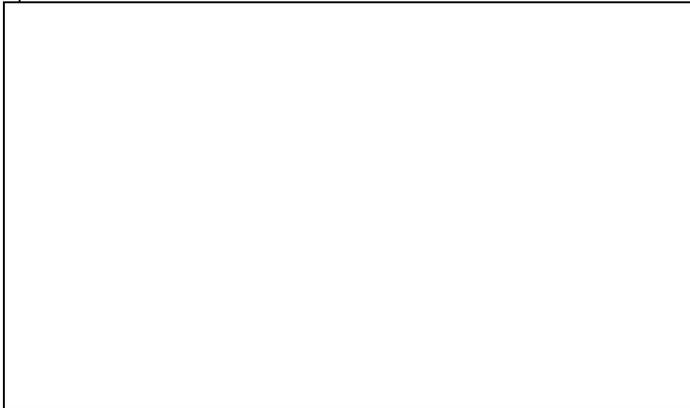
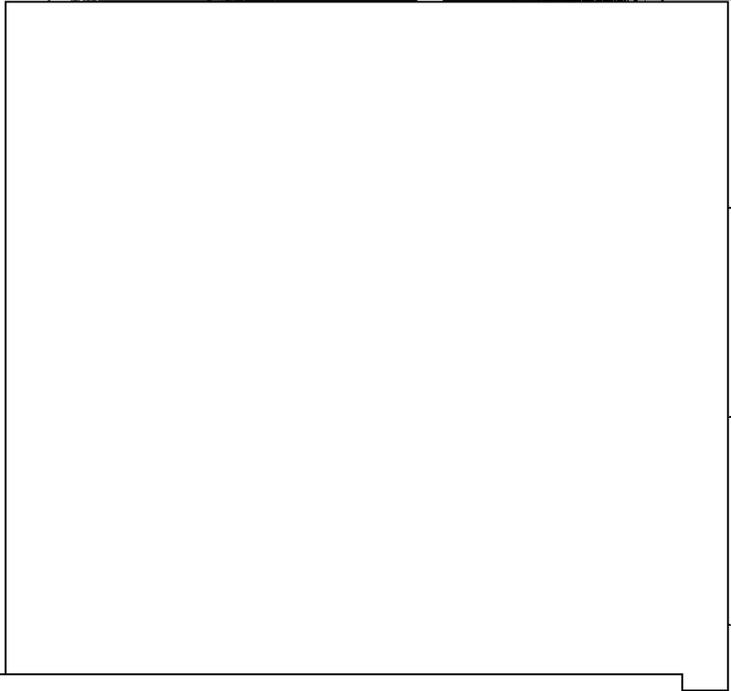
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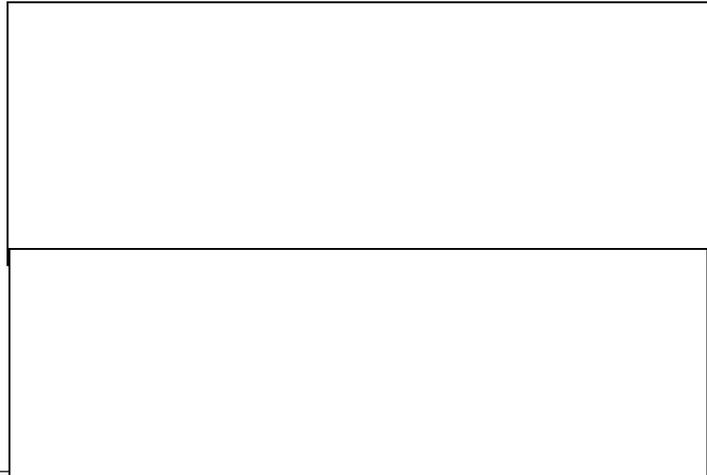
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Note: A supplement to today's *Near East and South Asia Review* has been published and disseminated in Special Intelligence Channels.

Some articles are preliminary views of a subject or speculative, but the contents normally will be coordinated as appropriate with other offices within CIA. Occasionally an article will represent the views of a single analyst; these items will be designated as noncoordinated views. Comments may be directed to the authors, whose phone numbers are listed.



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**Jordan: Economy
Squeezed by Iraqi
Financial Woes**

The foreign exchange crisis afflicting Iraq, Jordan's major export customer, is braking the growth of Jordan's domestic economy, aggravating its foreign exchange shortage, and cutting into government revenues. Iraq's default on its aid commitments will prompt Jordan's King Hussein to push harder for additional Saudi and US assistance to meet his country's ballooning military debt payments.

Baghdad's severe financial difficulties come at a particularly inopportune time for Amman, since they coincide with the stagnation in Jordan's other sources of economic growth and foreign exchange—Arab aid, worker remittances, and phosphate exports. The slow-down in Iraqi trade will bankrupt some Jordanian firms that sprang up in 1979-81 to serve the Iraqi market and put pressure on Amman to extend government loans to the troubled companies. The drying up of private-sector profit opportunities in Iraq also will chip away at domestic support for King Hussein's active backing of Iraq in its war against Iran, though it will not prompt the King to abandon his support for Iraqi President Saddam Husayn. Should the Iran-Iraq war end and reconstruction begin in Iraq, however, Jordanian firms would probably be well placed to capitalize on their wartime trading relationships and win substantial construction and other contracts.

A Profitable Connection . . .

Iraq's ambitious efforts, beginning in the late 1970s, to parlay its rapidly rising oil revenues into industrial expansion and an improved standard of living proved to be an economic windfall for Jordan. Exports of goods and services to Iraq accounted for a substantial share of Jordan's 11 percent average GNP growth rate in 1979-81 and helped finance Amman's very high investment rate. In 1979, when Iraq's oil revenues doubled, Baghdad nearly quadrupled its purchases of Jordanian goods—boosting imports from

Jordan to \$42 million. The total had soared by 1981 to \$195 million, nearly 40 percent of all Jordan's commodity exports, as Saddam Husayn tried to have both guns and butter—continuing his development efforts as well as financing the war against Iran. Jordanian service companies also landed large contracts in Iraq, particularly construction firms cashing in on Baghdad's building plans.

Saddam's desire to cement his political alliance with King Hussein early in 1980 and his need to secure additional supply routes to pursue the war against Iran prompted him to approve sizable aid increases. In addition to the \$186 million in annual aid that Iraq committed itself to at the Arab League's Baghdad summit in 1978, Saddam promised in 1980 to kick in roughly another \$55 million per year to make up for Libyan and Algerian defaults on their Baghdad commitments. He also promised to underwrite Jordan's \$225 million deal for Soviet SA-8 missiles and its purchases of French Roland missiles.

In April 1980 Baghdad agreed to extend another \$280 million in soft loans and grants over several years to finance a major expansion of Aqaba port, an upgrading of the rail and road routes linking Aqaba to the Iraqi border, and a new College of Technology near Kerak. In addition to facilitating the flow of goods to Iraq, the port and transport projects enhanced Jordan's ability to export its rising phosphate production—now Jordan's single largest commodity export. Iraqi state procurement agencies gave Jordanian companies preference in bidding on tenders; the Jordanian price could be up to 15 percent above the next lowest bid and still win the tender.

The two governments also cooperated in creating several joint ventures, including an air freight service

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and a trucking company to facilitate cargo shipments between Aqaba and Baghdad. Finally, Hussein and Saddam opened export promotion centers in each other's capitals, setting a target volume of about \$170 million in sales from each center in 1982. []

Iraq's hunger for imports also translated into a leap in Jordan's earnings from transit trade through its port of Aqaba; Jordan's civilian reexports doubled between 1978 and 1980. The trade soared another 30 percent in 1981—to \$226 million—after hostilities in late 1980 stopped shipping along the Shatt-al-Arab waterway, closing Iraq's principal deepwater port at Basrah. The rise in transit trade boosted employment at Aqaba port and poured additional customs fees—Amman's main source of domestic revenue—into the treasury. []

... Dries Up

In 1982 the benefits from the Iraqi connection began to dry up. Mounting financial difficulties precipitated by Iraq's war against Iran forced Saddam in January to postpone indefinitely nearly all the new contracts the regime had hoped to let under the development plan and to slow down payments for contracts Baghdad had already signed. In November Saddam clamped down on imports of consumer goods and at about the same time informed Iraq's aid recipients that he was suspending assistance to them. []

By the fourth quarter of 1982 Jordanian exports to Iraq had fallen to half the amount sold a year earlier; we expect exports of locally produced goods to Iraq will fall this year to a maximum of \$80 million—compared with the 1981 peak of \$195 million. The official export centers have also turned in a disappointing performance. Press reports note that Jordanian exports to Iraq via the centers barely exceeded \$4 million in 1982—only 2 percent of the original goal. Early in 1983 Amman and Baghdad agreed to slash the target by nearly 80 percent, but we believe actual trade via these centers will continue to fall far short of even the reduced target. []

Baghdad's clampdown on imports has also hurt Jordan's lucrative transit trade. We estimate that in the last quarter of 1982, Jordan's civilian reexport trade

shrank to less than one-third of year-earlier levels, mostly due to the Iraqi shortfall. The drop in reexports has hurt Amman's customs revenues and left the joint venture transport companies languishing. []

[] the Iraqi/Jordanian trucking firm has been forced to cancel its orders for 750 new trucks that were to have carried cargo to Iraq. The newly formed joint air freight company, for which each side contributed \$60 million, is also likely to suffer large losses. []

At the time of Iraq's decision to slow down payments, Jordanian firms had outstanding contracts []

[] Many of these firms had been founded after 1978 specifically to capitalize on the newly lucrative Iraqi trade. Baghdad's slowdown in payments on development projects is the first reversal that many of these firms have faced. []

Rather than force these companies to borrow at commercial rates until Iraq could make good—and incur criticism from local businessmen who hold the King responsible for promoting their involvement with Iraq—the Jordanian Government financed a temporary bailout. Jordan's Central Bank lent Iraq \$65 million in March to help cover outstanding payments owed to Jordanian companies. The government-to-government loan was originally scheduled to run for six months; we believe, however, that by September Amman will find itself pressed not merely to roll over but to increase the loan as Iraq falls further behind in its payments. []

Compounding the effect on GNP and balance of payments of the decline of over \$100 million in export receipts and customs revenues this year is the even larger loss of Iraqi financial aid. Late last year Saddam notified the King that Baghdad would not follow through on its roughly \$242 million in annual Baghdad aid obligations and could no longer pay for such projects as upgrading the Aqaba-Baghdad road or finance the new technical college. Also postponed indefinitely was further preparatory work on a canal

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to carry water from the Euphrates into Jordan—a project that a senior Jordanian water official claims is the only politically feasible solution to the acute water shortage that Jordan will probably experience in the 1990s. [redacted]

than 10 percent. In view of its current well-known foreign exchange worries, the Central Bank could have a hard time arresting a sudden widespread market tumble. [redacted]

Outlook

[redacted]

[redacted]

[redacted]

[redacted] Amman may cite the loss this year of nearly \$350 million in foreign exchange receipts from Iraq as one of several reasons to appeal to Washington to ease debt servicing terms and increase aid levels. Hussein will continue to press Saudi Arabia for aid over and above Riyadh's Baghdad obligations of \$357 million per year and may press the United States to intercede with King Fahd on his behalf. [redacted]

[redacted] Nonetheless, the recognition that the state of Iraqi-Jordanian trade relations is a sore spot will probably prompt the King to soft-pedal the alliance with Iraq. Should the Iran-Iraq war end and reconstruction projects begin in Iraq, however, Jordanian firms would probably be well placed to capitalize on their wartime trading relationships and win substantial contracts. [redacted]

This article is Secret [redacted]

The slump in Iraqi business will present many small Jordanian firms with the first real challenge to their management skills and financial soundness, and some are bound to go bankrupt. One recent rumor of a bankruptcy, though it eventually proved false, sparked a nearly disastrous run on a major local bank. The very real problems facing many firms could easily trigger another market panic, particularly since the heavy runup of Amman's bank stocks in recent years has been built more on speculation than on economic soundness. The grim prospects for trade with Iraq already have helped trigger a steep fall in industrial and service company shares on Amman's young stock market. The share price index of mining and manufacturing companies on the exchange fell from a peak of 244 in March 1982 to 153 in February 1983. Service companies' stock dropped more than one-third in the same period. In contrast, stocks of banks, which have less at stake in Iraq, continued to rise by more

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Table 1
NESA Oil Producers:
Production and Revenue

	Oil Production (thousand b/d) ^a			Oil Earnings (billion US \$) ^b		
	1980	1981	1982	1980	1981	1982
Total						
OPEC						
Iraq	2,515	995	970	25.1	10.6	9.4

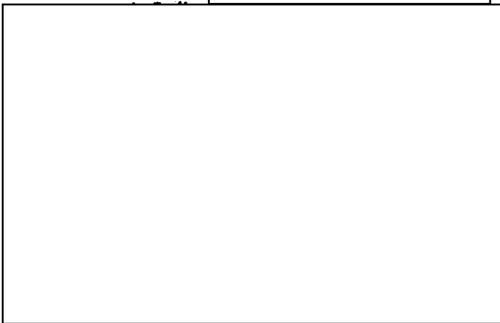
- ^a Does not include natural gas liquids. Based on industry and US Embassy reporting from producing countries.
- ^b CIA estimate. Includes revenue from exports of crude oil, products, and natural gas liquids.
- ^c Includes one-half production from the Neutral Zone.

[Redacted]

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Effects of Soft Oil Market Ricochet Through Near East and South Asia

The reduced flow of petrodollars into the Middle East over the past year has begun to impose financial constraints on both oil-exporting and oil-importing countries in the Near East and South Asia. Although financial reserves will cover the loss of income for the major oil exporters in the short term, they face tough spending cuts if the soft oil market persists beyond the middle of the decade.



Revenue Losses Force Oil Exporters To Tighten Belts
Cuts in prices and sales of oil have already begun to pose economic and financial constraints for most of the oil exporters of the region. Revenues in 1982 of approximately \$163 billion were more than \$60 billion below peak revenues in 1980. Based on industry and US Government estimates of demand for oil from OPEC, we expect income to decline an additional \$25-50 billion this year.

OPEC. Even though the OPEC oil producers in the region have clearly suffered the largest revenue losses, we expect them to draw on their foreign reserves to ease the transition to less rapid economic growth and, ultimately, to a possible reduction in benefits for their small populations. Combined foreign official assets at the end of 1982 were more than \$300 billion. An oil

Table 2 *Billion US \$*
NESA Oil Producers:
Current Account Balance and
Assets—1982 ^a

	Current Account Balance—1982	Official Foreign Assets Yearend—1982 ^b
OPEC		
<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>
Iraq	-18.8	5.0
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<input type="checkbox"/>	<input type="checkbox"/>	<input type="checkbox"/>

^a CIA estimates and international financial statistics.
^b Includes gold valued at \$457 per ounce.

price decline or continued low levels of production, however, would force more painful spending decisions.

We expect that Iraq will not do as well as other OPEC oil producers in isolating their populations from the economic setbacks of the soft oil market. We believe that the governments of these states are poorly equipped to meet domestic expectations because their financial reserves are already low or depleted and their economies are not sufficiently diversified.

Table 3
NESA Oil Importers—
Oil Imports—1981

financial institutions, or more aid from the industrialized countries. Any of these measures might require a set of domestic economic restrictions that would make a larger share of the population susceptible to recruitment by forces in opposition to the government.

Ties to OPEC Expose Economic Vulnerability. Returning migrant workers, lowered remittances, and/or reduced aid payments would exacerbate the economic problems already present in the capital-poor and labor-surplus countries. Many of these countries—

would have limited employment opportunities for even a small fraction of the returning workers. A reduction in foreign exchange from remittances or aid would require new domestic austerity measures, additional assistance from international

Job Prospects in the Middle East Threatened. We believe that the diminished market for jobs poses the greatest potential danger for the capital-poor states in the Near East and South Asia.

Table 4
Foreign Exchange Earnings
From Worker Remittances ^a

Million US \$

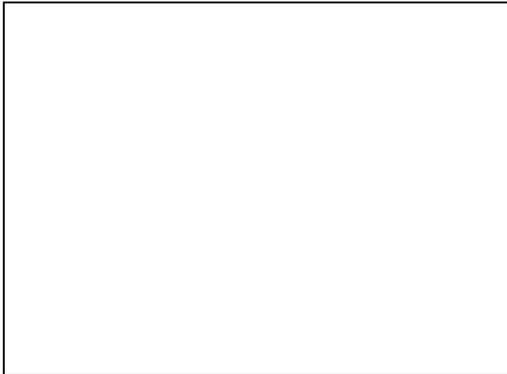
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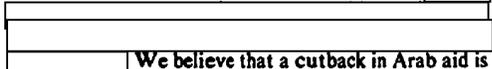
persist beyond another year or two, some reductions already have been made and more are expected. The Arab oil producers have been averaging \$13 billion annually in bilateral aid, about 99 percent of total OPEC aid. Over 95 percent of total Arab aid disbursements has gone to other countries in the region, 90 percent of it to other Arab states. We expect the Arab donor states-

to take a harder look at aid requests but believe they will be discouraged from making sizable cuts because their security and influence abroad rest so heavily on cash transfers. If they do make cuts, we expect that they will cut the states least vital to their security

Cutbacks in Arab Aid To Be Limited. While we do not expect a dramatic cutback in Arab aid to any of the recipient countries unless depressed oil prices



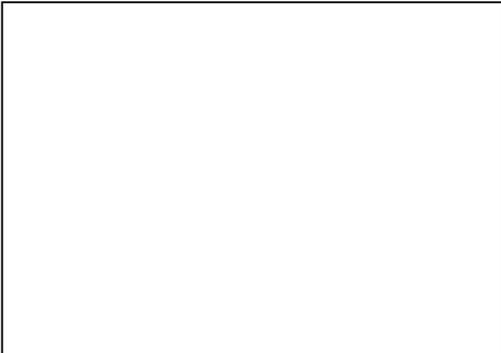
rapidly growing labor forces in the capital-poor, labor-surplus countries of the region. We expect that the accompanying slowdown in the growth of remittances would adversely affect economic development.



We believe that a cutback in Arab aid is almost a certainty if the soft oil market persists. The most immediate impact of reduced revenues from remittances and aid probably would be a reduction in imports. The governments would also face an increasingly narrow range of options in implementing development plans.



In the unlikely event of a sudden expulsion of several hundred thousand workers from the Middle East, we believe that the economies and societies of many of the labor-exporting countries would be hard pressed to absorb their return. A sharp decline in hard currency from remittances, particularly if accompanied by a cutoff in Arab aid, would force many to adopt unpopular austerity measures and press the IMF, Western donors, or Arab sources for additional financial support. If the governments failed to meet the economic and social expectations of the domestic population, a likely event under such a scenario, we expect that opposition forces would pick up additional political support and provide opportunities for Soviet or other outside influence.



Implications for the United States

In our view, the major concern that will face the United States if the soft oil market persists will be coping with the greater demands for financial assistance. With a reduction in worker remittances and aid from the oil-exporting states, the oil-importing nations will look increasingly to the United States and Western financial institutions to help cover the projected growth in foreign exchange deficits.

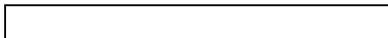


If the soft oil market persists, diminished opportunities for foreign workers in the oil-exporting states would eliminate that major employment outlet for the

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We believe that financial problems for both the oil-exporting and oil-importing states of the region could translate into political problems for their leaders. Under such circumstances, we would expect these governments to be even less disposed to take positions on regional issues favorable to the United States that could provoke domestic criticism or the wrath of their neighbors.



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