

JIC Assessment: 14 February 2001

IRAQ: ECONOMIC SANCTIONS ERODING

Key Judgements

- I. Saddam wants sanctions lifted because the UN arms embargo has severely limited Iraq's capacity to re-build and re-equip its military. But there is broad international consensus to **maintain the arms embargo** as least as long as Saddam remains in power. **Saddam faces no economic pressure to accept UNSCR 1284 because he is successfully undermining the economic sanction regime.** (paragraphs 1 & 13)
- II. Through abuse of the UN Oil-for-Food programme and smuggling of oil and other goods we estimate that **Saddam will be able to appropriate in the region of \$1.5bn to \$1.8bn in cash and goods in 2001, slightly up on 2000.** There is scope for earning even more if new surcharges and commissions become the accepted norm. (Paragraphs 3 – 7)
- III. **Iranian** interdiction efforts have **significantly reduced smuggling down the Gulf.** Saddam has compensated by **exploiting land routes** to Turkey and Syria. (Paragraph 4)
- IV. [Syria has become a significant export route for illegal Iraqi oil.]
- V. The apparent **success of the illegal Iraq/Turkey border trade agreement** has encouraged other **front-line states** to respond to Baghdad's initiatives to improve economic ties. Attracted by the promise of cheap oil or lucrative business contracts, they **are in the forefront of efforts to test the enforceability of the sanction regime.** (Paragraph 11)
- VI. **Most countries believe that economic sanctions on Iraq are ineffective, counterproductive and should now be lifted.** Without active enforcement, the **economic sanctions regime will continue to erode** as the front-line states increase their trade links with Iraq and as Saddam's officials devise more ways to capture the revenue from OFF oil sales. (Paragraphs 12 – 13)

**Implications:** Any smarter or refocused sanctions regime that aims to control Saddam's revenue will need to address the problem of unregulated trade with Jordan, Turkey, Syria and Gulf states.

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*At FCO request we update our assessment of the erosion of economic sanctions on Iraq, addressing in particular: How is the Iraqi regime evading the UN sanctions regime? How much is Saddam able to appropriate for the regime's use outside the UN escrow account? Is the Iraq/Syria oil pipeline operational?*

1. Oil accounts for over 60% of Iraq's GDP and virtually all of its foreign exchange earnings. The introduction of the "Oil-for-Food" (OFF) programme in December 1996 helped stabilise the desperate humanitarian situation following the end of the Gulf war. Saddam wants sanctions lifted because the UN arms embargo has severely limited his capacity to re-build and re-equip the military. But, he is not prepared to curtail his WMD programmes and accept UN inspectors. **Saddam faces no economic pressure to accept UNSCR 1284 because he is successfully undermining the economic sanction regime.** And the Iraqi elite are content because they profit from sanctions breaking. Saddam is content to play a waiting game on full sanctions lift.

The arms embargo remains largely intact, but we have seen some leakage of:

- air defence equipment;
- spares for military equipment and armoured vehicles; and
- some dual-use goods

But we have no evidence to indicate that major equipment such as complete weapons systems have been successfully imported.

2. Iraq produced on average 2.5m barrels of oil per day (b/d) in 2000, little changed on 1999 levels. Around 2m b/d are sold on world markets via the OFF programme. The remaining 500,000 b/d are split between domestic consumption, a long standing **UN-tolerated trade protocol with Jordan**, a more recent but **illegal border trade agreement with Turkey** and other smuggling operations.

3. Iraq's legitimate income from OFF amounted to \$17.5bn last year. It has over \$4 bn unallocated in its UN escrow account. Baghdad's priorities limit the effectiveness of the OFF programme; it delivers the bare minimum standard of living for most Iraqis. Saddam needs funds to maintain his military and security apparatus and secure its loyalty, along with the Ba'ath party and tribal leaders. He cannot legitimately use OFF income for these purposes. But he has other sources of income outside of the UN escrow account:

- **smuggling oil** through Turkey, Syria and via the Gulf to [...] (up to \$650m);
- **abuse of the OFF** through bribes, surcharges, transportation costs and "commissions" on contracts (up to \$600m);
- **the Jordan/Iraq trade protocol** (worth around \$400m in total); and
- **smuggling of other non-oil goods** (up to \$150m).

We estimate that **Saddam will be able to appropriate in the region of \$1.5bn to \$1.8bn in cash and goods in 2001, slightly up on 2000.** There is scope for earning even more if new surcharges and commissions become the accepted norm.

#### Oil smuggling

4. We estimate that **smuggled oil last year yielded up to \$650m** in cash or was bartered for goods. We judge that a **similar figure will be achieved in 2001**, [...]. There are three main oil smuggling routes: by truck into Turkey, into Syria by tanker, rail and pipeline and by tanker down the Gulf, mainly to [...]. As the Iranians have clamped down on the Gulf smuggling so Saddam has exploited other routes, particularly the re-opened pipeline into Syria:

- Iranian maritime interdiction efforts have **significantly reduced the Gulf smuggled oil trade.** In the early months of 2000 around 100,000 b/d were smuggled by tanker down the Gulf. Estimates derived from satellite imagery suggest that in December the illegal exports were at the lowest level since August 1999, at around 15,000b/d;
- [There are indications that the illegal border trade agreement between Turkey and Iraq has been extended] claims it is a barter trade, not for cash, and that it wants to regulate the trucking of crude oil and refined product and place it under the UN umbrella, but UN approval has not been granted. [...] around 70-80,000 b/d of crude and refined oil is trucked over the border. This trade could be worth up to \$350m to Iraq in 2001, with 30% of the value paid in cash. **The fact it is tolerated has encouraged other regional neighbours to profit from closer economic ties with Iraq;**
- Intelligence confirms a significant improvement in economic relations between **Syria** and Iraq. In recent months, up to 35,000 b/d have crossed the border by truck and rail. **The oil pipeline**, closed since 1982, **has been repaired.** [Syria has become a significant export route for illegal Iraqi oil] and Lebanon is also looking to secure part of the oil flow. We assess that if the UN pressed Syria on this breach of sanctions, **Damascus would justify it by reference to Iraq's similar oil trade with Jordan and Turkey.**

#### Exploiting OFF – the export side...

5. Since December OFF exports have halved as Baghdad has tried to force its oil buyers to pay surcharges of up to \$0.50 per-barrel into unsupervised Iraqi bank accounts. Iraq claims – falsely – that it needs the extra revenue for investment in the oil infrastructure. Most oil companies refused to pay the surcharge [...] senior figures in the regime believe that halting oil exports was a mistake. The surcharge has now been cut to \$0.25 a barrel and sales have increased.

6. UK and US oil companies that buy from unidentified middlemen seek paper assurances that no extra payments have been made. [...] some oil buyers may be paying a surcharge, though this is negotiable and Iraq may be making exceptions to "friends". **If oil prices continue to firm up, Iraq is likely to succeed in institutionalising the surcharge.** If all oil companies were to pay a surcharge, this and other price manipulating deals would be worth up to \$300m a year.

**...and the import side**

7. Foreign companies that want a contract to provide goods to Iraq under OFF have first to bribe Iraqi officials [...]. All contracts over \$10 million require the approval of Saddam and are allocated to reward companies of "friendly" countries. [...] **The abuse of OFF imports could equal or even exceed revenues from oil smuggling.** Iraq uses a series of bank accounts in Jordan, Lebanon and the UAE to receive commission payments. Worth up to \$300m in 2000, we assess that [...] this figure could rise to \$1 billion in 2001.

8. Despite the availability of funds, Iraq has been slow to comply with the UN's recommendation on food allocation. **Saddam needs the Iraqi people to suffer to underpin his campaign against sanctions.** [...] Good quality products are often stolen, sold on the open market and inferior goods bought to replace them.

**Also outside of the UN escrow account**

9. There is a widespread abuse of the UN tolerated **Iraq/Jordan trade protocol**, begun in 1991, which allows Iraq to import Jordanian goods in return for the cheap oil needed to keep Jordan's economy afloat. The trade protocol is worth around \$400m a year, but by over-invoicing for Jordanian goods a substantial amount is likely to be freed up by the Iraqis in hard currency to pay for military procurement outside Jordan.

10. There is evidence of non-oil sanction-breaking, for example through exports of urea (an oil-based fertiliser), foodstuffs (especially dates), cement and scrap metal by truck or dhow. Destinations are mainly the **frontline states of Turkey, Iran, Syria, Jordan and [...]**. This trafficking is worth up to \$150 million a year.

**UN sanctions**

11. We assess that UN sanctions are still being respected by most governments around the world. But, encouraged by the success of the Iraq-Turkey border trade agreement, **front-line states are not enforcing trade sanctions.** There has been a **significant increase in the erosion of sanctions** over the past six months. Governments and private companies, lured by the promise of cheap oil or business contracts, are testing the limits of the enforceability of the sanction regime:

- since its re-opening in August, **around 160 foreign civilian flights** have landed at Saddam International Airport – all but a few had UN permission, but only a handful were inspected. More regular flights have recently begun from Amman and Damascus;
- there is **widespread and increasing business contact** with the regime, especially in the oil and telecoms sectors. More than 140 companies attended the Baghdad trade fair in October. We judge most contacts by Western and Japanese companies represent jockeying for position for when sanctions are lifted. [...];
- Baghdad continues to take steps to improve relations with countries such as Japan, South Africa, India and Malaysia. India has just negotiated a major deal to barter wheat for oil. Portugal, Austria and Switzerland have re-opened their embassies in Baghdad, and Norway is considering such a step. [...].

### Prospects

12. [...] the Iraqi leadership believes that the UN embargo is cracking and that the new US administration will be unable to prevent further deterioration. Most countries believe that economic sanctions on Iraq are ineffective in terms of changing the regime's behaviour and counterproductive in that they actually strengthen Saddam's grip. Arab countries especially decry the impact of sanctions on ordinary Iraqis. Neighbouring countries, with the exception of Saudi Arabia and Kuwait, will continue to respond to Baghdad's initiatives to improve economic ties. Active engagement is profitable and is argued to be a better mechanism for exerting influence than a policy of exclusion.

13. Without active enforcement the economic sanctions regime will continue to erode as the front-line states increase their trade links with Iraq and as Saddam's officials devise more ways to capture the revenue from OFF oil sales. However, Saudi Arabia and Kuwait remain nervous of Saddam's ambitions and there is broad international consensus to maintain an arms embargo at least as long as he remains in power.