

JIC Assessment, 3 September 2002

IRAQI TRADE: A TOOL OF INFLUENCE

Key Judgements

- I. Iraq is successful in manipulating its trade relations to obtain diplomatic support from other countries. It will continue to be so. The weakness of the economies of many of Iraq's neighbours means they will continue to be susceptible to Iraqi pressure through the offer of lucrative trading opportunities.
- II. Trade dependency has muted, but not eliminated, criticism of Iraq by its neighbours – whose policies are influenced but not determined by economic factors.
- III. Iraq's ability to use cuts in oil supplies or threats of such disruption to cause spikes to world energy market prices is likely to be temporary and limited by the extent to which Saudi oil production can make good any loss of Iraqi supplies.
- IV. Iraq uses economic levers to put political pressure on Russia for support, whilst Russia sees its political importance to Iraq as a means to extract economic benefit. But Russia remains the dominant partner. At present Russia is able to exercise the greater leverage.
- V. Russian policy on Iraq will continue to be heavily influenced by its determination to protect its economic interests. The status quo provides the benefit of a privileged commercial position; but contracts which can only be realised after sanctions are lifted may not be honoured by a post- Saddam regime.
- VI. Iraq's use of trade to further its political influence will be limited in future by its inability to significantly expand oil production.

IRAQI TRADE: A TOOL OF INFLUENCE

At the request of the JIC, we analyse how Iraq uses its trade with other countries to exert influence over them.

1. Sanctions have been imposed on Iraq by the UN Security Council (UNSC) since 1990. Disagreements between the UN and Iraq meant there was limited external trade with the country until 1996 when the UN "oil for food" (OFF) programme was introduced. Under this, the UN handles all Iraqi oil revenues, 72% of which are used to buy humanitarian goods for Iraq. The supply of goods which have a WMD or military application is prohibited. Originally, OFF sales of up to US\$4bn per year were permitted but the UNSC removed the ceiling altogether in 1999. Iraq has used the OFF programme to divert funds illegally to Baghdad using a number of schemes, the most important being a 10% commission on all OFF contracts for goods coming into Iraq, and the imposition of a surcharge on exports of its oil. All trade must still be processed through the UN. Any that is not is illegal.

Trade as a strategic tool

2. **Iraq deliberately uses trade with other countries as one way to achieve strategic goals.** It has worked hard to build up trading relations, legal and otherwise, both with its neighbours and influential countries on the UNSC. **The granting of future oil/gas extraction rights for the post sanctions period is also a source of leverage.** Iraq's oil and gas reserves are large. But new fields can only be exploited once sanctions are lifted and a post-Saddam regime may not recognise the deals that have been signed.

3. **Iraq manipulates OFF contracts to obtain political support from other countries.** The lifting of the US\$4bn per year ceiling in 1999 increased Iraq's power of patronage significantly. In 2001 it amounted to about US\$7bn. The countries that have received most OFF contracts are Iraq's neighbours, and its trade partners on the UNSC – Russia, China and France. Recently, however, both France and China have been taking a less overtly supportive line than in the past; [...] Russia now feels it is getting less support on the UNSC concerning Iraq from these countries. We judge that as a consequence, Iraq has awarded significantly fewer OFF contracts to these countries so far in 2002 compared to previous years.

4. **Iraq ensures illegal trade is highly lucrative for complicit countries.** Typically, it will involve the transfer of Iraqi oil at below world prices, with payment in a mixture of foreign currency and bartered goods, often poor quality and over-valued. Although much smaller in monetary terms than OFF trade, illegal trade is valuable to Iraq: it gives the regime direct access to foreign currency (unlike OFF trade), and allows it to procure goods prohibited by the UN from countries, firms and individuals willing to break sanctions.

5. Once trade is established, legally or not, it provides influence for Iraq in a number of ways:
- Countries are keen to retain the benefits from the generous terms of trade; Iraq applies pressure on countries by threatening to withdraw incentives
 - Payments of bribes and commissions to members of the elite in trading countries provide incentives for those individuals to protect the trade.
 - Countries are more likely to oppose military action against Iraq which would disrupt such trade flows; although the economic shock would be short-medium term (with an improved economic outlook for the region post-Saddam), the economies of the area are typically weak. This has been one factor amongst others contributing to the opposition of Iraq's neighbours to US military action.
 - Companies which profit from the Iraqi trade tend to lobby their governments for it to continue.

Dependent countries

6. **Jordan is the country most dependent on Iraqi trade.** About 20% of its GDP is accounted for by OFF and other trade with Iraq, on whom it is entirely reliant for its oil, which was worth an estimated US\$900m in 2001. It pays for this with a mixture of cash and preferentially priced goods. The benefits from the economic relationship have been a contributing, though not decisive, in Jordan's public support for Baghdad. [...]

7. **Trade with Syria has been a particular success for Iraq. Syria is the second most dependent country on Iraqi trade and the largest purchaser of illegal Iraqi oil,** which is for the most part used for domestic consumption. This allows Syria to increase exports of its own oil by at least 100,000 barrels/day, according to open sources. Illegal oil exports through the pipeline between the countries began two years ago and has become very important to the Syrian economy. The recent meeting of the Syria-Iraq joint commission underlines the importance of the economic relationship – which has helped change Syrian hostility toward Iraq into official opposition to a US attack on the country.

8. Syrian trade with Iraq could exceed more than US\$2bn in 2002, about 10% of its GDP. This does not include the earnings of Syrian firms and individuals who earn significant amounts dealing with Baghdad directly. Nor does it include some revenues derived from allowing illicit trade from other countries to pass through into Iraq. **Syria is now the major transit route for illegal Iraqi trade.**

Countries with relatively significant trade

9. **Egypt** conducted OFF trade amounting to US\$1.41bn in 2001, about 1.6% of its GDP. [...] **Turkey** would also like to increase its trade with Iraq and eventually develop Iraqi oil fields. Its

total trade with Iraq amounted to about US\$940m in 2001, 0.7% of its GDP, with illegal trade an estimated US\$400m in 2001, paid with 70% goods and 30% US dollars. Iraq recently announced it planned to sign an agreement for increased trade with Turkey, although it is not yet clear how significant this will be. **UAE OFF** trade with Iraq was US\$1.31bn, about 2% of its GDP. [...] We judge this has fallen significantly following greater Western efforts, facilitated by Iranian co-operation, to stem the flow. In these countries, although Iraqi trade is a smaller percentage of GDP than for Jordan and Syria, [...]

Russia: a heavyweight player

10. **Russia's interest in Iraq is primarily economic although Iraq regards it as an important political ally.** Although total Iraqi trade only amounted to about 0.5% of Russia's GDP in 2001, this belies the significance of the relationship (see box). Moscow is also concerned about the recovery of its outstanding debt, which it is at least US\$8bn.

11. **Iraq uses its economic relationship to put pressure on Russia**, sometimes threatening that Russia would suffer commercially if it did not push the Iraq cause. But Russia is the dominant partner in the relationship. [...]

12. **Iraq has attempted to pressure Russia to engage in illegal trade, so far without significant success.** Whilst some Russian firms are known to have broken sanctions, the Russian Government position has been to follow the letter – if not the spirit – of the UN guidelines and resist Iraqi pressure. [...]

13. **Russian policy vis a vis Iraq is to hope for the best and plan for the worst – so far as its economic interests are concerned.** But there is a debate within the country over its policy towards Iraq. The lifting of sanctions on Iraq could lead to a considerable loss of trade as many of the Russian goods supplied [...] could not be sold on world markets. The status quo, therefore, serves the interest of some companies. [...] But Russian policy could be undermined by a pro-Western regime. **Russia may see the trade and long-term deals it has signed with Iraq as a card to negotiate some form of compensation should the current Iraqi regime be toppled by the US.**

Russian economic interests in Iraq

- Russian OFF contracts since the programme began amount to US\$4.3bn, the largest for any country; intelligence shows Russia expected to earn US\$2.5bn in 2002 through OFF contracts.
- Russian firms have contracts for the largest share of undeveloped Iraqi oil and gas fields. A five year trade agreement with Russia has recently been announced, though yet to be signed. It covers transport, agricultural projects and energy exploitation. Some of these apply now; some after sanctions are lifted. Iraq claims the agreement is worth US\$40bn – but Russia denies a price tag is attached to the deal.
- Iraqi bribes paid to Russian officials, businessmen and politicians, along with oil industry lobbyists, helps nurture an influential pro-Iraqi lobby in Russia
- Russia benefits from any temporary dislocation of Iraqi oil supplies through higher prices on world markets for its energy exports.

The blunted oil weapon

14. **Iraq has tried in the past to create temporary spikes in the world energy prices through withholding supplies of oil.** The effect has been limited because Iraqi output is a

relatively small proportion of total world output; there is spare oil-producing capacity in the world, and Saudi Arabia has always stated it would make up any shortfalls to stabilise world markets. The markets also know Iraq's action is likely to be short-term. Iraq's most recent halting of its OFF exports was April this year. It had minimal effect and OFF exports were resumed after a month.

Prospects

15. **Iraq will continue to exploit its trade relations, legal and illegal, in pursuit of political influence.** Although UN resolutions will continue to act as a restraint, Iraq's strategy will be successful so long as there is no alternative supply of oil on preferential terms to the countries it is targeting – given the parlous state of most of these economies. Although Saudi Arabia looks set to open its border with Iraq to benefit from increased trade under OFF, this will not increase Baghdad's influence on the country.

16. **There are limits to the extent to which Iraq will be able to increase its sales and hence its influence.** Iraq's production levels of oil are unable to expand significantly without substantial further investment, which will not be forthcoming so long as sanctions are in place. The market for illegal oil exports is becoming saturated and sales appear to have reached a ceiling – thanks to logistical difficulties and the unwillingness of more countries to break UN sanctions.

17. Iraq may attempt to win back some of the support it has lost from France and China by the offer of attractive deals under OFF to companies in these countries, which would also serve the purpose of warning Russia that it could not rely on winning these contracts.

18. **Russian policy on Iraq will continue to be heavily influenced by its determination to protect its economic interests.** For now the status quo appears to suit its interests. The projected trade agreement with Iraq suggests Russia is hoping to maintain and possibly expand its present trading position which it sees as the best way to protect its interest in a post-sanction or post-Saddam period. Russia wants to maintain good relations with the US while at the same time opposing an attack on Iraq – which would remove Saddam and jeopardise its long-term trade agreements. It is becoming increasingly irritated by Iraq's refusal to allow the return of UN inspectors, which Russia sees as the best way to avoid a conflict in Iraq and get sanctions lifted.