

MEMORANDUM TO THE BOARD OF DIRECTORS  
Africa and Middle East Division

February 21, 1984

COUNTRY: Iraq

SUBJECT: Country review and recommendations for Eximbank's programs. (Country Appendix attached.)

BACKGROUND AND  
COUNTRY SUMMARY:

Eximbank currently has no exposure in Iraq and has not been active in the country for more than a decade due to a number of reasons. Iraq broke diplomatic relations with the U.S. in 1967 at the time of the Arab-Israeli war, subsequently embargoed imports from the U.S. until 1973, and the country paid cash for most imports in the late '70s following the large oil price increases after 1974 and until 1981. Iraq was cited by the U.S. as a country linked to international terrorism from 1979 through March 1982 and as such there were more stringent requirements for obtaining U.S. export licenses.

Iraqi-U.S. Relations.

Iraq broke diplomatic relations with the U.S. in June 1967 at the time of the Arab-Israeli war. Since late 1971 the U.S. has been represented by a U.S. Interests Section in the Belgian Embassy in Baghdad.

In 1973 Iraq ended its political ban on U.S. and West German imports, deciding to separate its economic and political policies. In its desire to proceed as rapidly as possible with the country's economic development, Iraq turned toward using Western technology and capital imports. The rapid rise in Iraq's imports from the U.S. prior to the war with Iran - from just \$23 million in 1972 to \$724 million in 1980 - attested to the change.

The U.S. Government has been willing to resume full diplomatic relations with Iraq but the Iraqi Government has not been prepared to take this step to date.

International terrorism has been an issue in relations between the U.S. and Iraq. The Fenwick Amendment to the Export Administration Act of 1979 established more stringent rules for the granting of export licenses for U.S. exports to countries cited for supporting international terrorism. In 1979, Iraq along with Syria, Libya, and the People's Democratic Republic of Yemen was put on the list. Iraq remained on this list until March 1982 when the U.S. Departments of Commerce and State removed Iraq; Cuba and Iran were added.

Since the removal of Iraq from the list of countries supporting international terrorism and more recently with the war going against Iraq along with the Iranian threats toward blocking oil shipments in the Arabian Gulf, the U.S. has shown renewed interest in a peaceful solution to the conflict.

In December 1983, the U.S. Special Mideast Envoy, Donald Rumsfeld, visited Baghdad to urge restraint and to discuss ways the U.S. could be of assistance. Subsequently, the press reported that the U.S. was tilting toward Iraq.

The official U.S. position is one of neutrality in the war and of seeking a peaceful solution.

In the Staff's opinion, due to both unsatisfactory country economic conditions and the possibility of physical damage to new projects due to the ongoing war, there would not be reasonable assurance of repayment for any medium and long term transactions based solely on Iraqi security. Although Iraq has considerable oil reserves, these do not, by themselves, provide reasonable assurance of repayment. Until the war ends and satisfactory solutions are found as to who will control Iraq's government and how war reparations and debts will be paid, we could not find reasonable assurance of repayment for medium and long term transactions in the absence of satisfactory external security arrangements.

Since Iraq is still paying for some of its top priority items, such as foodstuffs, Staff could recommend modest amounts of short term FCIA insurance for these items. Because of the priority of such transactions and the short repayment, Eximbank support for these transactions would provide an opportunity to test this troubled market and support some exports while avoiding risks associated with lower priority, larger, longer term transactions.

#### External Debt

No official information is available on the amount of Iraq's current external debt. Various reports indicate that external debt at the end of 1983 was between \$37-50 billion. Of this amount, \$22-30 billion has been provided by Saudi Arabia and Kuwait since 1982 to cover balance of payments deficits and no information is available as to when or if these loans are to be repaid. As long as the war continues and without increased oil exports, the current account deficits of \$8-10 billion annually would add substantially to the external debt. Iraq has negotiated with contractors concerning payments due on cash contracts. It is understood that payments on these will be deferred until 1985 and payments will be spread over a three to five year period. Similar arrangements are being negotiated for payments due on cash contracts for 1984. New tenders from Iraq request deferred terms with no payments for two years even for such items as spare parts.

#### Balance of Payment Projections

Balance of payment projections for Iraq carry more than the usual hazards due to the on-going war, the lack of adequate base statistics, incomplete data on external debt, and pitfalls in estimating future oil production and prices. Nonetheless, the following scenarios are presented to show the order of magnitude of key elements and to help formulate an Eximbank policy for this market.

Foreign Exchange Reserves. Reflecting the large oil exports and balance of payment surpluses in the last half of the 1970's and through 1980, net foreign assets of the banking system rose from \$11 billion at the end of 1978 to \$37 billion at the end of 1980. Since then, they have declined to \$24 billion at the end of 1981 and to about \$6 billion at the end of 1982. A further erosion took place in 1983. While no precise figures are available, liquid foreign exchange might approach \$2 billion.

A general policy has emerged in Iraq towards the refinancing of foreign contractors. For contracts involving firms from industrialized countries whose military or financial support has been, and will be, crucial to the war effort, Iraq directly negotiates with the firms, or with home country governments or bank consortia. These countries include Japan, France, Germany, and Italy. The refinancing package typically includes a 1-3 year rescheduling of a certain percentage of the debts, cash payments for another certain percentage - and, increasingly, the lifting of crude oil as partial payment.

As for contracts involving firms from non-industrialized countries, Iraq informs contractors that financing will end and suggests that they turn to their home countries for financing. Iraq will not negotiate refinancing, because it does not wish to increase its debt to countries such as India or the Philippines, which have not been in a position to assist Iraq financially or militarily.

Cessation of hostilities with Iran is critical to Iraq's economic recovery. Unfortunately, no end to the war is in sight at this time. In addition, when the war does end Iraq will be faced with serious obstacles on its path to economic recovery. Paramount among these are repayment of sizeable debt accumulated during the war years and the ability to sell larger amounts of Iraqi oil.

Against this background of deteriorating economic conditions, rapidly increasing foreign debt, and continuing war, Eximbank has received many inquiries concerning the possibility of financing for transactions ranging from feed concentrates to large power plants.

If one continues to assume that the Gulf states will not - or cannot afford to - let Iraq collapse through economic attrition, it becomes clear that a big part of this debt will be financed by Iraq's neighbors. The flow of loans from the Peninsula states is currently reported to be around \$6 billion per year. Unless it increases to over \$10 billion per year during the next years, it is quite likely that Iraq will be forced to abandon more civilian projects, seek to reschedule its debts beyond 1985, and intensify its efforts to negotiate future payments in oil.

The CCC reports that Iraq is current on the 1983 CCC credit. The CCC is willing to take some risk in this market as Iraq is expected to be a potentially large market for U.S. agricultural sales. A few commercial banks contacted reported that they would consider only short term credits for Iraq currently. One bank reports very good experience working with the Iraqi Central Bank and with Rafidain Bank.

Berne Union members have recently reported on their attitude and experience. Two members are "off cover" for short term and seven are "off cover" for medium and long term. In certain cases there is a reduced percentage of cover offered and a few limit cover to non-war zones. Some delinquencies are reported and claims have been paid.

Medium-Term Outlook. Considering the low likelihood of the war ending in the near future, there are no grounds for optimism concerning the possibility that Iraq's foreign exchange problems may be alleviated anytime soon. With the Gulf terminals and the Syrian pipeline closed, Iraq's export potential will remain limited. Under the best circumstances - successful expansion of the Turkish pipeline capacity to around 960 thousands barrels per day by mid-1984, and continued Saudi and Kuwaiti oil sales credit to Iraq - Iraq may be able to expand its effective export volume to 1.1-1.3 million barrels per day by 1985. This, however, will by no means be sufficient to meet the increasing financial demands on the country.

During the period between 1983 and 1985, Iraq is projected to accumulate \$24.8 billion in current account deficits. In addition, there will be over \$1.5 billion of debt deferred to 1985 and 1988 alone. Thus, by the end of 1985, Iraq will find itself facing a debt of well over \$26 billion - possibly in the \$30-\$35 billion range. This amount does not include the soft loans that the Gulf states (Saudi Arabia, Kuwait, the UAE and Qatar) have made to Iraq so far.

#### RECOMMENDATIONS:

It is recommended that the following program be adopted until the war has ceased:

1. Supplier Credit Transactions.

Short-term: Consider requests for small amounts of essential imports on a case-by-case basis with a letter of credit issued by the Bank Rafidain or the Central Bank.

Medium-term: Discourage all requests unless a satisfactory external security arrangement can be provided.

2. Direct Credits and Financial Guarantees.

Discourage all requests unless a satisfactory external security arrangement can be provided.

Feb. 1984

APPENDIX I  
IRAQ

<u>Project</u>	<u>Estimated Potential</u>		<u>Potential U.S. Supplier</u>
	<u>U.S. Costs</u> (millions)		
<b>Al Mussaib Power Project</b>			
- Capital Goods	\$ 43.0		Not yet determined
- Design Work	14.0		C. T. Main
- Turbine Generators	159.0		Westinghouse
<b>Daura Power Project</b>			
- Boiler Portion	\$ 40.0		Combustion Engineering
- Turbine Generators	50.0		General Electric
<b>Yusifiya Power Project</b>	\$500.0		Combustion Engineering
-			General Electric
-			Combustion Engineering
			General Electric
<b>Baghdad Metro (may be deferred)</b>			
- Design	\$ 10.6		Deleuw Cather
- Engineering/Procurement Construction Mgmt.	150.0		Bechtel
<b>Oil Pipeline-Jordan</b>			
- Construction			Foster Wheeler
- Engineering/Procurement/ Construction	?		Bechtel
Oil Field Equipment	\$ 8.0		Midland Int'l
Oil Field Equipment	\$ 10.0		Halliburton
Scanners & Computer for Shopping Mall	\$ 7.0		NCR
Arab Company for Detergent Chemicals	\$ 35.0		Combustion Engineering
Linear Alkyl Benzene Plant			
Oil and Gas Treatment Equipment	\$ 25.0		Howe-Baker Engineers
Turnkey Ammonium Storage Plant	\$ 6.0		Howe-Baker Engineers
Medical Systems	\$ 30.0		General Electric
Transmission Substations	\$ 25.0		General Electric
Poultry Farm Equipment	\$ 5.0		E. Holzer/Barco Int'l
Helicopters for Civilian Ambulance Service by Air Force	\$300.0		Bell Helicopter/Lockheed
Antibiotic Plant	\$ 30.0		Foster Wheeler
Feed Concentrates	\$ 13.0		Bankers Trust for Pillsbury
Total		\$1,510.6 million	