

A



CCATP

DEPARTMENT OF TRADE AND INDUSTRY
1-19 VICTORIA STREET
LONDON SW1H 0ET

TELEPHONE DIRECT LINE 01-215 5422
SWITCHBOARD 01-215 7877

JU564

Secretary of State for Trade and Industry

29 September 1983

CONFIDENTIAL

The Rt Hon Nigel Lawson MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Whitehall SW1

Dear Nigel,

CREDIT FOR IRAQ

As you will know, the Iraqi Deputy Prime Minister Ramadhan, with the Trade and Oil Ministers and a large official party, arrive as guests of the Prime Minister on 5 October. The Anglo/Iraqi Joint Commission will take place concurrently. The Iraqis have recently made clear that they regard credit as by far the main issue and would judge the visit accordingly.

2 On instructions from EGC, the Ambassador in Baghdad wrote to the Governor of the Central Bank in February about the re-financing of existing major contracts - the Iraqis' top priority at the time; the letter stated that when the refinancing process was complete, we would consider extending £100m, minimum 3 year credit for new business at consensus rates. The Iraqis are now reported to be taking this offer for granted and have just given us a draft financial protocol for £1.35 billion of new credit! At present ECGD, like other credit insurers, offer only 1 year against letters of credit.

3 Clearly none of us like the idea of leading a move to convert a cash to a credit market. I set out below the arguments for and against doing so in this case.

4 Against extending credit

Iraq's economic situation has deteriorated since February and their economic prospects for the next 2/3 years (during which period the bulk of repayments would fall due) also look appreciably worse. There is no sign of the war ending and whilst Iran appears able to sustain a war of attrition it is increasingly having a serious effect on Iraq. ECGD's experience has also been deteriorating with claims up to £15 million either paid or under examination and a further £30 million potential losses reported. In addition some contracts have been arbitrarily cancelled by the Iraqis where the contractor has been



unable to provide financing facilities. No Western credit insurer (except possibly Austria) is currently prepared to offer support for medium credits to Iraq (indeed many are off cover even for cash business). Finally to grant credit would be incompatible with our decision to adopt a more rigorous ECGD approach to country under-writing, and would lead to criticism from other countries forced to follow the UK lead.

5 In favour of extending credit

a Commercial

Though the Iraqi economy has deteriorated since EGC authorised the February offer, the basic commercial case remains valid. Iraq is a striking example of a wealthy country with a serious, albeit temporary, cash flow problem, arising from the war, and closure of its Gulf oil outlet. Its oil reserves are the second largest in the Middle East. It has no accumulated debt, so extending credit is not a question of bailing out the banks. Iraq is a major market for our goods. In 1982 Iraq took £875m of UK exports - more than Japan and Korea combined. Once its oil exports resume, it will again be a major market. Although payments problems are likely to persist for 2 to 3 years, and there is considerable uncertainty about the state of Iraqi reserves, they should be in a position to pay debts in 5 years time, whether through the end of the war or through the development of alternative oil outlets, such as the Red Sea pipeline. The only current oil outlet, through Turkey, will in any case be expanded by 50% next spring to produce a revenue flow of \$10 bn annually. Saudi aid continues at about \$1 bn per month. Although there is still no hard evidence of other major credit insurers offering medium term cover, Austria is known to be considering it; (Mr Ramadhan will come here from Vienna).

b Political

The political arguments seem even more compelling. Commercial decision-taking in Iraq is more centralised and more subject to political considerations, than in almost any other Arab country. Mr Ramadhan ranks effectively as Prime Minister in the Iraqi hierarchy, and is the formal overlord of the entire economy. He has a powerful voice in Defence Sales matters, in the DSO's best recent market. His visit will be quite the most important meeting between British and Iraqi Governments for several years, and "success" or "failure" will have repercussions on our political and commercial relations for years to come. To appear in Iraqi eyes to renege on the undertaking implicit in the February letter would be seen as an act of bad faith with damaging long-term effects across the whole range of Anglo/Iraqi relations.



6 I conclude that the commercial case supports what is in effect a political imperative, to extend credit. Furthermore, if we are to move into medium-term credit at all, there is a good case for doing it boldly - not in such a half-hearted way that our competitors would at once more than match us, and our people would face an impossible task of choosing the lucky few from the several good contracts now in prospect. It would give us the worst of both worlds to start the race in such a way as to ensure we were soon running behind the pack. Thus the minimum we can do politically (£100m) - is commercially too small an amount. £250m for 5 years (a more sensible period, since in 5 years the underlying strength of the Iraqi economy should have been re-established) would enable us to cover serious business now in prospect, with a small margin. In my view it is both politically and commercially about the minimum realistic figure. We would naturally limit it to British capital goods, with some minimum contract value.

7 I am not, of course, suggesting that any offer should be unconditional. We shall wish to ensure in negotiation of the details that the Iraqis meet our interests, for instance over prompt payment of 1983 and 1984 maturities from the earlier refinancing exercise. On past form, these negotiations would take some considerable time to complete, before credit was actually made available. All we can sign next week with Mr Ramadhan will be an agreement in principle, subject to satisfactory negotiation.

8 Red Sea pipeline

Of all the civil projects in Iraq in which British firms are interested, this is unique both in scale, (the larger version would have £500m UK content, the smaller £200m), and more importantly in its role as a revenue-earner rather than spender for Iraq. Even if the war drags on indefinitely, this project offers Iraq a return to a positive cash-flow within 3 years of starting work. The Oil Minister and his officials will wish to discuss it again next week with the British-led international consortium and with my Department. To keep these discussions going I propose that my officials should tell the Iraqis that we are prepared to support this project, subject to satisfactory security in the form of either a Saudi guarantee of last resort or acceptable equivalent arrangements.

9 Iran

Although it is not strictly relevant to this letter, I should mention my concern that, if we do reach agreement with the Iraqis, we should consider some gesture, for instance in the defence sales field, to moderate Iranian dissatisfaction. Officials should, in my view, pursue this separately.



10 I am sending copies of this letter to the Prime Minister, other members of E(X), and to Sir Robert Armstrong. I fear there is considerable urgency about taking a decision, in that if we cannot at least give the Iraqi officials arriving for the Joint Commission meeting some kind of positive indication by 1 October, there is a real danger that Ramadhan will cancel the visit at the last moment, rather than risk a rebuff. I would therefore welcome your most urgent comments.

The 1 October deadline is no longer thought pressing

James
Ear,
Leil

Iraq: visit by Ramadhan

165
4
3
2
11 12 1

29 SEP 1983