



PM/90/058

PRIME MINISTER

Prime Minister
Re Foreign Security; thoughts
on aid to Jordan. The
balance of payments cost to
Jordan of sanctions is likely
to be around \$1bn. a year.

The Gulf Crisis: Jordan

Some sort of collective effort

1. King Hussein has given a commitment to President Bush that Jordan will enforce UN sanctions against Iraq. It remains to be seen how thoroughly this commitment will be implemented. The King may well be tempted, given his relations with Saddam Hussein and the level of support for Iraq in Jordan, to allow some leakage. Nevertheless his undertaking is an important step forward. We shall do everything we can to keep the King up to the mark. It is essential that Jordan should not be allowed to create a loophole in the UN Embargo.

to help
is
needed.

2. The implementation of sanctions would produce a major economic crisis in Jordan, with a prospect of instability, carrying risks for the regime. The JIC assessed prospects last week. Instability in Jordan would greatly heighten the risk of confrontation between Israel and Iraq.

The
Foreign
Security
will write
in Europe
tomorrow.

3. I attach a paper prepared in the FCO and discussed with other Departments which assesses Jordan's economic position and lists some possible options for international assistance. The conclusion to be drawn from the paper is that the impact of the crisis on the Jordanian balance of

Meanwhile, he
says he
cannot
make
any

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additional
funds from
his own
budget.

P.S. Chief Sec's who attached,

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payment will be around \$1 billion over a 12 month period. Jordan's economic position was already precarious. Assistance of this order of magnitude would not guarantee the maintenance of stability. But without it collapse looks inevitable.

4. Before the meeting between King Hussein and President Bush we suggested to the Americans that they look at the possibility of setting up and leading a group of international donors. At the meeting the President raised the possibility of international assistance in very general terms. James Baker confirmed to me over the telephone on 18 August that the US had undertaken to explore the possibilities for economic assistance. I am now instructing our Embassy in Washington to discuss these possibilities further with the Americans on the basis of our paper. The obvious potential donors include Japan, the Government of Kuwait and the United Arab Emirates. Saudi relations with Jordan are at the moment in poor shape, for obvious reasons, but the Saudis too have a considerable interest in stability in Jordan.

5. Jordan's predicament will no doubt be raised at tomorrow's EPC ministerial meeting in Paris. The paper concludes that European assistance would be best mounted done through national contributions perhaps coordinated among the Twelve, rather than through a contribution through the EC budget. But it should be for the US, and not the Twelve to lead.



6. I should make clear that our support for any sort of international rescue package would be conditional on Jordan implementing sanctions in a satisfactory manner. The quicker that this can be established the better the chances of an early solution to the crisis, with financial savings for all, including those other countries badly affected by the imposition of sanctions.

7. The Chief Secretary has addressed (his minute of 16 August) the possible size of a UK contribution and how it should be funded. I cannot agree that I should have to abandon priority FCO/ODA objectives and activities elsewhere and cut their corresponding budgets. These budgets are already under heavy pressure this year and beyond. It will be essential for any UK contribution to international assistance for Jordan to be properly funded from the Reserve, in the same way as has happened in previous international crises.

8. I am sending copies of this minute to Norman Lamont, Lynda Chalker and to Sir Robin Butler.

(DOUGLAS HURD)

Foreign and Commonwealth Office

20 August 1990

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JORDAN: THE EFFECTS OF THE GULF CRISIS

1. This paper is a preliminary attempt to assess the implications for the Jordanian economy of recent events in the Gulf. It does not aim to draw policy conclusions. The paper falls into two parts. The first attempts to set out how far Jordan's already precarious economic situation will have deteriorated as a result of recent events. It also considers how far this is affected by whether or not the Jordanians themselves apply the UN embargo. The second looks at possible ways to reduce the risk that the economy (and perhaps the regime) will collapse. All the figures are provisional - in part because of the haste with which the paper has been put together, in part because it is impossible to foresee how events will develop. An annex sets out more fully the assumptions on which the figures are based.

2. The most recent comprehensive balance of payments scenario for Jordan was prepared by the IMF for a review of Jordan's SBA programme (paper dated 21 May). We have taken this as the base line against which to compare Jordan's current situation. Ever since Jordan called in the IMF and rescheduled its debt in the Paris Club last year, it has been clear that the financing position for 1990 would be tight. To balance the external account in 1990 the Fund optimistically assumed an 11% increase in exports, 15% increase in remittances, \$380 million in Arab aid, \$50 million of new money from the commercial banks, and some \$100 million in fast disbursing money from the World Bank. Some of these assumptions already appeared implausible even before the Iraqi invasion of Kuwait: owing to slippage particularly on fiscal targets, the Jordanians and the IMF were planning to renegotiate the programme in August.

I. The Financial Cost to Jordan of the Gulf Crisis

3. Over the last few years, as a consequence of Jordan's support for Iraq in the Iran/Iraq war, the Jordanian economy has become heavily dependent on Iraq. In 1988 Iraq accounted for 10% of Jordan's total imports and takes 16% of its exports. A further

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2.5% is exported to Kuwait. Oil imports, which account for about one sixth of the import bill, come predominantly from Iraq (65% in 1988); Kuwait supplied a further 10%. The services sector, which accounts for two thirds of GDP, is heavily oriented towards Iraq.

4. The impact on Jordan's balance of payments of fully supporting the embargo might be as much as \$1 billion in a full year. Visible exports would fall by around \$230 million in a year if alternative markets are not found. The oil price rise, together with resourcing of imports previously received from Iraq under a trade clearing arrangement, will cost a further \$170-270 million, assuming an oil price of \$25/barrel is maintained. Workers' remittances, which amount to \$0.7 ^{billion} ~~million~~ a year and come mostly from Gulf countries, are likely to fall. The value of services provided for Iraq is estimated to be in the region of \$100 - 200 million (Amman telnos 394 and 415), all of which would be lost. Aid from Iraq and Kuwait will presumably cease as would cash debt repayments from Iraq.

5. A breakdown of these figures is set out below. Given the complicated nature of the trade clearing arrangements between Jordan and Iraq, these figures are particularly uncertain; explanatory notes are attached at Annex A.

	\$ million
<u>Trade account</u>	
(1) Visible exports	- 230
(2) Additional cost of oil imports	- 170 / 270
<u>Invisible account</u>	
(3) Workers remittances	- 175 / 375
(4) Services	- 100 / 200
(5) Arab aid receipts	- 50 / 150
<u>Capital account</u>	
(6) Debt repayment from Iraq	- 70

Total	- 800 / 1295

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6. In addition to these costs, other inflows, totalling over \$300 million, which Jordan was expecting this year are likely to be held up for the duration of the crisis. Jordan's IMF programme is likely to remain in suspense, holding up disbursements of some \$40 million. This in turn would hold up a \$75 million tranche of the World Bank's Investment and Trade Policy Loan (ITAL). The Jordanians were hoping for \$150 million of Japanese cofinancing with this loan. The \$50 million new money expected as part of the London Club rescheduling is also likely to be held up.

Cost to Jordan of supporting the embargo

7. If Jordan supports the embargo, it could not continue to receive Iraqi oil. The advantage to Jordan of sourcing oil from Iraq is that it can pay by barter rather than cash. (This would of course allow Iraq to obtain food from Jordan up to the value of the oil supplied. As Iraq's capacity to make cash payments diminishes on account of the blockade, there would be a decreasing incentive for Jordan to export to Iraq beyond this level.) Continuation of Iraqi supply could therefore substantially reduce the trade account losses identified at both (1) and (2) above. But evading the embargo would not prevent the losses on the invisible account, since remittances and aid receipts would still be affected, and Iraq has no cash to pay for services. So, even if Jordan does not support the embargo, it faces losses of at least \$300 - 800 million on the balance of payments.

Cost to Jordan of not supporting the embargo

8. If Jordan were flagrantly to circumvent the UN embargo, the four fifths of its trade with countries other than Iraq would be severely affected, as would expected capital account inflows. There is even the threat that the embargo might be extended to all trade through Aqaba. The net result could be even larger losses than outlined above. Surreptitious circumvention of sanctions might not generate such a marked response.

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II. POSSIBLE MEASURES TO SUPPORT THE JORDANIAN ECONOMY

Oil supplies

9. The most effective relief that could be given to Jordan would be oil supplies on favourable terms. The Tapline pipeline from Saudi Arabia to Jordan, although in poor repair, has a 0.5mbd capacity (more than current Iraqi supplies) and could quickly be upgraded to supply Jordan (Amman telno 632). Alternatively more limited supplies could be shipped from the Saudi terminal at Yanbu to Aqaba. If Saudi Arabia is prepared to contribute to efforts to support Jordan (see para 22 below), the provision of free or subsidised oil might be the most attractive form for their contribution.

Alternative markets for exports

10. The 11% increase in exports this year projected by the IMF already seemed optimistic, given the upheaval in Eastern European countries which are the main market for Jordanian phosphate. Exports to Iraq are predominantly agricultural and manufactured goods (mainly construction materials and textile products). With protected world markets for both agricultural and textile goods, finding markets for these products will be difficult. With the likelihood of slower world growth, the prospects for construction materials do not look good either.

Reducing debt service payments

11. According to latest IMF figures, Jordan was due to make interest payments of some \$500 million and principal payments of some \$200 million this year. This includes:

- about \$200 million to Paris Club creditors (about £24 million to the UK); this is interest only, since Jordan's last Paris Club rescheduling covered principal for 1990;
- about \$80 million to commercial banks; this again is interest only since the banks have offered to reschedule principal for 1990 (the deal is yet to be concluded due to the Jordanian wish for concessions on debt reduction and new

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money);

- about \$60 million in interest and \$90 million in principal to the IFIs;

- about \$100 million in interest and principal to Arab and other countries.

Only a very small amount of this has so far been paid; it was questionable even before the invasion whether anything like the full amount would actually have been paid by the end of the year.

12. It is now very likely that Jordan will default on some or all of these payments - with damaging consequences for future flows from ECAs and banks. If it defaults on Paris Club payments, these might presumably be rescheduled post facto following a further IMF agreement. For Jordan to go into arrears with the IFIs would seriously damage its long-term reputation.

Reducing imports

13. The IMF projected imports to rise by 5% this year, after a fall of 12% last year. There is little scope for import compression, particularly given the current level of popular unrest.

Drawing down reserves

14. The IMF projected a rise of some \$140 million in reserves from their very low 1989 level. This will almost certainly not now happen, but there is no scope for further reserve drawdown.

Money from the IFIs

15. The IMF cannot provide further assistance to Jordan until it gets its adjustment programme back on track. We must assume this will not be till after the crisis is over. It would be contrary to our normal policy to encourage the IMF to put further money at risk in Jordan while the political situation is so uncertain. The World Bank may continue disbursing on project loans, but fast-disbursing lending will have to await reactivation of the IMF programme. The IFIs may be able to help in picking up some of the

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mess afterwards, including making good any drawdown from the scanty reserves, but there is no prospect of any immediate help from this source.

Money from EC

16. "Topping up" the Third Financial Protocol to the EC/Jordan Cooperation Agreement At the EPC Ministerial meeting on 10 August, M Delors suggested that one way for the EC to help Jordan would be to provide further funds through the Third Financial Protocol (3FP). The 3FP provides 100 mecu to Jordan, over four years, expiring on 31 October 1991. 63 mecu is in the form of European Investment Bank (EIB) loans, and 37 mecu is in the form of grants from the Community's budgetary resources. The funds are used for development projects in Jordan, mainly agriculture, water resources, industry and education. Delors said that these funds were already exhausted. Our records show that only 57% of the EIB loans, and 50% of the grants have been committed, though the rest may have been earmarked in discussion between the Commission and the Jordanians.

17. A "top-up" could be effected by a Council decision to allocate additional funds to the 3FP from within existing resources (there is 50 mecu spare in the 1991 budget). But amendments to the 3FP would require approval by the European Parliament as well as the Council. This process would probably not be complete until October or November at the earliest, although the EC could state its political commitment in advance. The funds themselves would probably not be available before early 1991. The UK contribution would be in the order of 20% of the total. Attribution would fall to the ODA.

18. Community Facility for Jordan: The Community could agree to a range of measures for Jordan in a similar way as was done last year for Poland and Hungary. These measures ranged from the provision of food aid to support for Hungarian and Polish currencies in the form of loans at advantageous rates (Hungary was given a medium term loan of \$1 billion in principle guaranteed from the EC budget). The EC also offered large EIB loans (\$1

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billion for Hungary and Poland). These measures were taken in response to specific needs assessed by Commission fact-finding teams.

19. Again, if modest enough, such a move could stay within agreed financial ceilings (ie under 50 mecu in 1991). A larger EC gesture would involve a revision of the Financial Perspectives. This would erode budget discipline (containment of the budget is a major UK objective) and might create an unhelpful precedent for other countries wanting EC assistance. The UK contribution would again be about 20%: the question of attribution would be a potential difficulty.

20. Co-ordinated Contributions by the Twelve on a National Basis: This might be the most effective "European" approach. See para 25 below.

Money from Arabs

21. Arab States have been making direct financial contributions to Jordan since at least 1978, but only Saudi Arabia's payments have been at all regular. Under pledges made at the Arab Summit in Baghdad in May Jordan has already received \$295 million from other Arab states this year. Principal sums have been Saudi Arabia (\$100 million), UAE (\$60 million) and Kuwait (\$50 million plus \$35 million in oil). In July the Jordanian Finance Minister claimed firm pledges for a further \$75 million; this would have brought the total to more than the \$360 million Arab aid envisaged in the 1990 budget.

22. The prospects for further help in the current crisis depend on the attitude of Saudi Arabia. The Jordanians had hoped that the \$100 million from Saudi Arabia would be first installment of their assistance, but the Saudis have presented it as a non-recurrent payment. There has been increasing Saudi reluctance to support Jordan financially, partly because of Saudi Arabia's own financial concerns, partly because they feel they have been paying more than their share, and partly because they believe Jordan has not always spent the money wisely. King Hussein has not helped himself by

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publicly criticising the positioning of US forces in Saudi Arabia. But the Saudis may take into account the strategic importance of discouraging Jordan from evading the embargo, and averting the collapse of the regime.

23. The other Gulf states, particularly the UAE, could be approached for contributions: broadly the same considerations apply to them, although they have traditionally been more laggardly in their donations, and are less immediately threatened by a Jordanian collapse.

Kuwaiti Funds

24. If Saudi Arabia took the lead in an Arab aid effort, a further contribution might be forthcoming from Kuwaiti funds. At their recent meeting, the Kuwaiti Foreign Minister did not respond to Mr Waldegrave's suggestion that funds might be used to assist those countries suffering as a result of the embargo. The freeze on Kuwaiti assets might present legal obstacles to the use of funds to assist Jordan, although many Kuwaiti-owned businesses are continuing to operate and generate income. But depending on developments, the Kuwaitis might find it difficult to resist pressure from the other Arabs.

Money from Western Donors

25. Jordan was already in discussion with Japan about the provision of \$150 million balance of payments support in connection with its adjustment programme. Although these discussions will be in abeyance pending the reactivation of the IMF programme, Japan might be persuaded to make a financial contribution on an emergency basis. President Bush has already told Prime Minister Kaifu that a financial contribution from Japan would be welcome to compensate for its inability to contribute to the military effort against Saddam Hussein. Japan is perhaps more likely to contribute as part of a combined effort with other donors, in which the US would have to take a lead.

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26. If there were an international fund involving the US and Japan, we could press our European partners that the Twelve should agree to contribute (on a national basis) to such a Fund. The amount of the contributions could be co-ordinated and the outcome published as an effort by the Twelve. Something similar was done in the case of the US-launched \$1 billion Polish Stabilisation Fund (UK contribution \$100 million). Such a collective approach might be the best way to obtain realistic contributions from European countries.

Help from the UK

27. The UK would be expected to contribute to any International Fund. One possible form for such a contribution would be balance of payments aid. This could not be done on the basis of existing PES provision.

28. The Jordanians have suggested that we might provide them with technical assistance on the application of sanctions. It is not clear what expertise we could offer; and the provision of such assistance could identify us too closely with the extent to which the Jordanian authorities are implementing sanctions.

Use of Article 50 of the UN charter

29. Article 50 of the UN charter allows the Security Council to decide that assistance be provided to countries suffering as a result of sanctions imposed by the UN. The UN does not itself have any balance of payments funds which could be triggered by such a decision, and any assistance its agencies could in the longer term provide Jordan is not relevant to the immediate problem. On previous occasions where Article 50 has been invoked (for Zambia, Mozambique and Botswana in the context of sanctions against Rhodesia) the Security Council have appealed for help from bilateral donors. It is possible that a decision under Article 50

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would make it easier for some donors to contribute (perhaps Japan, Saudi Arabia, the Kuwaiti Funds and France). But any decision in favour of Jordan could lead to a long queue of other claimants. India, Bulgaria and Turkey are already reported to be seeking support under the Article.

Economic Relations Department/ Economic Advisers
15 August 1990 (7pm version)

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ANNEX A: EXPLANATORY NOTES ON CALCULATIONS

1. The figures have been calculated in the following way:

(1) Exports: 16% of Jordan's exports go to Iraq; a further 2.5% go to Kuwait. Jordan's total exports are around \$1,250 million giving a total for lost exports of \$230 million. This is broadly in line with the \$200 million figure quoted in Telno 415 from Amman. It of course assumes that products are not diverted elsewhere.

(2) Oil imports: Jordan imports 2.4 million tons of crude oil (approximately 19 million barrels) a year of which. In addition it imports 0.6 million tons of oil products. In 1988 75% of this came from Iraq and Kuwait; the balance came from Saudi Arabia. It is not clear what price Jordan currently pays for its oil. It claims it receives oil from Iraq at a discounted prices as repayment for war debt. This is not supported by IMF data for 1988, although the situation may have changed since the end of the Iran/Iraq war. Telno 425 from Amman claims the total oil import bill in the first half of the year was only \$163 million, (implying an annual figure of \$326 million). At world market prices for the first half of the year (roughly \$18/barrel) Jordan would have had to pay roughly \$215 million for this (\$430 for a year). If Jordan is now forced to pay current world prices (say \$25/barrel) it would face an annual oil import bill of \$597 million. (Telno 415 quotes Jordanian estimates of \$600 million). The additional cost is therefore \$170 (compared with a no discount baseline of \$430 million) but could be as high as \$270 million (if the discounted baseline of \$326 million is correct).

(3) Remittances: 330,000 Jordanians work abroad, of which half are in Saudi Arabia. They remitted \$0.9 ^{b/}million in 1987 and 1988 but only \$0.6 ^{b/}million last year. This year IMF projections for remittances are \$0.7 ^{b/}million. It is not clear how remittances will be affected but with workers returning home and others not remitting a 25-50% fall in remittances does seems plausible.

(4) Services: there is no data to confirm the figures quoted in telno 394 and 415 form Amman on the value of Jordan's export of services to Iraq. Net services excluding remittances amount to only \$20 million - \$1,280 in receipts and \$1,260 on payments. The receipts include travel (\$548 million) investment income (\$40 million) and other services, mostly freight and insurance, accounts for \$412 million. On

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this basis the upper and lower range \$ 100-200 million of the figures quoted in the telegrams seem reasonable and have been used.

(5) Aid: of the \$431 million aid Jordan received in 1988 \$293 was bilateral aid form Arab countries. This year Jordan has already received \$295 million in Arab aid: UAE \$60m, Kuwait \$50m, Iraq \$25m, Qatar \$20m, Oman \$5m, and Saudi Arabia \$100m. But more than this was pledged: Iraq was due to pay another \$25m. The Jordanian Minister of Finance described the Saudi figure of \$100 million as a first instalment although the Saudis are treating it as a non-recurrent payment. At the very least Jordan is likely to receive \$50 million less than it expected to from Iraq and Kuwait. The \$150 million figure implies no further receipts at all.

(6) Debt repayment: Iraq was due to repay Jordan \$144 million in monthly sums (in addition to discounted oil supplies). It is not clear how much of this has been paid only that the last monthly payment was two months overdue. The \$70 million figure is based on the assumption that roughly half of the figure was paid in the first half of the year.

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