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Iraq: Oil-For-Food Program, International Sanctions, and Illicit Trade

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Summary

The “oil-for-food” program has been the centerpiece of the long-standing U.N. Security Council effort to alleviate human suffering in Iraq while maintaining key elements of the Gulf war-related sanctions regime. In order to ensure that Iraq remains contained and that only humanitarian needs are served by the program, U.N. Security Council resolutions have mandated substantial controls on Iraqi oil exports and humanitarian imports. All Iraqi oil revenues earned under the program are held in a U.N.-controlled escrow account and cannot be accessed by the Iraqi government.

The Bush Administration is currently working on proposals, including a U.N. Security Council resolution, that would continue the program into the post-war period to serve as a vehicle to provide humanitarian relief. The Administration says the program provides a convenient and effective vehicle for delivering relief in the aftermath of the war. With hostilities now under way against Iraq and U.N. personnel having departed from Iraq, the program is in a state of suspension.

After six years of the program’s operations (1996-2002), there is a consensus among observers that the program has substantially eased, but not eliminated, human suffering in Iraq. Concerns about the program’s early difficulties prompted criticism of the United States; critics asserted that the U.S. strategy was to maintain sanctions on Iraq indefinitely as a means of weakening Saddam Husayn’s grip on power. At the same time, growing regional and international sympathy for the Iraqi people resulted in a pronounced relaxation of regional enforcement — or even open defiance — of the Iraq sanctions. The United States argued that continued sanctions were critical to preventing Iraq from acquiring equipment that could be used to reconstitute banned weapons of mass destruction (WMD) programs.

Seeking to improve international unity on containment of Iraq, in early 2001 the Bush Administration devised a “smart sanctions” plan that it said would speed the flow of civilian goods to Iraq and thereby improve living conditions for the Iraqi people. The U.S. plan offered to significantly ease restrictions on exportation of purely civilian goods to Iraq in exchange for greater international and regional cooperation to prevent any arms or weapons-related technology from reaching Iraq. The U.S. plan also sought to prevent the Iraqi government from receiving the proceeds of illicit oil sales to Iraq’s neighbors. The U.S. proposals appeared to move away from post-Gulf war linkages between sanctions easing and full Iraqi cooperation with U.N. inspections of Iraq’s WMD capabilities. After a few rounds of negotiations on the U.S. plan, the Security Council adopted (Security Council Resolution 1409, May 14, 2002) the portion of the U.S. plan that facilitates civilian exports to Iraq. Regional resistance scuttled the aspects of the plan that would have curbed Iraq’s illicit trade with its neighbors.

This product will be updated every six months or sooner, if warranted by major developments.

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Iraq: Oil-For-Food Program, International Sanctions, and Illicit Trade

Background and Structure of the Oil-For-Food Program

The “oil-for-food” program reflects a longstanding U.N. Security Council effort to alleviate human suffering in Iraq while pressing Iraq to comply with all relevant U.N. Security Council resolutions.¹ The program represents a temporary and limited exception to the comprehensive international trade embargo imposed on Iraq by U.N. Security Council Resolution 661 (August 9, 1990) as a consequence of its invasion of Kuwait. U.N. Security Council Resolution 687 (April 3, 1991) provided for the international embargo on Iraq’s exportation of oil² to end once Iraq had fully complied with U.N. efforts to end its weapons of mass destruction (WMD) programs. The WMD inspections began in April 1991 but proceeded more slowly than expected, and an end to sanctions did not appear to be in sight by April 1991. Without oil export revenues, Iraq was unable to import sufficient quantities of food and medical supplies, and, according to virtually all accepted indicators (infant and child mortality, caloric intake, and other indicators), living conditions deteriorated sharply during 1991-1995.

The first version of an oil-for-food plan would have allowed Iraq to export \$1.6 billion in oil every six months. It was adopted by the Council in 1991 in Resolutions 706 (August 15, 1991) and 712 (an implementing plan adopted September 19, 1991), but Iraq rejected it as too limited in scope and an infringement on Iraq’s sovereignty. There was little movement on the issue during 1991-95, despite dramatic declines in Iraq’s living standards. On April 15, 1995, the Council adopted Resolution 986, which took into account one of Iraq’s concerns by allowing the export of \$2 billion in oil every six months. Iraq and the United Nations signed a memorandum of understanding on the program on May 20, 1996 (document number S/1996/356) and, after several more months of negotiations on details, the first Iraqi oil exports began on December 10, 1996. After the first year of the program, the Secretary General determined that the program was not meeting the food and medical needs of the Iraqi people, and Resolution 1153 (February 20, 1998) raised the oil export ceiling to \$5.256 billion per 6-month phase. In an effort to provide Iraq an incentive to cooperate with a new program of U.N. weapons of mass destruction (WMD) inspections, the U.N. Security Council, in Resolution 1284 (December 17, 1999),

¹ For a further discussion of Security Council resolutions and requirements on Iraq, see CRS Issue Brief IB92117, *Iraq: Compliance, Sanctions, and U.S. Policy*.

² That embargo was imposed by U.N. Security Council Resolution 661 of August 6, 1990.

abolished the export limit. This resolution had a number of additional provisions and implications for the oil-for-food program, as discussed below.

Program Operations

In order to ensure that only humanitarian objectives are served by the program, the oil-for-food program places substantial controls on Iraqi oil exports and humanitarian imports. Iraq's state-owned oil marketing company (State Oil Marketing Organization, SOMO) negotiates with international oil companies to sell Iraqi oil. Oil purchase contracts are reviewed by a panel of oil contract overseers reporting to the U.N. Sanctions Committee,³ which administers the implementation of sanctions on Iraq. The oil overseers review Iraq's pricing proposals monthly. Iraq is only allowed to export oil under the program, not any other products.

The oil sold is exported through an Iraq-Turkey pipeline and from Iraq's terminals in the Persian Gulf. According to Resolution 986, "the larger share" of oil exports must run through the Turkish route. The proceeds from these sales are deposited directly, by the oil purchasers, into a U.N.-monitored escrow account held at the New York branch of France's Banque Nationale de Paris (BNP). Iraq's oil exports are monitored at the point of exportation by personnel from Saybolt Nederland BV, an energy services firm working under contract to the program.

In each six-month phase of the program, Iraq purchases goods and services directly from supplier firms, in accordance with an agreed distribution plan allocating anticipated revenues among categories of goods to be purchased in that phase. Prior to the major amendment to the program approved in May 2002, which is discussed later, the Sanctions Committee reviewed and had authority to approve contracts for the export of goods to Iraq. The Committee operates by consensus. Any Sanctions Committee member could place a "hold" on a contract for goods to be imported by Iraq, and the United States often placed holds on exports of dual use items (civilian items that could have military applications). In deciding whether to place a hold on a contract, the U.S. representative on the Sanctions Committee consulted with agencies of the U.S. government to determine whether Iraq could use the requested items for military purposes.

Under the new procedures adopted in Security Council Resolution 1409 (May 14, 2002) and placed into effect in July 2002, the U.N. weapons inspection unit (UNMOVIC, U.N. Monitoring, Verification, and Inspection Commission) reviews export contracts to ensure that they contain no items on a designated list of dual use items known as the Goods Review List (GRL). If so, the Sanctions Committee then decides whether to approve that portion of the contract containing the GRL items in question.

Under U.S. regulations written for the program, U.S. firms can buy Iraqi oil and sell goods to Iraq, including oil industry spare parts and equipment. Over the past few years, purchases of Iraqi oil by U.S. firms have ranged between one-third to one-

³ The Sanctions Committee, set up by Resolution 661, consists of representatives of the member states on the U.N. Security Council.

half of Iraq's normal export volume of about 2.1 million barrels per day. As of February 2003, U.S. imports of Iraqi oil are tending toward the high end of that range, about 1 million barrels per day. The U.S. imports come primarily by purchases from intermediate energy trading firms rather than direct buys from Iraq. (See appendix for an overview of U.S. regulations governing U.S. firms' participation in the program.)

Once a contract is approved, BNP uses the funds deposited in the escrow account to pay letters of credit for the purchased goods. The arriving supplies are monitored at their point of entry into Iraq by about 50 personnel from the Swiss firm Cotecna⁴ at four approved border crossings — Umm Qasr on the Persian Gulf; Trebil on the Iraqi-Jordanian border; Walid on the Iraqi-Syrian border; and Zakho on the Iraqi-Turkish border. In Baghdad-controlled Iraq, the Iraqi government distributes imports to the population through a government rationing system, and distribution is monitored by about 158 U.N. workers from the World Food Program, the Food and Agriculture Organization, the World Health Organization, and UNICEF. The U.N. personnel visit ration centers, marketplaces, warehouses, and other installations to ensure that distribution is equitable and accords with the targeted allocation plans submitted by Iraq for each six month phase. In Kurdish-controlled Iraq, about 65 U.N. workers, accompanied by about 130 U.N. security guards, perform the distribution function. Some goods bound for the Kurdish-controlled areas are combined with Baghdad's purchases in order to obtain more favorable prices in bulk.

Under Security Council Resolution 1051 (March 27, 1996), exports to Iraq of dual use items are supposed to be monitored by U.N. weapons inspectors at their point of entry and site of end use in Iraq. This import monitoring mechanism was altered during 1998-2002 when the U.N. weapons inspection regime was not in operation inside Iraq. Security Council Resolution 1284 (December 17, 1999) replaced UNSCOM with UNMOVIC, which now performs that end-use monitoring function after reentering Iraq in November 2002. During the 1998-2002 hiatus in weapons inspections, end use monitoring in Iraq was performed by some of the 158 U.N. employees who monitor the distribution of civilian goods coming into Iraq. However, these monitors were not trained weapons inspectors, and this caused the United States and Britain to closely scrutinize, and to place many holds on, exports of dual use items to Iraq.

The oil-for-food program attempts to help Iraq meet its international obligations and ensure equitable distribution of imports to the Iraqi people. The revenues from Iraq's oil sales are distributed as follows:

- 25% is transferred to a U.N. Compensation Commission (UNCC) to pay reparations to victims of Iraq's invasion of Kuwait. As provided for in Security Council Resolution 1284 (see below), the deduction percentage fell to 25% from its previous level of 30% at the commencement of phase nine of the oil-for-food program (December 6, 2000).

⁴ Cotecna replaced Lloyd's Register as point-of-entry monitoring contractor on February 1, 1999.

- 59% is used to purchase humanitarian items for Baghdad-controlled Iraq. This account was increased from its previous level of 53% when the reparations deduction was reduced in December 2000.
- 13% is used to purchase supplies in the three Kurdish-inhabited provinces of northern Iraq.
- 3%, the remaining amount, pays for U.N. costs to administer the oil-for-food program, as well as UNMOVIC's operating costs.

Changes Outlined in Resolution 1284. U.N. Security Council Resolution 1284, adopted December 17, 1999,⁵ was intended in part to improve the provision of relief for the Iraqi people and to offer Iraq an incentive to readmit U.N. weapons inspectors. The following highlights key provisions of it and related decisions:

- As noted previously, Resolution 1284 eliminated the limit on the amount of oil Iraq could export, in order to enable Iraq to generate more revenues for humanitarian purchases.
- Resolution 1284 began the process, continued in subsequent oil-for-food program rollover resolutions, of easing restrictions on the flow of civilian goods to Iraq. The resolution directed the Sanctions Committee to draw up lists of items, in several categories, that would no longer be subject to Sanctions Committee review, and therefore would not be vulnerable to "holds." The accelerated approval procedures for foodstuffs and educational goods began on March 1, 2000, and continued with pharmaceuticals, medical supplies, medical equipment, and agricultural equipment (March 29, 2000). Subsequent oil-for-food rollover resolutions made eligible for the new procedures water treatment and sanitation supplies (August 11, 2000) goods for the housing sector (February 26, 2001) and electricity supplies (May 24, 2001).
- The resolution laid the groundwork for foreign investment to explore for and produce oil in Iraq, although the resolution made this investment contingent on full Iraqi cooperation with UNMOVIC. Since late 2000, the Sanctions Committee has approved drilling in existing fields by two Russian firms (Tatneft and Slavneft) and a Turkish firm (Turkish Petroleum Company), but exploration of new fields is still not permitted.
- Resolution 1284 created incentives for Iraq to cooperate with UNMOVIC by "express[ing] the intention," if Iraq is deemed to have "cooperated in all respects" with UNMOVIC, to suspend export and import sanctions for 120 days, renewable by Security Council. The resolution implies that the Security Council would have to vote to implement the sanctions suspension. If sanctions had

⁵ For full text of Resolution 1284, see [<http://www.un.org/Docs/scrses/1999/99sc1284.html>].

been suspended under this provision, Iraq would have been allowed to control its own revenues, although subject to strict but unspecified financial controls, according to the resolution. Arms exports to Iraq would still be banned and exports of dual use items would still be subject to scrutiny by the Sanctions Committee. As of February 2003, there has been virtually no discussion within the Security Council of suspending sanctions. The Council has focused instead on whether to authorize the use of force against Iraq to ensure its WMD disarmament under applicable resolutions, particularly Resolution 1441 of November 8, 2002.

- Resolution 1284 also made some oil industry spare parts eligible for a streamlined approval process — contracts for such equipment are scrutinized by the same Sanctions Committee panel of oil overseers that review Iraq's oil sales contracts, without requiring full Sanctions Committee review. U.N. Security Council Resolution 1293 (March 31, 2000) increased to \$600 million, from \$300 million, the value of oil industry spare parts that Iraq could import per oil-for-food phase. This decision was taken in response to recommendations by the U.N. Secretary General that improving the humanitarian situation was contingent on the rehabilitation of Iraq's ability to export its oil. As of November 30, 2002, about \$1.55 billion worth of oil industry spare parts have arrived in Iraq under the program.

Accomplishments of the Program

There is a consensus among U.N. officials and outside observers that the oil for food program has eased substantially, but not eliminated, human suffering in Iraq. The program, as well as some economic liberalization measures and illicit activity outside the program (discussed below), enabled Iraq to achieve 15% economic growth during 2000, according to the CIA's "World Factbook: 2001."

Few observers question that the program has made vast amounts of funds available for the purchase of food, medicine, and essential civilian goods. Table 1, supplied by the United Nations' Office of the Iraq Program, shows that higher oil prices, coupled with program modifications, have enabled Iraq to generate substantial revenues to fund imports. At times since the program began operations in December 1996, Iraq has generated more oil revenue than it did before the U.N. embargo was imposed in 1990 (about \$12.5 billion in *total* exports was generated in 1988), although substantial deductions are taken to pay the cost of implementing the program and for reparations payments.

From inception until February 21, 2003, the program has generated over \$63 billion in revenues. From inception until November 30, 2002, contracts for exports to Baghdad-controlled Iraq of civilian goods worth \$38 billion have been approved, with goods worth \$24.4 billion having been delivered. For Kurdish-controlled northern Iraq, import contracts worth about \$4 billion have arrived from inception until November 30, 2002, including about \$3 billion purchased in concert with Baghdad's purchases. Another \$600 million in locally produced goods and contracts in the north were procured during the time period.

As noted in **Table 1**, Iraq's sales of oil ran significantly below capacity during 2001 and much of 2002. The decrease was largely a result of disputes between Iraq and the United Nations over the formula for pricing Iraq's oil. Some members of the Sanctions Committee have sought to complicate Iraq's ability to impose surcharges on its oil buyer — such surcharges of about 30 - 50 cents per barrel constitute illicit revenue and are prohibited. In September 2001, to reduce Iraq's surcharging ability, the pricing formula was changed to "retroactive pricing," in which the oil is priced after sale. This significantly reduced Iraq's oil sales by about 25%, although the United Nations noted a rebound to previous levels (about 2 million barrels per day) as of September 2002. Iraq has sometimes unilaterally interrupted the sale of oil to protest Security Council policy or to challenge the United States and its allies. For example, Iraq suspended its oil sales for the month of April 2002 in protest against Israel's military incursion into the West Bank.

Table 1. Revenue Generated by Oil-For-Food Program
(through February 2003)

Phase Number (each phase is six months)	Volume Sold (millions of barrels)	Value of Export (\$billion)	Average Price per Barrel (\$)
One December 10, 1996 - June 7, 1997 (\$2 billion export ceiling) ^a	120	2.15	17.92
Two June 8, 1997 - December 4, 1997	127	2.125	16.73
Three December 5, 1997 - May 29, 1998	182	2.085	11.46
Four May 30, 1998 - November 25, 1998 (Export ceiling raised to \$5.2 billion by Resolution 1153)	308	3.027	9.83
Five November 26, 1998 - May 24, 1999	360.8	3.947	10.94
Six May 26, 1999 - December 11, 1999	389.6	7.402	19.00
Seven December 12, 1999 - June 8, 2000 (Export ceiling lifted permanently by Resolution 1284)	343.4	8.302	24.13
Eight June 9, 2000 - December 5, 2000	375.7	9.564	25.50
Nine December 6, 2000 - July 3, 2001	293	5.638	19.24
Ten July 4, 2001 - November 30, 2001	300.2	5.35	17.82
Eleven December 1, 2001 - May 29, 2002	225.9	4.589	20.31
Twelve May 30, 2002 - December 4, 2002	232.7	5.639	24.3
Thirteen (as of February 21, 2003) December 5, 2002 - June 3, 2003	130.5	3.618	27.7
Totals	3,117.3	56.412	

Source: U.N. Office of the Iraq Programme. [<http://www.un.org/Depts/oip/>].

- a. Applicable U.N. Security Council resolutions allow Iraq to generate revenue, over and above the ceilings, to pay the costs of transit fees for exporting oil through Turkey, which explains why some figures might exceed stated ceilings.

The following represent the major accomplishments of the program in improving the living standards of the Iraqi people, taken mostly from a report by the U.N. Secretary General to the U.N. Security Council, dated November 12, 2002.

Food. According to the U.N. report, in Baghdad-controlled Iraq, the Iraqi government is now importing and distributing about 2,200 kilocalories of food per person per day - about 90% of the U.N. target caloric intake of 2,463 kilocalories per person per day. The full ration was achieved only during December 2000. The report notes that 60% of Iraq's families rely solely on the food ration under the program to meet all household needs. The U.N. report does not identify any food problems for the three Kurdish provinces, which is consistent with press reports that food has become relatively abundant there, sometimes to the detriment of local agricultural production.

Health, Sanitation, and Electricity. The U.N. report said that there have been "notable" achievements in the health sector, including an increase in major surgeries performed and a reduction in communicable diseases. This and previous U.N. reports on the program have noted improvement in the diagnostic and other equipment in use in Iraq's hospitals. In the related area of water and sanitation, the U.N. report said that there has been some recent improvement in access to potable water, although access is still insufficient in both quantity and quality. The U.N. report says the situation in the electricity has been "improving gradually," noting a more reliable supply of electricity to Iraqis than was the case previously.

In mid-1999, UNICEF released its first country wide survey of infant and maternal mortality in Iraq since 1991. The survey took a number of precautions to ensure that the survey results would not be altered or modified and UNICEF is confident that the survey information is accurate. It showed that infant mortality in the southern and central sections of Iraq (under the control of the Iraqi government) rose from 47.1 deaths per thousand live births during 1984-1989 to 107.9 deaths per thousand during 1994-1999. The under five-year-old mortality rate rose from 56 to 130.6 per thousand live births in the same time period. According to the report, this increase in mortality resulted in about 500,000 more deaths among children under five than would have been the case if child mortality trends noted prior to 1990 (imposition of sanctions) had continued. In northern Iraq, the mortality rate has declined over the same period: infant mortality dropped from 63.9 per thousand live births in 1984-1989 to 58.7 in 1994-1999 and under five-year-old mortality dropped from 80.2 per thousand live births to 71.8 per thousand.

Education. The U.N. report identifies significant shortages of materials and equipment throughout the education sector, particularly school overcrowding. The report says that the recent distribution of 1.2 million school desks has met 60% of the need at primary and secondary schools. According to an earlier report (September 8, 2000), Iraq's literacy rate (53.7% of adults and 70.7% of the youth) "has remained fixed for a number of years."

Recent Debates Over Sanctions

The accomplishments of the program did not end debate over how strictly to enforce some of the program's restrictions. The United States and Britain tended to place most of the blame for the program's shortcomings on Iraq, alleging that the Iraqi regime disregards the needs of its people. U.N. administrators of the program have criticized Iraq on similar grounds, but they also attributed program deficiencies to U.S. and British policy, which they alleged slowed or halted the flow of infrastructure equipment that is required to realize the program's benefits.

The issue of contract "holds" on infrastructure equipment has been one of the most contentious that the United Nations has faced. Past U.N. reports on the program claim that infrastructure equipment, such as trucks, communications gear, forklifts, electricity, and water treatment equipment, are crucial to the timely distribution and proper storage and functioning of foodstuffs and medical products. At the time of the adoption in May 2002 of aspects of the "smart sanctions" plan discussed below, the United States had placed almost \$5 billion of goods on hold.

In response to international criticism of the holds, the United States asserted that 90% of all contracts were approved and that the holds had minimal impact. The United States maintained that all contracts needed to be scrutinized to ensure that no equipment would be used to rebuild WMD programs, especially during the time U.N. weapons inspectors were not in Iraq (December 1998 - November 2002) to monitor dual use exports that are shipped there. U.S. officials said they also wanted to ensure that no contract was being awarded solely to encourage political support for Iraq from parent governments. U.N. reports have not accused Iraq of purposely diverting imports from the program to the military or regime supporters, although some U.S. reports, such as a February 28, 1998 State Department fact sheet, say Iraq has diverted other food stocks to these elements.

The "Smart Sanctions" Plan. With no permanent end to international sanctions in sight due to the lack of U.N. weapons inspections, the debate over further modifications to the oil-for-food program was the centerpiece of a broader debate over Iraq sanctions during 2001. This debate intensified in May and June 2001 when the five permanent members of the U.N. Security Council first discussed the U.S. plan to adopt "smart sanctions" on Iraq. The smart sanctions plan represented an effort, articulated primarily by Secretary of State Colin Powell at the beginning of the George W. Bush Administration, to rebuild a consensus to contain Iraq. When it came into office, the Bush Administration asserted that international sanctions enforcement was collapsing and that Iraq was using the relaxation to acquire prohibited goods and raise illicit revenue. The U.S. smart sanctions proposal centered on a trade-off in which restrictions on the flow of civilian goods to Iraq would be greatly eased and, in return, Iraq's illicit trade with its neighbors would be brought under the oil-for-food program and its monitoring and control mechanisms. The net effect, according to the concept, would be to target sanctions only on limiting Iraq's strategic capabilities, and not on its civilian economy.

The smart sanctions plan was intended to defuse criticism by several governments, including permanent members of the U.N. Security Council France, Russia, and China, that the United States is using international sanctions to promote

the overthrow of the Iraqi government or to punish Iraq indefinitely for the invasion of Kuwait. These governments appeared to believe that no amount of Iraqi cooperation with the United Nations would be sufficient to persuade the United States to lift sanctions on Iraq, and they and other governments moved unilaterally to skirt or erode the sanctions regime.

Differences between the permanent members over how to implement these measures prevented immediate agreement on the U.S. plan. With phase nine of the oil-for-food program set to expire on June 4, 2001, the permanent five members of the Security Council began discussions on the U.S. smart sanctions plan, but no agreement was reached, and the oil-for-food program was extended with no changes. With the September 11, 2001 attacks and the war in Afghanistan bringing the United States politically closer to Russia and, to a lesser extent, China, the Security Council reached agreement to adopt some elements of the U.S. plan, as provided for in Security Council Resolution 1409 (May 14, 2002). The resolution created the Goods Review List (GRL), mentioned above, a list of dual use items that are subject to review by UNMOVIC before they can be exported to Iraq. The Goods Review List is contained in U.N. document S/2002/515 of May 3, 2002; it can be found online at the U.N. oil-for-food program Web site [<http://www.un.org/depts/oip>].

Resolution 1447 (December 4, 2002) contained a pledge to add, within 30 days, certain items to the GRL, items that the United States said could be used by Iraq to counter a U.S. military offensive. The Security Council added 36 U.S.-suggested items to the GRL on December 30, 2002 (Resolution 1454).

The following discusses the debate over the U.S. smart sanctions plan and compares what was agreed to in the resolution versus what had been sought in the original U.S. smart sanctions proposals.

- **List of Restricted Items.** A major point of dispute was the criteria for placing items on the GRL. Russia and France initially maintained that the proposed list, which included such goods as high performance computers, optical sensing technology, drilling equipment, aircraft spare parts, and marine sensing gear,⁶ was too extensive, and would have the net effect of hindering the rebuilding of Iraq's civilian infrastructure.
- **Border Controls.** Enhanced border control provisions, a central element of the original U.S. smart sanctions plan, were not included in Resolution 1409, largely because of strong opposition by Iraq's neighbors to controls on illicit trade with Iraq. Iraq's neighbors maintained that enhanced border controls would harm their economies.
- **Flights.** Early draft resolutions of the smart sanctions plan attempted to gain some control over international civilian flights to

⁶ A May 24, 2001 draft of the list of goods that would still be subject to review is at [<http://www.cam.ac.uk/societies/casi/info/annex010524.html>].

Iraq by requiring that their cargo be inspected at designated airports outside Iraq. The draft proposals would have permitted Jordan to return six Iraqi Airways passenger aircraft grounded in Amman since the Gulf war, and Tunisia to return four planes there. These provisions were not contained in Resolution 1409.

- **Foreign Investment/Energy Exploration.** Early drafts of the smart sanctions resolution “expresse[d] an intention” to permit foreign companies to provide services in Iraq. Some diplomats interpreted this as implicitly including energy exploration services, although most observers believed that such permission would need to be explicit. Permanent Security Council members Russia, France, and China have pressed for investment in Iraq’s energy sector, and companies from these countries have reached agreement with Iraq to develop several oil fields if and when the prohibition on foreign exploration is lifted. No provision along these lines was included in Resolution 1409.
- **Oil Sales Surcharges.** The early smart sanctions proposals attempted to address the reported practice of Iraq’s surcharges of about 30 - 50 cents per barrel of oil, which goes into the coffers of Iraq’s government. The drafts stipulate that a list of companies authorized to do business with Iraq be drawn up, a list which it is widely understood would include only large, well-known international oil firms that would not pay Iraq these surcharges. This provision was not incorporated into Resolution 1409, but the Sanctions Committee subsequently addressed the issue separately by adopting the “retroactive pricing” mechanism. The surcharging issue is discussed further below in the section on illicit trade.

Other Sources of Humanitarian Aid

UNICEF, the World Food Program (WFP) the U.N. Development Program (UNDP), the European Community (ECHO), the International Committee of the Red Cross (ICRC), governments, and private relief organizations such as Catholic Relief Services and Save the Children continue to provide additional relief to supplement the oil-for-food program. UNICEF, ECHO, and WFP focus their humanitarian aid on the South and Central part of the country rather than on the economically better off Kurdish north.

It is impossible to determine precisely the total amounts of bilateral and multilateral aid by all donors. However, the U.N. Secretary-General’s recent reports and statements have suggested that these aid sources are declining, possibly because donors believe the oil-for-food program is satisfying Iraq’s needs. Secretary General Annan has called for increased international assistance to Iraq, and Resolution 1284 “encourages” countries and international organizations to provide supplementary humanitarian aid and educational materials to Iraq. After Baghdad’s incursion into the Kurdish north in late August 1996, the United States virtually ended its assistance program for northern Iraq, which had been about \$45 million per year. The incursion

caused all American-based humanitarian relief organizations in northern Iraq to leave in fear of Iraqi reprisals against them.

There is no single source for information on humanitarian assistance to Iraq. A recent report of the Organization for Economic Cooperation and Development (OECD), which provides donor information for the years 1994 through 1998, indicates that Iraq received a total of \$76.36 million in bilateral assistance in 1998.⁷ This does not include any funds provided by U.N. agencies but does include grants by the European Commission (ECHO). A Washington-based official of the European Commission said in June 2001 that the European Union has given over \$200 million in aid to Iraq since 1991.

Illicit Trade

In order to generate funds that it can use without restriction, Iraq has conducted illicit oil dealings with its neighbors and other countries, imposed surcharges on oil buyers, and solicited kickbacks from suppliers of humanitarian and other civilian goods. The primary concern of U.S. officials is that Iraq is reportedly using these revenues to buy prohibited military and WMD technology. U.S. officials have accused Iraq of squandering the illicit revenues on projects and items that do not improve living standards for average Iraqis. In February 2000, the Clinton Administration accused the Iraqi government of using its resources to build nine lavish palaces (valued at about \$2 billion) and to import non-essential items such as cigarettes and liquor.⁸

There are no authoritative figures for the value of illicit trade with Iraq. However, the most widely cited estimates come from a study, released in May 2002 by the General Accounting Office (GAO).⁹ According to the GAO study, Iraq earned \$6.6 billion in illicit revenue from oil smuggling and surcharges during 1997-2001. Of that total, GAO estimates \$4.3 billion was from illicit oil sales and \$2.3 was from surcharges on oil and commissions from its contracts to buy civilian goods (kickbacks). The study estimates that during 2001, Iraq earned \$1.5 billion from illicit oil sales through Jordan, Syria, Turkey, and the Persian Gulf; and about \$700 million from surcharges and contract kickbacks.

Additional details on Iraq's illicit dealings are discussed below.

Jordan. Since the Gulf war, Jordan has notified the Security Council that it imports Iraqi oil (between 70,000 - 100,000 barrels per day as of March 2002, according to the GAO study) at below-market prices. The oil is in exchange for

⁷ Geographical Distribution of Financial Flows to Aid Recipients. Disbursements, Commitments, Country Indicators. 1994-1998. OECD. 2000.

⁸ Alcohol is classified as a food, so the imports are technically legal under the international sanctions regime in place since Iraq's August 2, 1990 invasion of Kuwait.

⁹ GAO-02-625. Weapons of Mass Destruction: U.N. Confronts Significant Challenges in Implementing Sanctions Against Iraq. General Accounting Office, May 2002.

civilian goods and write-downs of Iraq's debt to Jordan. The United States supports the Sanctions Committee decision to "take note of" the Jordanian purchases, neither approving them nor deeming them a violation. The Administration has routinely waived unilateral sanctions on Jordan that could be imposed because of this trade.¹⁰ In October 2000, Jordan cancelled an agreement with Lloyd's Registry, in force since 1993, for the firm to inspect Iraq-bound cargo in Jordan's port of Aqaba. This inspection agreement covered goods other than those imported under the oil-for-food program; goods imported under the program are monitored at all points of entry, including the Iraq-Jordanian border.

Iran/Persian Gulf. The GAO study estimates that Iraq was exporting illicitly about 30,000 - 40,000 barrels per day through the Persian Gulf in March 2002. This exportation is apparently conducted with cooperation from Iran. Of the funds generated through this export channel, about one-half go to Iraq, one-quarter go to smugglers and middlemen, and one-quarter go to Iran's Revolutionary Guard for "protection fees" to allow the shipments to hug its coast and avoid capture. Many believe that exports through the Gulf were higher during 1998-2000, but they have fallen because Iraq is diverting oil to the Syrian route, where there are fewer middlemen to pay.

Syria/Military Technology Exports to Iraq. In late 2000, according to several press reports, Iraq began exporting oil through an Iraq-Syria pipeline, closed since 1982 but now repaired. According to the GAO study, Iraq exported 180,000 - 250,000 barrels per day through this route in March 2002, and exports through Syria are believed to be at similar levels as of early 2003. This exportation is reputedly under a bilateral agreement with Syria under which Syria refines the Iraqi oil for domestic use, and pays Iraq about half the world market price for oil, freeing up extra Syrian oil for export. The United Nations has not formally approved this export route and the U.S. position is that it is illegitimate. Many experts believe the United States has not forcefully pressed Syria to cease this importation in order to enlist Syria's support in the global war on terrorism and the U.S. effort to build international support for confronting Iraq.

There is growing concern that Syria is becoming a major transit point for prohibited imports by Iraq of military equipment and technology that could be used for WMD. In July 2002, a respected Israeli military expert reported that Syria had served as a transit point for Iraq's importation of Russian-made engines for combat aircraft (sold by Ukraine) and tanks (sold by Bulgaria and Belarus), and Czech-made anti-aircraft cannons (sold by the Czech Republic).¹¹ According to the same article, Syria also passed on prohibited equipment to Iraq sold by Hungary and Serbia.

In late September 2002, both Ukraine and Belarus denied providing weapons systems or dual use technology to Iraq. However, in late September 2002, the Bush Administration initiated what it called a "temporary pause" in U.S. assistance to Ukraine (about \$55 million held up) because of allegations that Ukraine has provided

¹⁰ Every fiscal year since 1994, Congress has included a provision in foreign aid appropriations cutting U.S. aid to countries that violated the Iraq embargo.

¹¹ Schiff, Ze'ev. Syria Buys Arms for Iraq. *Ha'aretz*, July 15, 2002.

the “Kolchuga” early warning radar system to Iraq. In February 2001, the United States struck an air defense network that was being upgraded with the help of a Chinese firm, according to press accounts, although it is not known how the fiber optic equipment reached Iraq.

Turkey. According to the GAO study, Iraq exported the equivalent of 40,000 - 80,000 barrels per day of oil through Turkey in March 2002. The exportation is in the form of 450 Turkish trucks per day carrying Iraqi oil products (not crude oil) through the Iraqi Kurdish areas into Turkey in spare fuel tanks. The Turkish government taxes and regulates the illicit imports. As in the case of Jordan, the U.S. Administration has routinely waived the imposition of U.S. sanctions on Turkey for permitting this illicit trade. Some reports suggest that commerce between Iraq and Turkey has slowed to a crawl, if not halted entirely, in February 2003 in anticipation of a possible U.S.-led war against Iraq.

Oil Sales Surcharges. As noted above, the GAO study estimates that Iraq earned over \$700 million in 2001 from oil sales surcharges and kickbacks on purchases of goods. The GAO study obtains that estimate by assuming that Iraq obtained a surcharge of 35 cents on each barrel of oil sold under the oil-for-food program. The GAO estimated the “kickback” percentage for Iraq at 5 percent of the value of each purchase contract. In September 2001, the Sanctions Committee moved to curb Iraq’s ability to surcharge on oil sales by adopting a “retroactive pricing” formula. The United Nations said in late September 2002 that Iraq, in part due to the pricing formula, had ended its surcharging practice and that Iraq’s oil sales were rebounding.

Prior to adopting retroactive pricing, the Sanctions Committee had evaluated a number of alternative methods. One proposal, not adopted, was to price Iraq’s oil every ten days or every fifteen days rather than monthly. Another idea, not adopted, was to limit Iraq’s oil buyers to major international oil firms, rather than smaller oil traders that were willing to pay Iraq the surcharge. A press report in March 2001 (Reuters, March 8, 2001) listed companies that were purchasing Iraqi oil; many are small companies from countries that seek to do business with Iraq or are sympathetic to easing sanctions on Iraq. U.S. major oil companies are said to buy Iraqi oil shipments from these small traders.

The list included: Italtel (Italy); Mastek, and Quantum Holdings (Malaysia); Zarubezhneftegas, Mashinoimport, Slavneft, Sidanco, and Rosneftimpex (Russia); Fenar (Lichtenstein); Emir Oil, Coastal Oil Derivatives, and Benzol (United Arab Emirates); Nafta Petroleum, and KTG Kentford Globe (Cyprus); Glencore, and Lakia Sari (Switzerland); Al Hoda (Jordan); Belmetalenergo (Belarus); Samasu (Sudan); Erdem (Turkey); African Petroleum (Namibia); Shaher Trading (Yemen); Aredio (France); Commercial Home (Ukraine); Awad Ammora (Syria); Montega (South Africa); Afro Eastern (Ireland); and Bulf Drilling (Romania).

Oil Exploration Contracts. There are no public allegations that any international oil companies have begun new oil exploration investments in contravention of existing U.N. resolutions. However, a number of companies have signed exploration deals that would go into effect if and when the ban on oil exploration is lifted. Much of the focus of U.S. officials has been on oil exploration

deals by Russian firms. In general, Russia seeks to obtain repayment of Iraq's \$7.6 billion in debt to Moscow, and possibly to earn funds selling arms to Iraq if such sanctions are eventually lifted. In August 2002, it was reported that Russia and Iraq had agreed to a \$40 billion economic cooperation agreement, although it is not clear that any of the planned cooperation would violate oil-for-food or other sanctions guidelines. Russian-Iraqi commercial relations were set back somewhat in December 2002 when Iraq overturned a presumptive contract with Russia's Lukoil to develop the West Qurna field (see below). Iraq acted reportedly on the grounds that Lukoil had held discussions with Iraq's opposition about Lukoil's possible role in developing the energy sector of a post-war Iraq. However, some reports suggest that Iraq might reverse that cancellation or offer the development contract to another Russian firm.

France¹² has long had substantial economic interests in Iraq as well, and reportedly is owed \$5 billion to \$ 7 billion by Iraq, although some reports cite a French National Assembly study that contains a much lower figure of about \$2.25 billion. Several major French companies export equipment to Iraq under the oil-for food program; these companies include Peugeot (automobiles and parts), Renault Trucks, and Alcatel (telecommunications equipment). The International Monetary Fund reported that French companies received the most money, \$1.8 billion, in 2001 for exports to Iraq, but other sources place French companies behind Russian and Egyptian firms.

Some of the presumptive contracts for oil exploration in Iraq include the following:¹³

- Al Ahdab field — China National Oil Company (China)
- Nassiriya field — Agip (Italy) and Repsol (Spain)
- West Qurna — Lukoil (Russia)
- Majnoon — Total Fina Elf (France)
- Nahr Umar — Total Fina Elf (France)
- Tuba — ONGC (India) and Sonatrach (Algeria)
- Ratawi — Royal Dutch Shell (Britain and the Netherlands)
- Block 8 — ONGC (India)

Flights to Iraq. Since September 2000, Iraq may have conducted an unknown amount of additional illicit trade aid from flights to and from Iraq. These flights began as relief flights carrying humanitarian aid, intended to challenge the U.S. and British interpretation of U.N. Security Council Resolution 670 (September 25, 1990). Resolution 670 requires the banning of flights to or from Iraq that are carrying any "cargo to or from Iraq or Kuwait other than food in humanitarian circumstances, subject to authorization by the Council ..." or the Sanctions Committee. Prior to September 2000, the U.S. interpretation prevailed that all flights to Iraq require Sanctions Committee authorization prior to takeoff. France, Russia, and other

¹² Some of the information and analysis in this section was provided by Paul Gallis, Specialist in European Affairs, Foreign Affairs and Trade Division.

¹³ Morgan, Dan and David Ottaway. In Iraqi War Scenario, Oil Is Key Issue. *Washington Post*, September 15, 2002.

governments, although not opposed in principle to inspecting cargo bound for Iraq, argue that passengers are not “cargo” and that the U.S. interpretation that Resolution 670 restricts all flights to Iraq is not correct.

The cargo on these flights has not been subjected to any U.N. monitoring to ensure that the cargo comports with oil-for-food guidelines. Since September 2000, regular charter flights have begun between Iraq and Syria and Iraq and Jordan. The United States criticized those governments that allow the flights to proceed without approval, but no U.S. or U.N. measures have been taken against the flights or against Jordan or Syria.

One donation to Iraq in November 2000 drew strong U.S. criticism and a sanction. A member of the royal family of Qatar presented Saddam Husayn with a Boeing 747 jumbo jet as a “gift.” The Qatari, Hamad bin Ali bin Jabr Al Thani, heads the Gulf Falcon air services company, which gave him access to the aircraft. On November 24, 2000, the Clinton Administration announced that exports and reexports of many U.S. goods would need specific Commerce Department approval for sale to Mr. Al Thani or his businesses. U.S. officials said that sanctions were imposed to ensure that U.S. goods would not be improperly diverted to Iraq.

Future of the Oil-for-Food Program In a Post-War Iraq

Bush Administration planning for administering a post-war Iraq has accelerated now that the President has decided to take military action to disarm and change the Iraqi regime. In mid-March 2003, the Administration said that it is preparing a draft U.N. Security Council resolution that would reportedly empower the United Nations to take direct control of all aspects of the program for the duration of the war, and possibly into the post-war period as well. The United Nations reportedly would, under the Administration proposal, assume from Iraqis the authority to write oil export and humanitarian import contracts. The Administration envisions that a post-war Iraqi interim administration would reassume those functions from U.N. staff when an interim administration is in place and able to perform these duties. If the proposed U.N. resolution is adopted, the program would perhaps be the primary vehicle for distributing humanitarian relief in the post-war period.

The program was largely suspended just before hostilities began, when U.N. staff in Iraq that run the various aspects of the program departed Iraq. As of March 14, 2003, about \$10 billion worth of humanitarian goods were in the process of being delivered or in production. There reportedly are still be some Iraqi oil exports via Turkey, and presumably the proceeds of these sales continue to be deposited into the U.N. escrow account.

Appendix: Overview of U.S. Regulations Governing U.S. Participation in the Oil-for-Food Program¹⁴

The Iraqi Sanctions Regulations implement Executive Orders No. 12722 (August 2, 1990) and 12724 (August 9, 1990), issued after Iraq's August 2, 1990 invasion of Kuwait. The executive orders imposed a ban on U.S. trade with and investment in Iraq, and froze Iraq's assets in the United States. The Iraq Sanctions Act of 1990 (Section 586 of P.L. 101-513, signed November 5, 1990) reinforces those executive orders. The August 9 executive order amended the August 2 executive order to align U.S. sanctions with U.N. Security Council Resolution 661 (August 6, 1990), in keeping with the United Nations Participation Act (22 U.S.C. 287c). That resolution imposed a comprehensive embargo on all Iraqi imports and exports.

In the aftermath of Iraq's invasion, Iraq was again placed on the U.S. list of state sponsors of terrorism under Section 6(j) of the Export Administration Act (P.L. 96-72). Iraq had been removed from the list in 1982. Countries on the terrorism list are barred from receiving U.S. foreign assistance, votes in favor of international loans, and sales of munitions list items (arms and related equipment and services). Exports of dual use items (items that can have military applications) are subject to strict licensing procedures.

U.S. regulations governing trade with Iraq have since been modified to allow for U.S. participation in the oil-for-food program. Key provisions of the U.S. sanctions include the following:

U.S. firms may apply to the Office of Foreign Assets Control (OFAC) of the Treasury Department for specific licenses for the following activities under the oil-for-food program:

- “the sale and exportation to Iraq of medicines, health supplies, foodstuffs, and materials and supplies for essential civilian needs.” The goods can be sold, subject to a license, to the government of Iraq or to a U.N. entity distributing aid under the program.
- “the purchase and exportation from Iraq of Iraqi-origin petroleum and petroleum products;”
- “the trading, importation, exportation or other dealings in or related to Iraq-origin petroleum and petroleum products outside Iraq; and”
- “the sale and exportation to Iraq of parts and equipment that are essential for the safe operation of the Kirkuk-Yumurtalik (Iraq-Turkey) pipeline system in Iraq.”

¹⁴ Source: Iraq: What You Need to Know About the U.S. Embargo. An Overview of the Iraqi Sanctions Regulations – Title 31, Part 575 of the U.S. Code of Federal Regulations. U.S. Department of the Treasury, Office of Foreign Assets Control, [<http://www.treas.gov/ofac/>].

In addition:

- The regulations “generally” prohibit “the performance of contracts in support of industrial, commercial, public utility, or governmental projects” in Iraq. U.S. persons may not provide financing or consulting services to a foreign country company where those services would benefit such projects in Iraq. U.S. persons may not provide consulting services or goods, in connection with Iraqi projects, to foreign subsidiaries of U.S. corporations, although foreign subsidiaries themselves are not subject to U.S. regulations.
- All transfers of funds by U.S. persons to the government of Iraq or to persons in Iraq, are prohibited, as are “all commitments or transfers of credit, financial transactions, or contracts.”
- All transportation-related services, or the use by U.S. persons of vehicles, ships or aircraft registered in Iraq, are prohibited. Travel-related transactions by U.S. persons are also prohibited, with the exception of travel related to journalism, or U.S. government or United Nations business.