

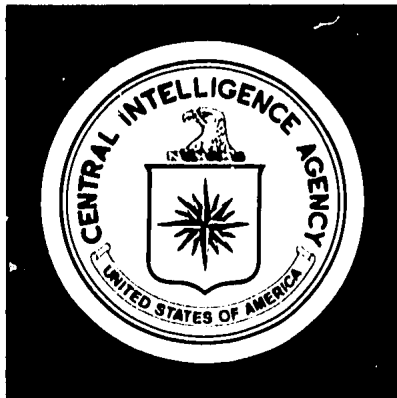
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DIRECTORATE OF
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Intelligence Memorandum

Iraq: Oil Gives Wider Economic Options

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July 1973

**Iraq: Oil Gives Wider Economic Options**

After more than a decade of sluggish growth, Iraq's economy appears to be entering a period of prolonged expansion spurred by increased output of oil. One year after the nationalization of much of the oil industry:

- Oil production has increased to 2 million barrels per day, the highest output ever reached.
- Commitments for marketing the government's share of the oil have been obtained through the mid-1970s.
- Investment in the oil industry has been guaranteed by Western and Communist participating countries, notably France and the USSR.
- Foreign exchange reserves have climbed above the US \$1 billion level.

Progress in agriculture, the other important economic sector, is slower. The current economic plan (1971-75) calls for increases in agricultural output through investment in irrigation and improved farming techniques. These programs, buttressed by considerable foreign assistance, probably will yield appreciable gains in the near term, perhaps sufficient to make Iraq an important exporter of grains.

As for foreign trade, increasing oil revenues will yield ample trade surpluses and will provide the government with wider options in foreign economic relations. Thus the heavy dependence on the USSR and other Communist countries for economic assistance probably will be diluted by expanding commercial ties to non-Communist countries, particularly France and Japan.

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Note: Comments and queries regarding this memorandum are welcomed. They may be directed to

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SECRET**DISCUSSION****Background¹**

1. The radical military regimes in Iraq during the past decade and a half have had little success in developing the country's principal economic resources – oil and agriculture. Weak governments have been unable to provide continuity in economic policies. Moreover, the population is a heterogeneous mixture of conflicting factions – the Sunni against the Shia sects of Islam, a split intensified by the lower social and economic status of the larger group, the Shias; the Muslims against the better-educated and Western-oriented Christian minority; the growing urban element against the rural population; the Arabs against the Kurds, who make up 18% of the population; and the Arabs against the smaller ethnic minorities, such as the Turkomans and Assyrians.

2. Besides the domestic turmoil, continuous frictions in foreign relations have served to stifle economic development. Iraq's strategic position at the head of the Persian Gulf, contiguous with Iran, Turkey, Syria, Jordan, Saudi Arabia, and Kuwait, has given the country's military leaders ample reason to emphasize a military buildup at the expense of economic development. Conflicts have abounded with Iran for its encouragement of the Kurds, with Saudi Arabia and Kuwait over disputed boundaries, and with Syria over transit rights for Iraqi people, goods, oil, and water. Finally, the government and the foreign oil companies have persistently been at loggerheads during the past 12 years.

3. The economy of Iraq is dominated by oil and agriculture. Earnings from oil provide the bulk of domestic development funds, 60% of government revenues, 85% of foreign exchange earnings, and nearly one-third of gross domestic product (GDP). Agriculture contributes about 20% of GDP and provides employment for more than one-half of the labor force.

4. Under the Baath regime, Iraqi economic policy has been directed more by radical idealism or political expediency than by deliberate economic planning. Economic units below the top have suffered in turn from the government's inaction and from its confused intervention. In the early 1960s, private incentive was stifled when large private landholdings were confiscated and all major industries were nationalized. Productivity in agriculture fell, capital fled the country, and the stock of managerial know-how declined. An expansion of the military forces from 75,000 to

1. A table of selected economic indicators is included as an Appendix.

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more than 100,000 men, together with outlays for expensive equipment, added to Iraq's economic difficulties in the 1960s. The regime turned to the USSR and other Communist countries for economic and military assistance. From 1958 through 1972, Communist aid extended to Iraq totaled \$2.2 billion, of which slightly more than \$1 billion was drawn.

Oil Production: Settlement of Longstanding Issues

5. Iraqi oil production has long been dominated by the international Iraq Petroleum Company (IPC)² and its affiliates -- the Mosul Petroleum Company (MPC) and Basrah Petroleum Company (BPC). In 1961 the Iraqi government canceled concessions of the IPC and affiliates in areas not then producing. The important North Rumaila field, which had been proved by IPC but was not then operating, remained a subject of contention between IPC and the Iraqi government from 1961 until early 1973. In 1964 the government created a state-owned petroleum company, Iraq National Oil Company (INOC), which from 1967 on proceeded to negotiate joint venture agreements for oil exploration and production with the French state-owned firm Enterprise des Recherches et d'Activites Petrolieres (ERAP) and contract agreements with the USSR, Hungary, East Germany, Romania, and Czechoslovakia. The North Rumaila field, being developed primarily with Soviet and East European aid, came into production in April 1972.

6. In comparison with that of other Middle Eastern countries, the expansion of Iraqi oil production and revenues lagged in the 1960s. Iraq's share of Middle East production dropped from 18% to 8%. In 1971, IPC pushed up oil production (see Table 1) under pressure from Baghdad, which saw other producing countries expanding output rapidly. However, IPC reined in production in early 1972 on the economic grounds that northern crude oil exported from the Mediterranean cost more than oil exported from Persian Gulf ports -- the result of separate, negotiated price adjustments with the Persian Gulf and Mediterranean oil producers. After months of unsuccessful negotiations between IPC and the government to restore production to 1971 levels, the government nationalized the IPC northern fields on 1 June 1972, leaving the Mosul Petroleum Company and the Basrah Petroleum Company as the only remaining IPC affiliates producing in Iraq. Iraqi oil production and exports fell by nearly 15% in 1972 (see Table 2).

7. Shortly after the nationalization, Iraq announced its intention to compensate IPC for the takeover in 1961 and the June 1972 nationalization. A new series of negotiations began. These negotiations were

2. Parent companies of IPC and its affiliates are British Petroleum (BP), 23.75%; Royal Dutch Shell, 23.75%; Compagnie Francaise des Petroles (CFP), 23.75%; Exxon Corp. and Mobil Oil Co., 23.75%; and Participations and Explorations Corp. (Gulbenkian), 5%.

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Table 1

Iraq: Crude Oil Production

		Thousand Barrels per Day	
1960	955	1967	1,227
1961	990	1968	1,506
1962	995	1969	1,526
1963	1,160	1970	1,567
1964	1,255	1971	1,712
1965	1,315	1972	1,449
1966	1,389		

Table 2

Iraq: Crude Oil Production and Exports,¹ 1972

Company	Thousand Barrels per Day					
	Production			Exports		
	Average Jan-Jun	Average Jul-Dec	Total	Jan-Jun	Jul-Dec	Total
Total	1,476	1,423	1,449	1,360	1,296	1,328
IPC/MPC	811	16	414	1,360 ²	635 ²	998 ²
BPC	636	675	655			
Government	29	732	380	Negl.	661	330
INOC (North Rumaila)	17	70	43	Negl.	62	31
Iraq Company for Oil Operations	12 ³	662	337	Negl.	599	299

1. Because of rounding, components may not add to the totals shown.

2. Estimate.

3. One month only.

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largely suspended in the final quarter of 1972 while other Persian Gulf states and the oil companies were discussing the issue of participation by host governments in ownership and control of their oil production. During this period the Iraqi government concluded agreements on marketing some oil from the Kirkuk fields, agreements which relieved the government of the financial strains that had built up since mid-1972.

8. The Iraqi government on one side and IPC and its affiliates on the other finally agreed on all outstanding issues on 28 February 1973. Under the settlement, IPC receives 15 million metric tons of crude oil at the rate of 1 million tons a month (valued at \$300 million to \$350 million) as compensation for all claims against the government, including claims incident to the 1961 expropriation of the North Rumaila fields. IPC is to pay the Iraqi government \$350 million (\$75 million in March 1973 and the remainder in monthly installments proportional to oil deliveries) for back taxes and claims that had accumulated because Iraq had not received increases negotiated by the Organization of Petroleum Exporting Countries (OPEC)³ during the 1960s. IPC also agreed to make its best endeavor to substantially increase production from the BPC concessions, and ceded the Mosul Petroleum Company holdings to Iraq.

9. By March 1973, Iraqi oil production had reached 2 million barrels per day (b/d) of which nearly 1.2 million b/d were from the government's Kirkuk fields, as shown in the following tabulation:

	Thousand b/d
Kirkuk (and other northern fields)	1,274
North Rumaila (and other small fields)	108
Rumaila and Zubair (BPC)	648
Other	16

Iraq has had no difficulty in exporting its oil from the Kirkuk and North Rumaila fields. Western oil companies take the majority of Iraqi oil. CFP has a 10-year contract to purchase nearly one-fourth of Kirkuk production; Royal Dutch Shell is expected to reach agreements later in 1973 for major oil purchases in 1974 and 1975. The USSR and Eastern Europe will take about 194,000 b/d during 1973 in partial payment on economic and military credits.

3. OPEC members are Abu Dhabi, Algeria, Indonesia, Iran, Iraq, Kuwait, Libya, Nigeria, Qatar, Saudi Arabia, and Venezuela.

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Favorable Prospects for the Oil Industry

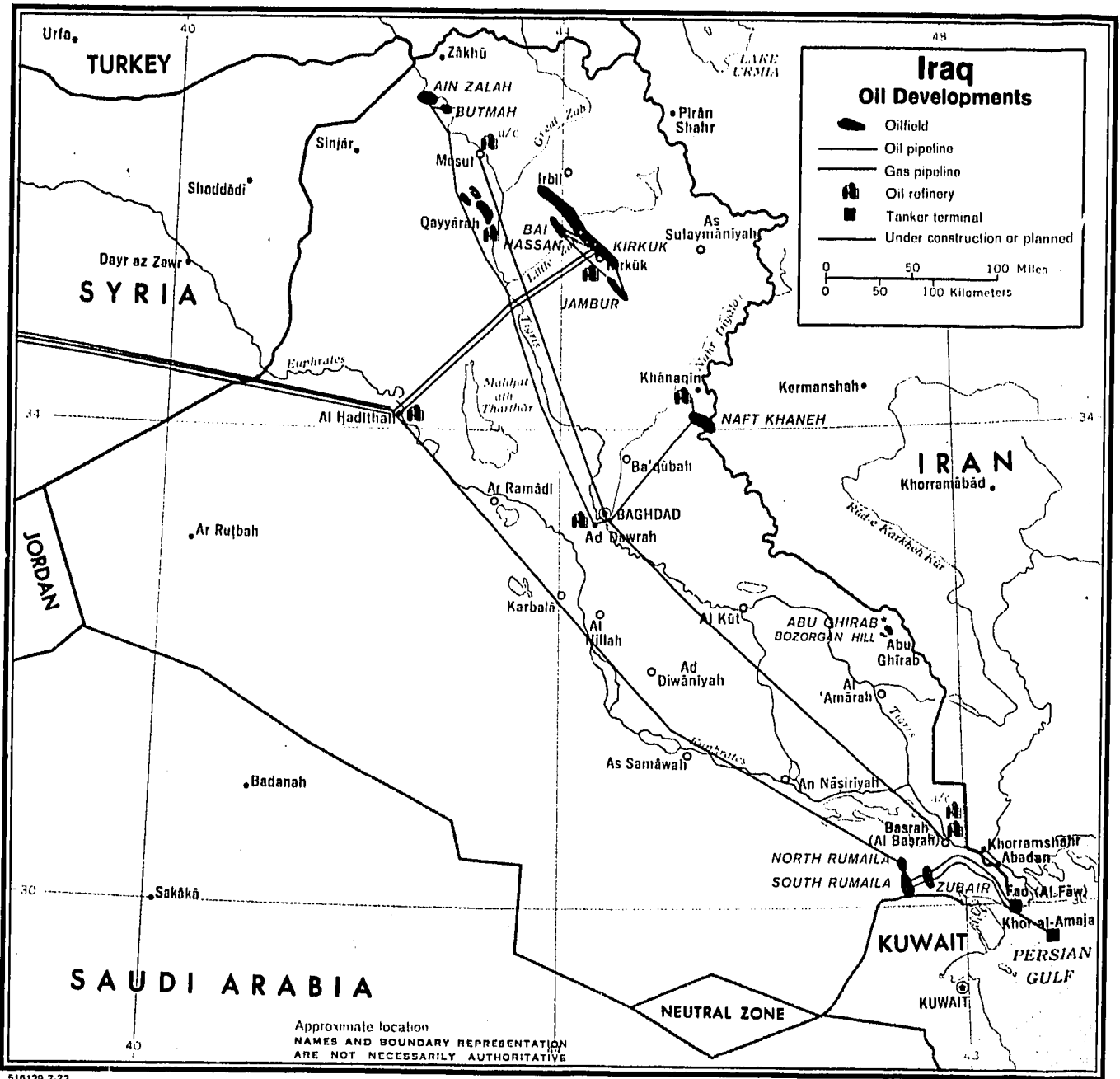
10. With the nationalization issue settled, Iraq is pushing plans for expanding the oil industry. Output probably will reach 3 million b/d in 1976 and could expand to 4 million b/d by 1980. Projects under way and planned include (a) further participation by the USSR and Eastern Europe in North Rumaila production, exploration, and development of other fields, (b) further investment by BPC in the southern fields, and (c) further development of existing fields, new exploration, and new pipelines by INOC.

11. Soviet assistance in the North Rumaila fields will bring the output level up to 370,000 b/d by 1974, with an eventual output of up to 830,000 b/d on completion of the third stage of development. The USSR is building a pipeline to connect the North Rumaila fields with a 30,000 b/d refinery at Mosul, also being built with Soviet assistance. A pipeline is to be built to connect with the 70,000 b/d refinery under construction at Basrah with Czechoslovak aid. The two new refineries under construction will nearly double the country's 1972 refining capacity.

12. BPC is to increase output of the Rumaila field to more than 1.6 million b/d by 1976. Investment by BPC in this future expansion could run as high as \$160 million over the next one and one-half years.

13. New exploration and exploitation have been assured by agreements signed with the French firm ERAP and Brazil's Petrobras. The latter signed a contract in August 1972 calling for exploration over the next seven years. ERAP, joining recently with a Japanese consortium headed by Sumitomo Trading Company, has agreed to undertake exploration and expansion of fields at Abu Ghirab and Bozorgan Hill, as well as other areas, through 1974. Initial production of these two new fields is to be at a rate of 160,000 b/d and will be started as soon as the deepwater port near Fao (see paragraph 14) has been completed. About two-thirds of the production of these fields probably will go to Japan.

14. INOC has opened bidding for construction of a deepwater port and oil terminal near Fao at Khor-al-Amaja, which will be capable of handling 300,000-DWT tankers and is to cost around \$120 million. The deepwater terminal will be connected with nearby producing fields by pipelines that are under consideration by the ERAP-Japanese partnership. Several other pipeline projects are under consideration, including a north-south line from Hadithah to Fao, a second line through Syria to the Mediterranean, and a \$400 million line from Kirkuk to a Mediterranean terminal at Iskenderun in Turkey, for which a protocol has been signed (see the Map).



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15. A petrochemical plant with a capacity of 120,000 tons to be built in Basrah will use gas presently being flared in the southern oilfields.

Agriculture: Unrealized Potential

16. By Middle East standards, Iraq is well endowed with arable land and water for irrigation. Present agricultural output, however, is far below potential, yields having increased little if any since the 1958 revolution. Production of many crops is at best equal to the levels of the 1950s, the principal exception being the bumper wheat crop of 1972 (see Table 3).

Table 3**Iraq: Production of Major Crops**

	<u>Thousand Metric Tons</u>				
	1957	1961	1970	1971	1972 Preliminary
Wheat	1,120	860	1,240	820	2,460
Barley	1,310	910	680	430	900
Rice	N.A.	70	180	310	320
Dates	N.A.	300	480	300	390

Iraq has become increasingly dependent on imported foodstuffs, and exports of foodstuffs have never regained the pre-1958 levels. The production of dates, Iraq's principal export crop, was lower in 1971 than the average in the 1960s. In value terms, the net deficit on trade in agricultural products increased from about \$20 million in 1958 to more than \$200 million in 1971, admittedly a dismal year for Iraqi agriculture. The deficit was approximately \$100 million in 1972. The bumper crops of wheat, barley, and rice in 1972 suggest the extent to which production could be raised if the adverse effects of fluctuations in weather could be reduced.

17. Principal constraints on agriculture have been the variability of rainfall, particularly in the north; the inadequacy of water distribution and control facilities; excessive salinity from improper drainage; and a shortage of trained personnel needed to introduce new and improved farming techniques. Institutional and administrative problems have persisted since the 1958 revolution. Land redistribution after 1958, for example, quickly

fell behind schedule because the government was slow in completing irrigation canals, organizing rural education and health facilities, completing surveys, and identifying suitable farmers. The establishment of cooperatives in the 1960s faltered because of a shortage of facilities to train cooperative managers. The government has long recognized the problems but has not been able to overcome bureaucratic inertia. Experts from the West and from Communist countries have submitted recommendations to overcome problems in credit and marketing, seeds and fertilizers, salinity and drainage, and extension services and rural education. The greatest need, however, is the accumulation of indigenous skill and experience.

18. Following an austerity budget of \$70 million in fiscal year (FY) 1972/73,⁴ about \$200 million has been designated for agriculture in the FY 1973/74 national budget. Projects that are in being or have been agreed to include:

- An irrigation project northeast of Baghdad in the Diyala basin financed jointly with the World Bank.
- New grain storage facilities that will add a total of about 770,000 tons to existing capacity, to be financed in part by loans from the World Bank, the USSR, and East Germany.
- Various irrigation projects and water treatment plants.
- A number of small projects to expand the cultivated area and to raise yields through increased use of fertilizer.

Industries Other Than Oil

19. Industrial production, excluding oil, increased in 1972 by about 7%, about the same as the average of the past several years. Plants coming on stream in 1972 included a sulfur recovery plant, a fertilizer plant, a glass factory, several textile manufacturing plants, and assembly plants for automobiles, tractors, and agricultural machinery. Some slowdown in public investment in industry probably occurred late in 1972 to judge from cuts in the development budget and a reduction in the level of imports. In 1973, industrial expansion probably has been resumed as a result of the increased import program and the impetus from the forward movement in the oil industry.

4. The Iraqi fiscal year runs from 1 April through 31 March.

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20. The government restricts the development of basic industries, such as the petroleum and related industries, to the public sector. The role of the private sector is to develop production of light industries - such as textiles, leather and plastic goods, and foodstuffs - construction materials, and certain chemicals. To encourage private businesses, the government has expedited the granting of business licenses, the importing of raw materials and spare parts, and the expansion of industrial credit by the Iraqi Industrial Bank.⁵ Growth in industrial output is constrained by deficiencies common to developing countries - inefficient marketing, transport, and storage; a shortage of skilled laborers; poor management in public enterprises; shortages of spare parts and raw materials; and low labor productivity and rising labor costs.

Defense: Heavy Expenditures

21. The Iraqi military regime, which has been intensely antagonistic toward Iran, has emphasized defense expenditures to the detriment of economic development. About half of current expenditures are budgeted for defense. The defense budget has jumped from \$315 million in FY 1971/72 to \$640 million in FY 1973/74. Actual expenditures probably will be far short of budget levels, reaching perhaps \$500 million in the new fiscal year. Iraq maintains an army of 90,000, an air force of 10,000, and a navy of 2,000 men. Its armed forces are twice as large as Saudi Arabia's, but less than half of Iran's.

22. Iraq has obtained most of its military equipment from the USSR and Czechoslovakia. Communist military deliveries from 1958-72 have totaled \$806 million, about 40% in the form of Soviet grants. Deliveries during 1972 from the USSR were valued at about \$80 million and included equipment for the SA-3 missile system, T-62 tanks, guided missile patrol boats, MIG-21 jet fighters, helicopters, and ground forces equipment. Repayments on military debts to the USSR are small - \$30 million to \$40 million a year. The total outstanding debt to the USSR on military aid is less than \$100 million.

Government Spending: Temporary Austerity

23. The drop in oil output and the nationalization of IPC facilities in 1972 threatened a serious decline in revenues. The government reacted by adopting widespread austerity measures, but the impact was small. Planned expenditures were cut by nearly one-third to about \$1.4 billion, with ordinary expenditures being cut 20% and development expenditures

⁵. The Iraqi Industrial Bank was set up in 1946 to provide medium-term and long-term loans to industrial enterprises and short-term loans for working capital. Its capital was increased by \$8.5 million in 1971 to \$34 million.

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50%. Non-military imports were reduced by 10% from the 1971 level. Import restrictions primarily affected luxury imports. A good harvest permitted reductions in food imports. Imports of raw materials necessary for industrial production were continued, and ongoing development projects were not affected.

24. To fill the expected gap in oil revenues, the government issued new revenue bonds, instituted compulsory savings, and appealed to other Arab states for aid. Pledges of aid from members of the Organization of Arab Petroleum Exporting Countries (OAPEC)⁶ amounted to \$130 million by mid-1972. Nonetheless, only about \$75 million was actually made available during the year, and that took the form of short-term loans rather than grants. Other foreign aid included French loans for \$120 million and a \$12 million loan from the World Bank for education projects. In the end, the drop in oil revenues was not so drastic as had been anticipated, and in any case oil revenues were soon to skyrocket.

25. The FY 1973/74 budget was expanded almost to the point of extravagance because of the settlement with IPC. Spending was set at \$2.3 billion, of which about 40% is to be in the development budget. Of the money allocated to public investment, 21% is to go for agriculture, 18% for industry, 15% for construction and services, and 13% for transport and communications. The remainder is to go for investment by the INOC and other national companies and to meet unforeseen increases in the costs of projects under way.

Bright Prospects for the Balance of Payments

26. Prospects for an improved balance-of-payments position have been assured by the settlement with IPC. Annual oil revenues should exceed \$2 billion in 1975 while imports probably will be around \$1.8 billion. Iraq experienced a small balance-of-payments deficit in 1970, the first since 1967. A small deficit probably occurred also in 1972. The size of the 1972 deficit was held down by the 10% cut in imports and increased drawings on external loans.

27. Iraqi foreign exchange reserves have been mounting rapidly since the end of 1971 -- from \$600 million to more than \$1 billion as of June 1973. The high level of reserves is due partly to the Iraqi requirement that the stock of gold and hard currencies be at least 70% of the currency in circulation. About 56% of the present level of Iraqi reserves thus are committed. If oil earnings increased as estimated in this memorandum, Iraq

6. OAPEC members are Abu Dhabi, Algeria, Bahrain, Dubai, Egypt, Iraq, Kuwait, Libya, Qatar, Saudi Arabia, and Syria.

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will be guaranteed a comfortable level of foreign exchange reserves over the next several years. Growing expenditures for development and defense probably will prevent extraordinarily large accumulations such as those expected for Saudi Arabia, Kuwait, and Abu Dhabi in the remainder of the decade.

Foreign Trade

28. Oil, of course, dominates Iraq's exports. Non-oil exports, consisting largely of foodstuffs and cement going to other Arab states, are small and have been growing at a slow rate, as shown in the following tabulation:

	Million US \$					
	1967	1968	1969	1970	1971	1972
Net receipts from oil exports ¹	500	626	630	663	1,030	746
Exports (non-oil)	62	72	74	76	77	77
Imports	511	483	531	614	737	793

1. Total oil exports less repatriated company profits.

29. As for imports, machinery, transport equipment, and other manufactured goods made up two-thirds of the total in 1972. The emphasis on machinery and equipment imports has been increased in the FY 1973/74 import plan as development of transportation and industry are pushed. In 1972 the industrial countries of Western Europe supplied more than 40% of Iraq's imports, the Communist countries less than 30%, and the United States and the Arab countries only small amounts (see Table 4).

Western Commercial Interests in Iraq

30. The industrial non-Communist countries, particularly France and Japan, are moving rapidly to expand economic relations with Iraq, primarily to obtain oil supplies for the 1970s. Imports from major Western suppliers in 1972 rose both by value and as a percent of total trade at the expense of the Soviet Union. Japan's total trade with Iraq climbed from a low of \$16 million in 1968 to \$42 million in 1972. France, Japan, and Brazil are engaged in exploration in the oil sector, and Japan and France are committed to finance capital expansion in the Iraqi oil industry. Prior to the IPC settlement, France was the first Western nation to purchase Kirkuk oil. Furthermore, France made loans to Iraq in 1972 to help offset the financial impact of nationalization. In addition to participating in the oil

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SECRET**Table 4****Iraq: Geographic Distribution
of Imports, 1972**

	Percent
West European countries	41
Of which:	
United Kingdom	10
France	6
Italy	5
West Germany	5
East European countries	24
Of which:	
Soviet Union	7
Czechoslovakia	7
East Germany	3
Non-Communist Asian countries	15
Of which:	
Japan	5
North American countries	8
Of which:	
United States	4
Arab countries	6
China	3
Other	3

industry, Japan has offered a \$95 million contract to expand an Iraqi fertilizer plant at Basrah.

31. The embargo against US goods imposed after the Six-Day War in 1967 has not been removed. However, Iraq still comes to the United States for capital goods that cannot be purchased elsewhere. The decline in the presence of US oil firms resulting from the nationalization of IPC suggests that US sales of capital goods may decrease. The US oil companies' share of the remaining BPC oil assets in Iraq is estimated at \$25 million. Future investment by BPC in Iraqi oilfields, forecast at \$160 million, undoubtedly will be translated into some imports from the United States.

Communist Economic Involvement

32. Communist economic aid has been important to Iraq since the revolution in 1958. The USSR has supplied project aid, trade credits, and technicians to assist in Iraqi development. Soviet and East European economic aid drawn by Iraq during 1959-72 totaled nearly \$250 million. Unused credits total three times this amount. The Soviets have helped

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Baghdad develop oil production at the North Rumaila oilfields, have assisted in the construction of the Baghdad-Basrah railroad, have provided agricultural assistance, and have supplied equipment for communications facilities and several light industrial plants. Czechoslovakia has given credits for an oil refinery at Basrah, which is nearly completed. Poland has provided railroad tank cars and a sugar refinery. East Germany has extended credit for a number of industrial and agricultural projects now under construction. China has extended a \$45 million line of credit, but none had been drawn by Iraq by the middle of 1973.

33. The Communist countries also rallied to the support of Iraq at the time of the IPC nationalization, allowing repayments on outstanding debt to be made in oil. Outstanding debt to the Communist countries for economic aid at the end of 1972 was \$90 million, annual repayments being about \$18 million. In October 1972, Iraq requested observer status in CEMA, which would tie Iraqi commerce even closer to that of the Communists. No action on the request has been taken by CEMA, and the Iraqis have not pressed the case.

34. Since the IPC settlement, government leaders have implied some discontent with Iraq's close links with the Communists. Part of this is window dressing to calm anti-Communist Arab states, which note that the Iraqis are heavily dependent on the Communists for military training and servicing of equipment. Part is real. For example, Iraq recently closed the cultural centers in Baghdad operated by the USSR, Czechoslovakia, Bulgaria, and East Germany. The government recently recalled abruptly all Iraqi students studying in Moscow. The Iraqis also have announced that no further barter deals will be made that tie Iraqi oil to development projects. The large increases in oil revenues give Iraq a freedom of choice in making future economic ties with the highly industrialized countries.

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APPENDIX

Iraq: Selected Economic Indicators

	Unit	1963	1964	1965	1966	1967	1968	1969	1970	1971	1972 (Preliminary)
GNP (current prices)	Million US \$	1,580	1,780	1,960	2,100	2,130	2,330	2,460	2,980	3,320	3,800
Population	Million persons	7.6	7.8	8.1	8.4	8.6	8.9	9.2	9.4	9.8	10.1
Per capita GNP	US \$	210	230	240	250	250	260	270	320	340	380
Agricultural production	Thousand metric tons										
Wheat		870	800	1,000	820	1,030	1,540	1,180	1,240	820	2,460
Barley		950	620	800	830	730	990	960	680	430	900
Rice		170	180	200	180	310	350	320	180	310	320
Dates		420	320	310	280	380	330	260	480	300	390
Livestock	Thousand head										
Sheep		10,820	10,500	11,040	11,850	11,548	11,771	11,994	13,099	12,470	12,720
Goats		2,220	2,080	1,845	1,800	1,877	1,821	1,766	2,301	1,661	1,612
Cattle		1,510	1,540	1,459	1,390	1,790	1,871	1,955	1,689	2,134	2,230
Crude oil production	Thousand barrels per day	1,160	1,255	1,315	1,389	1,227	1,506	1,526	1,567	1,712	1,449
Foreign trade	Million US \$										
Receipts from oil exports		370 ¹	400 ¹	420 ¹	471	500	626	630	663	1,030	746
Non-oil exports		57	52	61	73	62	72	74	76	77	77
Imports		380	456	546	592	511	483	531	614	737	793
Balance		47	-44	-65	-48	51	215	173	125	370	30

1. Estimate.