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State Dept. review completed

DIRECTORATE OF INTELLIGENCE

10 January 1985

IRAQ-IRAN: Stepping Up the Pressure in the Gulf

Summary

Last month Iraq resumed shipping attacks in the Persian Gulf at record levels following a six week lull. The increased rate of attacks is another stage in Iraq's strategy of gradually escalating pressure on Iranian oil exports. We expect the tempo of Iraqi strikes to increase further this spring once all of its Mirage F-1 aircraft are operational. A major uncertainty is whether Iraq has sufficient Exocet missiles to permit it to continue intense attacks for a prolonged period. [Redacted]

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Iran has retaliated by hitting only three ships, well below the level of Iraqi strikes, and Iran's response is likely to remain limited as long as it can maintain oil exports. In addition to its dwindling air capability to defend against and launch shipping attacks, Tehran apparently is aware that its retaliatory strikes make ship owners even more reluctant to call on any port in the Gulf, including Khark Island. Iran, however, will need to boost oil discounts to offset the higher insurance rates in order to maintain oil shipments from Khark Island. Iran also is setting up a system to shuttle oil to a transloading facility in the southern Gulf and is increasing its oil storage capacity at another export facility in order to reduce its dependency on Khark. [Redacted]

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This paper was prepared by [Redacted] Office of Near Eastern and South Asian Analysis with contributions from [Redacted] NESAs, and [Redacted] Office of Global Issues. Comments and queries are welcome and may be directed to the Chief, Persian Gulf Division, NESAs, [Redacted]

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If Iraqi attacks were to seriously impede Iranian oil exports, we would expect Iran to retaliate against Iraq's Gulf allies. The world oil market could compensate for a loss of Iranian, Iraqi, and Kuwaiti crude, but any Iranian action that disrupts Saudi exports would drive prices up sharply. [redacted]

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Iraqi aircraft have attacked or attempted to attack tankers calling at Khark Island an average of every other day for the past five weeks. Iraq claims it has hit 19 ships since 3 December [redacted]

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[redacted] Strikes against five tankers and three cargo ships have been confirmed; two of the tankers were seriously damaged. [redacted]

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Iraq is following a strategy of phased escalation begun 18 months ago when Baghdad first threatened an economic blockade. In February 1984 it flew an "armed reconnaissance" flight with Super Etendard aircraft near Khark Island and the following month began regular attacks on tankers. With only five Super Etendard aircraft and a cautious war strategy, however, these shipping attacks have failed to reduce significantly Iran's oil exports. We believe that weak oil demand is the major reason Iran's oil exports fell from 1.8 million b/d early last year to 1.2 million b/d in late 1984. [redacted]

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#### Iraqi Attacks This Coming Spring

The delivery of twenty Exocet-armed Mirage F-1 aircraft from France is due to be completed early this year, enabling Baghdad to increase the frequency of its attacks. Indeed, the sharp surge in Iraqi strikes in December and early January probably reflects these deliveries. [redacted]

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[redacted] All Exocet-armed F-1 aircraft should be combat ready within a few months. [redacted]

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We expect Baghdad to begin using the F-1s on a sustained basis over the Gulf this spring when the weather becomes more favorable to air operations. Baghdad probably believes that an increase in strikes from the average of one a week in mid-1984 to the four or more per week mounted or attempted in December and early January will force a significant reduction of Iranian oil exports. Baghdad could damage Iran's economy further by launching airstrikes on other Iranian economic targets such as oil refineries and internal oil pipeline and pumping facilities if the current escalation fails to achieve this goal. Iraqi leaders have recently hinted that they may begin striking other economic targets should their campaign in the Gulf fail to force Iran to the negotiating table. [redacted]

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Major attacks against facilities on Khark Island, however, are likely to be only a last resort. A senior Iraqi official told US diplomats in Baghdad this month that, although Iraq was prepared to lose up to 25 aircraft in sustained attacks on Khark, Baghdad did not intend to launch an all-out campaign against the island because it would be too great a shock to Western economies. The real reason may be that Iraq's capability to hit Khark is more effective as a threat than if it is implemented. The Iraqis would probably

[Redacted]

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have to sacrifice more than 25 aircraft to close down the well-defended island for an extended period. [Redacted]

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France has supplied aerial refueling pods with the Exocet-armed F-1s enabling the planes to operate at much longer ranges over the Gulf. [Redacted]

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[Redacted]

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Although the F-1s do not need refueling pods to operate near Khark, the pods could enable the F-1s to attack ships around Iran's Sirri and Lavan oil terminals near the Strait of Hormuz. The F-1s also will allow Iraq to use less caution in choosing targets since they are faster, more maneuverable, and more survivable in air combat than the Super Etendard. [Redacted]

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Constraints

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The number of Exocet missiles in the Iraqi inventory [Redacted] could constrain Iraq's strategy. Baghdad apparently is concerned about the rate of supply. [Redacted]

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[Redacted]

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We estimate the Iraqis have about 100-125 Exocet missiles on hand. [Redacted]

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[Redacted]

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A stockpile of this size, combined with future, possibly stepped up, deliveries, would enable Iraq to conduct a relatively high level of shipping attacks this coming spring and summer and still maintain an emergency supply of missiles. If our estimate is too high, however, Iraq could face severe constraints on its ability to escalate attacks on shipping bound for Iran. [Redacted]

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[Redacted]

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A number of other factors could also cause temporary lulls in Iraqi strikes. The Exocet-Mirage F-1 combination is new and technical difficulties could force the periodic grounding of the F-1s. Weather conditions also will be a factor in Iraq's attack schedule. Public statements by Iraqi leaders last November suggest that the six-week lull in attacks last fall could have resulted from poor weather. In addition, the Iraqis may attempt to calibrate the intensity of their strike schedule to Iranian military activity along the front. Another limiting factor in the pace of Iraqi attacks is Baghdad's agreement not to hit tankers when Turkish ships are calling at Khark. [Redacted]

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Iranian Reaction

Although Tehran has declared a policy of responding in kind to Iraqi attacks, it limited its retaliation to only 18 ship attacks during 1984. Only three of these took place in December in response to Iraq's stepped up campaign. We believe Tehran has concluded that its attacks on ships only further Iraq's strategy of making the Gulf unsafe for shipping calling on Iran. [redacted]

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We expect Iran to only occasionally retaliate against ships calling at Gulf Arab ports. The Iranians are not likely to be any more successful than in the past in trying to intercept attacking Iraqi aircraft. During 1984 they apparently were able to damage only one Super Etendard. We believe Iran realizes that it is unable to forestall Iraqi attacks by intercepting aircraft or by retaliating against shipping elsewhere in the Gulf. [redacted]

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Instead, the Iranians appear to be relying on discounts to keep tankers calling at Khark [redacted]

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[redacted] Iran is also increasing crude storage capacity on Lavan Island [redacted]. These measures, however, cannot offset the loss of all exports from Khark Island. [redacted]

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Since early December the cost of moving and insuring oil cargoes from Khark Island has risen from \$1.29 to about \$3.00 per barrel. Iran probably will need to discount oil by about \$4-5 per barrel to offset these higher insurance and transport costs in order to maintain sales in a soft market. At current export levels such discounts would cause 1985 exchange earnings to fall by as much as 15 percent from 1984--itself a poor revenue year. Iranian resistance to pressure for oil price cuts would be even more damaging to revenues. Last August, Iran's unwillingness to offer more concessions caused oil sales and earnings to drop almost 40 percent. [redacted]

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Iran's economy has not yet been seriously threatened by the step up in Iraqi attacks, but Tehran is likely to have problems coping with still lower oil revenues. Reduced oil income in 1984 caused the regime to cut back both imports and domestic spending despite commodity shortages and high unemployment. Even with import cuts, Iran was forced to draw down its foreign assets to their lowest point of the war. Minimal assets and lower oil revenues will mean an erosion of living standards amid existing signs of domestic dissatisfaction with the performance of the economy. [redacted]

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A strong Iranian retaliatory response is probable if Baghdad's stepped up attacks were to reduce Iranian oil revenues significantly. Iran apparently is already prepared to react more strongly if necessary. Iran may have used F-14 aircraft armed with standard missiles in its shipping attack on 25 December. [redacted]

The willingness of Tehran to commit scarce F-14s to the shipping war indicates Iran may have decided to begin responding more forcefully to Iraqi attacks. F-14s should be more effective in locating ships and defending themselves from attacking aircraft than the F-4s Iran has used in previous shipping strikes.

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[REDACTED]

If Iran increases its retaliation, Saudi Arabia and other Gulf states will probably be forced to reestablish restrictions on tanker arrival and departure times, and more buyers will be forced to pay a premium for loading crude at the Saudi Red Sea outlet. [REDACTED]

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Tehran could also mine the ports of Iraq's Gulf allies. Iranian efforts to develop a mine warfare capability have increased in the past year and Tehran could probably lay enough mines to raise insurance rates and deter shipping to Gulf ports. Kuwait would probably be a prime target since mining its waters would reduce oil exports as well as the flow of arms to Iraq. Iran probably would not mine the Strait of Hormuz unless almost all of its own shipping were stopped because of its dependence on that strategic waterway.

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Iranian sabotage or air strikes against Arab Gulf states and increased terrorism worldwide are also possible responses. Tehran has trained Gulf Arabs and probably has some in place to carry out some operations. Most of the oil exported from Saudi Arabia, Kuwait, and Abu Dhabi pass through a small number of critical facilities that are susceptible to sabotage. Tehran also could increase its terrorist campaign worldwide in hopes of deterring countries from aiding Iraq. France would be a prime target for these attacks since Iraq is using French equipment to attack ships. [REDACTED]

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### Oil Market Response

Oil exports from the Persian Gulf probably can be maintained near current levels if producers adopt precautions and countermeasures similar to those used last summer, even if attacks continue at current rates. So far oil market buyers do not view the threat to oil supplies from the latest surge of tanker attacks as troublesome enough to reverse countervailing market forces. Continuing weak demand and the willingness of oil exporters to discount prices and exceed OPEC imposed production quotas have kept oil prices soft. Widespread surplus capacity and the growth of government stockpiles underpin consumer confidence in an ample supply. A warm start to the winter and OPEC's latest difficulties in restraining output add to complacency. Given strong prospects for further price slippage, buyers are loathe to bid up prices and risk losses if a scarcity fails to materialize. [REDACTED]

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Most market analysts believe that only a major escalation in hostilities--including a concentrated effort by Iran to disrupt Saudi exports--could reverse the current market psychology and force spot prices sharply upward. Even a cut off of all exports from Iran, Iraq, and Kuwait would affect less than four million b/d and could be readily offset by increased production from Saudi Arabia and other producers. [REDACTED]

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Outlook

Even if Baghdad can sustain its current level of attacks Tehran is not likely to agree to serious negotiations and Gulf oil exports probably will not be reduced significantly. In our view, an escalation of the conflict that does not significantly affect the availability of Saudi oil would not have a major, lasting effect on oil prices. [REDACTED]

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Iran, not Iraq, poses the main threat to the world oil market. Concentrated Iranian retaliatory attacks against either shipping or oil exporting facilities that threaten Saudi and other Gulf exports would have an immediate impact on the the market. A loss of oil shipments from all Persian Gulf terminals could remove about six million b/d from the market--more than double surplus productive capacity outside the Gulf--even if the Iraq-Turkey and Saudi East-West pipelines are still operating. Such an event would drive prices up sharply. The severity of the impact would depend on stock use and expectations about the length of the disruption [REDACTED]

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For the time being, however, we expect Tehran to concentrate on alternate ways to export its oil and not on increased retaliation. Iran probably will continue its current rate of two or three shipping attacks a month. Iran's economy is not threatened as long as Tehran is willing to offer discounts to move its oil. A large price drop along with an increase in the effectiveness of Iraq's shipping attacks, however, would present serious problems for Iran's leaders. [REDACTED]

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Shipping Attacks in December 1984 and January 1985

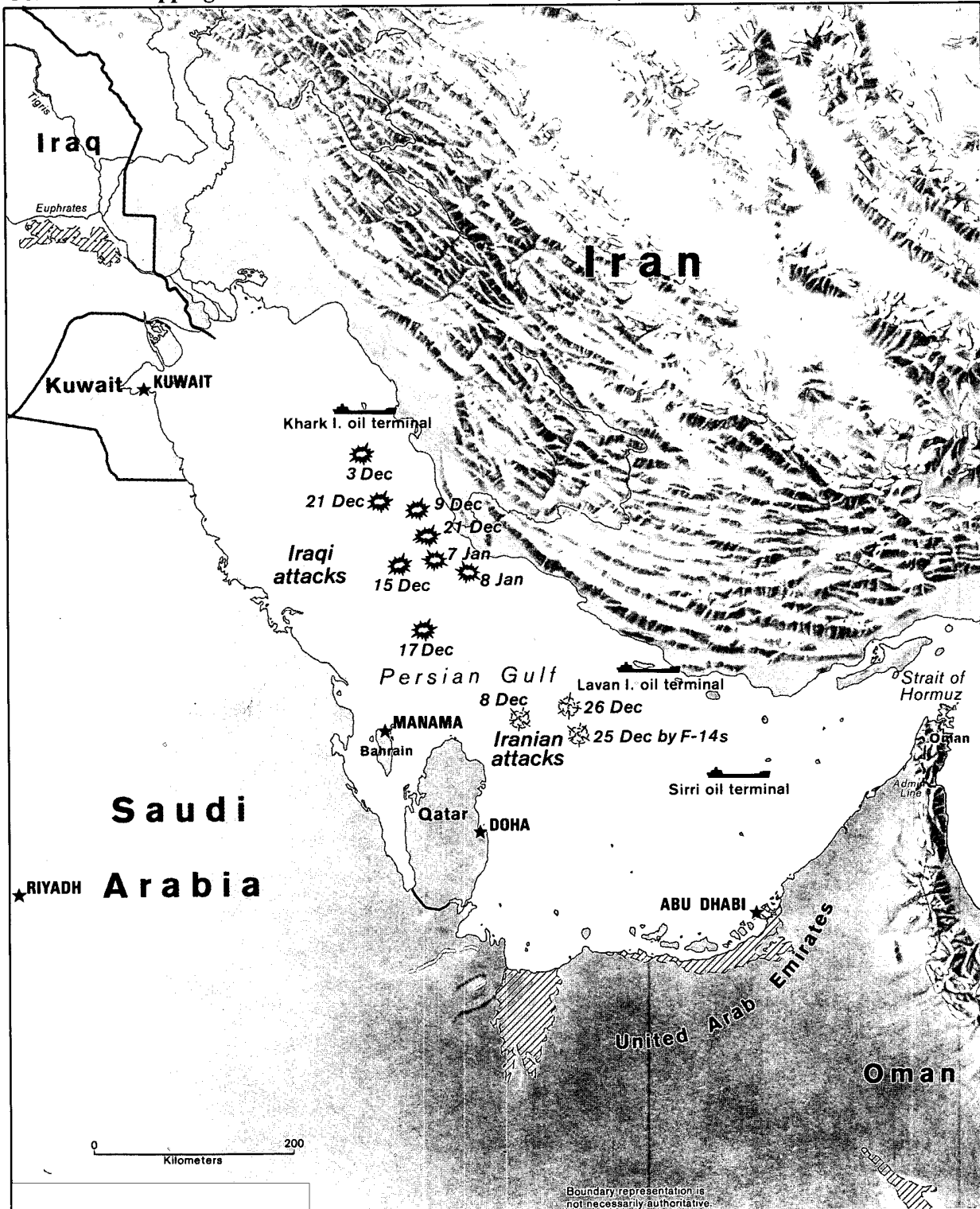
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- Dec 3 Iraqi aircraft hit Cypriot Tanker.
- Dec 5 Baghdad claims ship hit south of Khark... [redacted]
- Dec 6 Iranian ship and aircraft search for targets. 25X1
- Dec 8 Iranian aircraft hit Kuwaiti supply ship.
- Dec 9 Iraqi aircraft hit Bahamian Tanker. 25X1
- Dec 10 Iraq claims ship hit south of Khark. 25X1
- Dec 11 [redacted].Iran  
reports Exocet fired from Iraqi aircraft. 25X1
- [redacted] 25X1
- Dec 15 Iraqi claims two ships hit... [redacted]  
[redacted].probably by Mirage F-1. 25X1
- Dec 16 Iraq claims two ships hit...Greek tanker hit previous day hit  
again. 25X1
- Dec 17 Iraq claims ship hit south of Khark...Greek cargo ship hit.
- Dec 18 Iraq claims ship hit.. [redacted]
- [redacted] 25X1
- Dec 21 Iraq claims two ships hit...Norwegian tanker hit...probably  
Mirage F-1. 25X1
- [redacted] 25X1
- Dec 25 Iran hits Indian tanker...F-14s used.
- Dec 26 Iran hits Spanish tanker. 25X1
- [redacted]
- Dec 31 Iraq claims one ship hit. 25X1
- [redacted]
- Jan 7 Iraq claims two ships hit...Panamanian cargo ship hit. 25X1
- Jan 8 Iraq claims three ships hit...South Korean cargo ship hit.
- Jan 10 Iraq claims one ship hit.. [redacted]
- [redacted] 25X1

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Confirmed Shipping Attacks in December 1984 and January 1985



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