



Washington, D.C. 20505

DIRECTORATE OF INTELLIGENCE

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IRAQ-IRAN: The War Moves Into the Gulf [redacted]

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Summary

The Iran-Iraq war has escalated dangerously in the past few weeks. Iraq has inflicted serious damage on tankers calling at Khark Island and Iran has retaliated by striking tankers calling at Gulf ports. Baghdad is unlikely to cease its attacks because of Iran's retaliation. The Iraqis are attempting to internationalize the war and impair Iran's war making capacity by denying Tehran oil revenues. The frequency of Iraq's attacks--about once a week--is likely to increase when Baghdad receives the first of at least 10 Exocet-armed Mirage F-1 aircraft this summer. [redacted]

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Iran raised the stakes in the Gulf on 16 May by attacking a Saudi oil tanker carrying Kuwaiti crude near the Saudi oil terminal of Ras Tanura. Iranian leaders have indicated that they will try to reduce Gulf Arab oil exports in the same proportion as Iran's exports are reduced by Iraqi attacks. More Iranian airstrikes against Saudi and Kuwaiti shipping are likely as are sabotage and terrorist attacks against Arab Gulf states if the Iraqi strikes continue. The possibility of a clash between Saudi and Iranian fighter aircraft also is increasing. There have been no indications of new Iranian military preparations to close the Strait of Hormuz. Iran probably would undertake such an effort only if it were to lose substantial oil revenues. [redacted]

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The most recent Iranian attack is having a strong initial impact on the spot market, raising North Sea Brent crude prices by as much as \$1.00 a barrel on 16 May. If the frequency of Iraqi attacks on tankers calling at Khark Island increases, some tanker owners will stop accepting charters for Khark relatively quickly. Others will remain in the trade seeking to make a quick profit. Tehran also could use a combination of tactics--such as price discounts, diplomatic pressure, and transshipment of oil in Iranian tankers--to maintain oil exports. Because of surplus oil production capacity available in the Free World, a halt in exports from Khark Island would by itself not have a major impact on the oil market. If Iran were to seriously disrupt Gulf Arab oil exports, the impact on world oil supplies and prices would be greater and more immediate. [REDACTED]

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Iraq's Strategy

Iraq is embarked on a strategy to squeeze the Iranian economy and increase international concern over an escalation in the war. Iraq wants Japan to stop purchasing Iranian oil, the Western states to curtail arm shipments to Iran, and the US to find alternate outlets for Iraqi oil. Baghdad views the economy as Khomeini's achilles' heel and believes cutting Iran's oil revenues will damage the Iranian economy. Iraq hopes that by reducing Iran's oil revenues, cutting Iran's arms supplies, and inflicting heavy battlefield losses on the Iranians, it will force Tehran to the negotiating table. [REDACTED]

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To implement its strategy, Iraq recently has broadened its attacks on shipping. Until 24 March, Iraq concentrated its airstrikes mainly on merchant ships calling at the Iranian northern Gulf port of Bandar-e Khomeini. Bandar-e Khomeini is the only functioning Iranian port with a railhead and thus is vital to the Iranian economy. Iraq claims to have hit about thirty merchant ships in six attacks from January 1984 through 24 March 1984. At least five ships were in fact damaged. [REDACTED]

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On 27 March Iraq escalated the campaign against Iran by launching its first confirmed attack using Super Etendard aircraft armed with Exocet missiles against an oil tanker. Iraq mistakenly hit two friendly ships--a Greek tanker filled with Kuwaiti oil and a workshop leased to ARAMCO. In addition to hitting the wrong targets, the Exocet missiles performed poorly; the missile that hit the Greek tanker failed to explode. In order to avoid further strikes against friendly ships, Iraq has shifted the focus of its attacks to the eastern half of the Gulf. The Iraqis also pressed the French to improve the performance of the Exocet missile. Since late March, Iraq has hit at least five other tankers, but failed to sink any. [REDACTED]

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Iraq is launching strikes against Gulf shipping about every five to ten days and is likely to maintain this pace as long as it suffers no significant

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aircraft losses. With only five Super Etendard aircraft Iraq will not be able to launch sustained, high-intensity attacks on shipping. [redacted]

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Iraq will be able to increase its attacks on shipping late this summer, however, after it receives a squadron of Exocet-armed Mirage F-1 fighter aircraft. Four of the Mirage aircraft have been handed over to the Iraqis in France and at least ten Iraqi pilots will soon finish training on the aircraft there. The first Exocet-armed F-1 aircraft should arrive in Iraq next month and be combat ready by late summer. Iraq then will be able to increase both the frequency and size of its attacks. Instead of hitting one or two tankers once a week, the Iraqis could attack four or five tankers every few days. Iraq is unlikely to launch a sustained attack against Khark Island, however, unless Baghdad decides its campaign against Iranian shipping has failed to stop Iranian oil exports. [redacted]

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Shipowners and Oil Market Reactions to Iraqi Attacks

An intensification of Iraqi attacks could lead to a major withdrawal of trade from Iranian oil ports. Because of depressed shipping market conditions, however, some shipowners probably will continue calling at Khark as long as they can obtain insurance. There are about 168 tankers idle worldwide--with about 28 now awaiting business in the Persian Gulf. Even if insurance rates rise well beyond the current level of 3 percent, insurance will still be only a slight deterrent to shipowners and oil buyers. [redacted]

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As concern over the safety of tankers calling at Khark mounts we would expect to see the following sequence of indicators.

- A doubling or tripling in the charter rates for oil carried from Khark.
- Dramatic increases by Lloyds in hull and cargo insurance rates under war risk clauses.
- Withdrawal of substantial numbers of independent operators from the trade.
- Widespread cancellations or a significant drop in nominations of tankers calling at Khark Island.
- Denial of insurance by all insurers for ships and cargoes in the Khark Island trade. [redacted]

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A "domino effect" is not likely in the absence of steadily escalating Iraqi attacks. An across-the-board denial of insurance by all insurers, however, would effectively halt tanker traffic to Khark, except for nationally-owned Iranian vessels and those belonging to a number of independent shipowners who would accept a much higher risk as long as they have a chance at a profit. [redacted]

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Tehran probably will use a combination of tactics to keep its oil flowing. We believe these measures would be triggered by any significant drop in exports, perhaps from 1.8 million to 1.5 million barrels per day. Likely courses of action are:

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- Lower official prices or price discounts in the form of rebates covering higher insurance and transportation costs, easier credit terms, direct Iranian payment of insurance premiums, or favorable terms for commercial oil-barter arrangements.
- Diplomatic pressure on major bilateral trading partners, such as the Japanese, who have a large commercial stake in Iran.
- Transshipment of oil in Iranian ships from Khark Island to the southern end of the Persian Gulf, where it could transfer oil directly into waiting third-party tankers. [REDACTED]

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If the Iranian attacks on Kuwaiti and Saudi tankers during the past few days prove to be the first in a sustained series of Iranian attacks against tankers trading with Arab ports on the Gulf, both charter and insurance rates in that trade will start to move up. Charter rates from both Iranian and Arab ports have been quite close during recent weeks. War risk insurance rates, on the other hand, have been much lower for Arab ports--premiums on ships are currently less than 3 percent of those for tankers carrying oil from Khark Island; rates on Arab oil cargo are 20 percent of those for Iranian crude. Even if insurance rates on both ships and cargoes in trade with the Arab ports rise to the current levels for Khark Island, the impact will be slight, adding about \$.25 to the delivered cost of a barrel of Kuwaiti crude, for example.

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Due to surplus oil productive capacity available in the Free World, the combined loss of total Iranian and Iraqi exports could be absorbed without significant impact on overall price levels. Much of this excess capacity, however, is in the Persian Gulf. Any combination of actions which caused a net reduction in world oil supplies of about 1 million barrels per day would probably create strong pressure on prices. Judicious use of government and commercial stocks could mitigate such pressure, but use of the latter would be highly dependent on perceptions of the likely length of the disruption. [REDACTED]

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If Iran were to seriously damage or close the major Gulf oil-export facilities, the impact on world oil suppliers and prices would be more immediate. Currently about 10 million barrels per day of oil comes from Persian Gulf countries. Closure of the Kuwaiti export facility at Ahmadi and the Saudi terminals at Ju'aymah and Ras Tanura would remove over 3.5 million barrels per day in exports, a volume slightly above excess productive capacity outside the Middle East. The disruption of all oil shipments through the Strait of Hormuz would result in oil supply losses of about 7 million barrels per day from Gulf countries--the only exports available would be a maximum of 3 million barrels per day carried through pipelines in Saudi Arabia and Iraq--and would precipitate a significant round of oil price increases. [REDACTED]

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Iran's Response

Faced with an increase in Iraqi pressure on its oil trade, Iran has begun to retaliate by attacking tankers enroute from Kuwait. The Iranians so far have confined the location of their attacks to an area in the northern Gulf between 25 and 55 nautical miles north of Ras Tanura. Iran is signaling to

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the Arab Gulf states and the West that if the Iraqi campaign continues, Iran will not hesitate to make the Gulf unsafe for all oil shipments. Iran's Supreme Defense Council met Tuesday and, according to Iranian press reports, laid down guidelines for Iran's strategy of retaliation. [REDACTED]

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The Iranian attack on a Saudi tanker carrying Kuwaiti crude on 16 May is significant because it did not directly follow an Iraqi attack on Iranian shipping and it occurred close to Saudi Arabia near the major Saudi export facility at Ras Tannura. Iran's Foreign Ministry warned on 13 May that Iran would not tolerate Iraq's attacks on shipping and on the same day Iranian F-4s attacked a tanker that had just loaded at Kuwait. On 14 May Iran attacked at least one additional tanker, inflicting significant damage, probably in response to an Iraqi attack on two Iranian bound vessels a day earlier. [REDACTED]

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Baghdad may now feel a need to respond to Iran's latest strike. Even if it does not, it is likely to attack with the Super Etendards within the next few days if it keeps to its schedule of tanker strikes. Every time Iraq attacks a target in the Gulf, Iran probably will lash out at one of the Arab Gulf states. Kuwaiti targets are the most logical since that country is militarily weak and is the Gulf country least likely to ask for military assistance from the US. Kuwait is also the primary port for military equipment coming from the USSR to Iraq. [REDACTED]

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Iran knows Iraq used Kuwaiti facilities in some of its attacks on Iranian bound shipping. Tehran also holds all Arab Gulf States accountable for giving financial aid to Baghdad. [REDACTED]

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Tehran has about 70-80 operational fighter aircraft and has been using F4 fighter aircraft, probably equipped with Maverick TV-guided bombs, against tankers. Iran also apparently is using P-3 naval reconnaissance aircraft to target tankers for airstrikes. While Iran can sustain its campaign of harassment against Gulf shipping indefinitely, it cannot engage in sustained, large-scale air operations over the Gulf should it become involved in clashes with Saudi fighter aircraft. Such engagements will become more likely as the Saudis beef up their defenses along the Gulf and Iran continues its strikes on tanker traffic. [REDACTED]

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If, as we judge likely, attacks against Kuwaiti shipping fail to deter Baghdad, Tehran likely will mount strikes against targets inside Kuwait or other Gulf states. It also could shift the focus of its air attacks further south in the Gulf. Iran could attack oil and desalination facilities in Kuwait and other Arab Gulf states, hit the Iraq-Turkey oil pipeline, or begin sabotage and terrorist attacks in the Gulf states using local Shia sympathizers. Iran has trained Gulf Arabs in terrorism and sabotage and probably has some already in place. Kuwait's oil facilities are easily accessible to Iranian aircraft and damage to any of its terminal facilities could critically impair its production capacity. Saudi Arabia and Abu Dhabi's oil production and export also depend on a small number of critical chokepoints. [REDACTED]

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Iran has not substantially strengthened its forces near the Strait of Hormuz. We believe Iran would only attempt to block the Strait if Iraq [REDACTED]

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[REDACTED]

succeeds in substantially reducing Iranian oil exports, perhaps by more than 50 percent. Mining the Strait could result in a cutoff of Iranian shipping and would raise the possibility of a Western military response that Iran could not effectively counter. [REDACTED]

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Threat to US AWACS

Iraqi President Saddam Hussayn was quoted this week in a British newspaper as claiming that US AWACS in Saudi Arabia were supplying Baghdad with information. Tehran has picked up on the story claiming that it proves the US is behind the Iraqi strikes in the Gulf. If the strikes in the Gulf continue to escalate, we believe Iran will consider the AWACS and other US personnel and facilities as legitimate targets. The Iranians may try to intercept AWACS or launch terrorist attacks against US military personnel inside Saudi Arabia or the other Gulf states. [REDACTED]

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[REDACTED]

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Iraqi and Iranian Attacks on Shipping in the Persian Gulf

- 31 Jan - 1 Feb Iraq claims 8 ships were sunk during attacks over two days near Bandar-e Khomeini.
- 16 Feb Iraq claims 7 ships were hit near Bandar-e Khomeini.
- 27 Feb Iraq claims tankers at Khark Island were attacked. We have no confirmation that this attack occurred.
- 1 Mar Iraq claims 8 ships were sunk near Bandar-e Khomeini.
- 24 Mar Iraq claims 4 ships were sunk near near Bandar-e Khomeini.
- 27 Mar A Greek tanker is slightly damaged and Korean barge sunk by Iraq.
- 29 Mar Four ships attacked near Bandar-e Khomeini by Iraq.
- 18 Apr British tanker hit and slightly damaged by Iraq.
- 25 Apr Saudi-registered supertanker heavily damaged by Iraq.
- 27 Apr Four merchant ships attacked by Iraq near Bandar-e Khomeini.
- 7 May Saudi-registered tanker heavily damaged in Iraqi attack.
- 13 May Iran attacks Kuwaiti tanker.
- 13 May An Iranian tanker lightly damaged and Panamanian-registered tanker heavily damaged by an Iraqi attack.
- 14 May Iran attacks Kuwaiti tanker.
- 16 May Iran attacks Saudi-registered tanker.

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(million b/d)

	<u>Production</u>		<u>Consumption</u>	<u>Net Exports</u>
	Crude	NGIs ^a		
Iran	2.4	-- ^b	0.6	1.8
Iraq	1.1	0	0.3	0.8
Kuwait	1.0	0.05	0.15	0.9
Neutral Zone	0.5	0	0	0.5
Qatar	0.3	-----	-----	0.3
Saudi Arabia	5.0	0.3	0.9	4.4
UAE	<u>1.3</u>	<u>0.1</u>	<u>0.1</u>	<u>1.3</u>
Total:	11.6	0.45	2.0	10.0

^a Natural Gas Liquids.
^b Negligible.

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 45 - DDO/NE, [redacted]
 46 - EURA/EI/SI
 47 - SDO (2)
 48 - DDS&T/DO (2)
 49 - SCIO
 50 - C/CSG
 51 - C/ILS
 52 - C/ISS
 53 - C/PDB

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54 - C/NID
55 - CRES
56 - SOVA/CSD
57 - OGI/SRD E
58 - D/OGI
59 - C/OPSCTR
60 - DC/OPSCTR
61 - D/CPAS
62 - DD/CPAS
63-66 - CPAS/CMD/CB Rm. 7G07 Hqs
67 - OGI/IIC/TAB
68 - C/PES
69 - D/NESA
70 - NESA/PPS - 6G02 Hqs
71-74 - DDI/NESA/PG
ORIG:C/NESA/PG,

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