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# AWB and the Iraqi Oil-for-Food scandal: Just a cost of doing business?

*Peter K Ross*

## THE ENVIRONMENT OF INTERNATIONAL BUSINESS

In 2005, the Australian government initiated an inquiry into ‘certain Australian companies in relation to the UN Oil-for-Food program’, subsequently known as the Cole Inquiry. This inquiry investigated what was to become Australia’s biggest international corruption scandal – the A\$300 million paid in kickbacks to the Saddam Hussein-led Iraqi government by the Australian Wheat Board (AWB), an exporting monopoly (Holmes 2006). Even more damning was the fact that this money had been paid to the same dictatorial regime against which Australian soldiers had fought two wars. The seeds of this corruption went back to the introduction of a UN-administered Oil-for-Food Program (OFFP) that was negotiated with the Iraqi government following the First Gulf War.

## ■ First Gulf War 1990–91

In 1990, under a government led by Saddam Hussein, Iraq invaded Kuwait. Following an international outcry, a United Nations-endorsed, United States-led coalition force subsequently liberated Kuwait in 1991, in a military action named ‘Operation Desert Storm’. The peace terms required Saddam Hussein to open up Iraq to UN weapons inspectors, including the inspections of sites suspected of being linked to the development of ‘weapons of mass destruction’ (WMDs) (UN Security Council Resolution 687) (Fisher 2004, p. 462). The responsibility for finding weapons, including WMDs, was given to the UN Monitoring, Verification, and Inspection Commission (UNMOVIC) and the International Atomic Energy Agency (IAEA).

UNMOVIC and IAEA inspectors had some success in finding and disposing of weapons. This included the destruction of ‘38,500 munitions, 480,000 litres of chemical agents, and 1.8 million litres of precursor chemicals’ (Squassoni 2003, p. 4). But Iraqi officials became increasingly obstructive over time. This included delaying tactics and blocking access to ‘sensitive sites’. Inspectors also complained that interview rooms frequently were bugged by the Iraqi government. Some observers therefore suggested that ‘Iraqi compliance was superficial and oriented to facilitating the process of inspections, rather than on providing cooperation in substantive matters’ (Squassoni 2003, p. ii). By 1998, the Iraqi government had become emboldened by increasing disunity amongst UN Security Council members and evicted all UNMOVIC personnel from the country. Following pressure from the United States and the United Nations, UNMOVIC personnel eventually were allowed back into Iraq in 2002, but there had now been a four-year period with effectively no UN inspections of Iraqi sites.

The period following the First Gulf War was, therefore, typified by a high degree of distrust amongst the parties. Further, many coalition force country governments – particularly the United States – believed that Iraq had not fully complied with UN Security Council Resolution 687, which required it to provide *unrestricted* access to its weapons facilities.

## ■ The UN Oil-for-Food Program and sanctions

Following the invasion of Kuwait in 1990, the UN Security Council voted for economic sanctions against Iraq (Harris 2007). These sanctions effectively prohibited UN member states from trading with Iraq, and included an embargo on the purchase of Iraqi oil – the country’s predominant export revenue source. The UN Security Council hoped that the sanctions might apply sufficient economic and political pressure on the Iraqi government to persuade it to withdraw its forces from Kuwait. However, sanctions have often proven to be ineffective in changing regime behaviour – US trade sanctions against Cuba, Iran and Burma, for example, have failed to change the nature of the targeted regimes (Griswold & Lukas 1999). In this instance, the UN sanctions failed to induce Saddam Hussein to withdraw his forces from Iraq, resulting in the First Gulf War. Following the war, the UN Security Council renewed and maintained the sanctions because of the Iraqi government’s apparent failure to fully comply with UN Resolution 687. Much of the pressure to maintain this approach came from the US government.

A problem with implementing wide-ranging sanctions is that they are, by their nature, a blunt economic instrument. While sanctions aim to change a regime’s behaviour, the elite within the targeted countries often find ways to get around the sanctions and/or simply skim off a bigger percentage of a shrinking economy. Saddam Hussein, for example, continued to build new palaces and his family maintained a life of relative opulence throughout the sanctions period. Further, ‘the regime remained as brutal and uncompromising in its treatment of political opponents as it was prior to sanctions’ (Boone, Gazdar & Hussain 1997, p. 3).

Saddam Hussein was also prepared to use the economic plight of ordinary Iraqi people to pressure the United Nations to lift its sanctions, and overseas reporters who visited the country routinely were taken on state-organised tours of hospitals and other impoverished institutions. While much of this was a cynical ploy on the part of the Iraqi regime to pressure the United Nations into changing its stance, the fact remained that ordinary Iraqi people continued to suffer. Boone, Gazdar and Hussain (1997, p. iii) advise that real earnings for Iraqis:

fell by around 90 per cent in the first year of the sanctions, and then fell by around 40 per cent more between 1991 and 1996 . . . observations on the type of survival strategies that Iraqis are resorting to confirm this impression that in many ways Iraq is now very much like some of the poorest countries in the world, whereas before the sanctions it could be placed on par with the upper Middle Income countries.

Clearly, the sanctions had created an ethical and political dilemma for UN Security Council members, not to mention a public relations nightmare. In 1995, the *New York Times* published an article entitled ‘Iraq Sanctions Kill Children’ (Crossette 1995). Observers also suggested that the ongoing situation had led to ‘sanctions fatigue’ among UN Security Council members (Squassoni 2003).

## ■ The Oil-for-Food Program

A UN strategy to help address this problem was the creation of the OFFP, whereby limited amounts of Iraqi oil could be exported for defined essential goods such as foodstuffs and medicines. The United Nations passed an initial resolution to initiate such a program as early as 1992, but the Iraqi government rejected the initial UN terms and a negotiated agreement was not finalised until late 1996 (Harris 2007). In finalising this agreement, the United Nations made a significant concession by agreeing that the Iraqi government, *not* the United Nations, would make the final decision on who could buy its oil and which firms could supply the humanitarian goods (Holmes 2006). This allowed Saddam Hussein to exert a far greater influence over the OFFP process than the United Nations had intended initially, further increasing the potential for corruption of the program. In line with this agreement, the Iraqi government refused to approve any OFFP purchase of wheat from US farmers because of the US government's continued support for the sanctions (Mayman 2003). Given that the United States is a major wheat exporter, the Iraqi government's stance gave other competitor wheat-exporting nations, such as Australia, a major advantage in terms of securing wheat sales to Iraq.

The OFFP agreement stipulated that all monies received under the program were to be paid into a UN escrow account, which in turn would monitor the receipt and disbursement of all the funds. Between December 1996 and 2003, Iraqi oil worth US\$64 billion was sold under the auspices of the OFFP, with US\$34 billion spent on humanitarian goods and US\$18 billion spent on reparations. (Volcker, Goldstone & Pieth 2005a; Harris 2007).

In 2003, continuing tensions between the United States and Iraq boiled over into the Second Gulf War. Debate over the causes and responsibility for this war are wide-ranging and beyond the scope of this case study, but in 2003 the United States led an invasion force dubbed the 'Coalition of the Willing' into Iraq – Australia was a member of this coalition invasion force. Disagreements among UN Security Council members meant that, in contrast to the First Gulf War, this coalition force was not backed by the UN Security Council.

Rumours concerning the corruption of the OFFP had been circulating for some years, but it was not until the defeat of Saddam Hussein's forces in this Second Gulf War that significant amounts of evidence supporting these rumours emerged from Iraqi government files and archives. Following the discovery of this evidence, the then UN Secretary General, Kofi Annan, initiated an inquiry into the administration and workings of the OFFP, chaired by Paul Volcker. The Volcker Inquiry discovered that, while the OFFP had improved the lives of ordinary Iraqis, the process had also systemically been corrupted. *Time Magazine* put this more bluntly, calling the OFFP a 'massive scam' (Sullivan 2005, p. 112). The inquiry estimated that more than 2200 foreign firms had paid bribes and/or kickbacks to the Iraqi government (Harris 2007), with an estimated value of at least US\$1.8 billion. The inquiry also found that the Iraqi government had been able to smuggle a further US\$11 billion worth of oil out of the

country, again in direct contravention of UN sanctions. Of all the firms linked to illicit kickbacks and the OFFP, the company that was found to have paid the highest amount in corrupt payments to the Iraqi government was the Australian firm AWB. The Volcker inquiry estimated that, between 1999 and 2003, the AWB paid US\$221 million in illicit payments – approximately A\$300 million at the then exchange rate – which totalled an incredible 14 per cent of all the illicit funds paid to Saddam Hussein's regime under the OFFP (Harris 2007).

## ■ AWB

AWB's origins were in the government-owned Australian Wheat Board before it was privatised in 1999. Importantly, AWB was the beneficiary of the Australian government's 'single-desk' policy, which gave AWB the power to veto any other firm's application for a licence to export wheat from Australia (Aulich & Botterill 2007). This gave AWB a virtual monopoly on all wheat exports from the country. The logic behind the single-desk policy was to improve AWB's bargaining power. Australia is one of the world's biggest wheat exporters, and selling all its wheat exports through one source gave AWB – and, by extension, Australian wheat farmers – more power to negotiate deals in a competitive global market. The single-desk policy had broad general support from Australian wheat farmers and the National Party, a rural based political party that was a junior member of the ruling conservative Liberal/National Coalition that governed Australia from 1996 to 2007.

AWB gained a reputation for aggressively courting markets, which was in part related to the power it gained from its monopoly status. Aulich and Botterill (2007) further advise that, following privatisation, government regulatory oversight of AWB's export activities was relatively weak. Australia had sold wheat to Iraq for more than 50 years, and Iraq had developed into one of AWB's biggest export markets. Australian hard wheat was well suited to making Iraqi bread, while Iraq itself did not have the arable land available to grow its own requirements (Holmes 2006). The AWB therefore actively tendered for wheat sales to Iraq under the OFFP. Further, as outlined above, under the OFFP terms agreed upon by the United Nations in 1996, the Iraqi government was able to prohibit wheat imports from the United States, thereby eliminating a major trade competitor. In 2002, the year before the OFFP finished, Australia exported A\$800 million worth of wheat to Iraq and by 2005 the Iraqi wheat market represented around 10 per cent of AWB's entire wheat exports for that year (Tucker 2006). Clearly, Iraq had developed into a lucrative market.

## ■ Kickbacks: Wheat exports to Iraq

AWB's success in Iraq had raised suspicions. Canadian wheat farming representatives, for instance, had complained to UN personnel about rumours of kickbacks being paid by the Australian firm to the Iraqi government (Volcker, Goldstone & Pieth 2005b). However, the United Nations did not initiate any large-scale investigation. Australia

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has solid democratic and transparent institutions, and is generally perceived as having relatively low levels of corruption (see Transparency International 2010). The idea that a large, long-established, former Australian government-owned firm could be engaging in such high-level illicit activity appears to have been anathema to UN officials at the time (Holmes 2006).

Nevertheless, the kickbacks being paid by AWB to the Iraqi government began in 1999. During this year, two AWB representatives visited Iraq and were told that they would need to pay a US\$12 per ton 'trucking fee' on all wheat sold to Iraq (Cole 2006a, p. xiv). The Iraqi officials explained that this money was required to transport the grain from the port to the various inland regions of Iraq where it was required. The trucking fee would be added to the overall price that the Iraqi government was paying for the wheat, so AWB would not lose any money from the deal. This meant that AWB would receive an extra US\$12 per ton for its wheat, but this extra US\$12 would then be paid back to a transport firm nominated by the Iraqi government. Given that the US\$12 per ton was well above actual transport costs, this was in effect a kickback to the Iraqi government. Although this payment, in US dollars to an Iraqi-nominated company, was in direct contravention of UN sanctions, AWB simply inserted a clause in its contract advising that: 'Discharge costs will be maximum of US\$12 . . . And shall be paid by sellers to nominated maritime agents in Iraq.' (Holmes 2006) In July 1999, AWB submitted the contract to the Australian Department of Foreign Affairs and Trade (DFAT) for its scrutiny, and DFAT then forwarded the contract on to the United Nations for its approval (Holmes 2006). In the event, neither DFAT nor the United Nations appears to have uncovered or queried this clause.

Because UN sanctions did not allow AWB to pay the 'trucking fee' directly into any Iraqi financial institution, the Iraqi government asked AWB to pay the money to a Jordanian transport company, 'Alia Transportation'. During the Cole Inquiry, it emerged that this firm was 49 per cent owned by the Iraqi Ministry of Transport, and the monies for the 'trucking fees' that it received were later transferred to the Iraqi government (Holmes 2006). Between 1999 and 2003, the AWB entered into 26 contracts under the OFFP, but 'neither the fact nor the amount of the payments for the trucking fee made to Alia was shown on the face of any of the 26 contracts' (Cole 2006b, p. 9). During this period, the 'trucking fees' also increased from US\$12 to more than US\$50 per ton (Holmes 2006).

### ■ The Cole Inquiry

Following public pressure, in 2005 the Australian government initiated an inquiry into the activities of Australian firms in relation to the OFFP. The subsequent 'Inquiry into certain Australian companies in relation to the UN Oil-for-Food Program' (Cole 2006a, p. iii), focused on the activities of AWB and was presided over by Commissioner Terence Cole. The Cole Inquiry called many witnesses, including senior AWB management, and its published findings suggested that AWB knew that its payments of trucking fees to Alia contravened UN rules (Cole 2006a, 2006b). Its



report further claimed that AWB management had engaged in a pattern of deliberate obfuscation in order to hide the true nature of the trucking fee payments from UN officials (Cole 2006a, 2006b). In 2006, the now public nature of AWB's activities with the previous Iraqi regime caused the new Iraqi government to ban all imports of Australian wheat, subject to the outcome of the Cole inquiry investigation (Tucker 2006). In his summing up of events, Commissioner Cole was scathing about AWB's behaviour:

The consequences of AWB's actions have been immense. AWB has lost its reputation. The Federal Court has found that a 'transaction was deliberately and dishonestly structured by the AWB so as to misrepresent the true nature and purpose of the trucking fees and to work a trickery on the United Nations'. Shareholders have lost half the value of their investment. Trade with Iraq worth more than A\$500 million per annum has been forfeited. Many senior executives have resigned, their positions being untenable. Some entities will not deal with the company. Some wheat holders do so unwillingly but are, at present, compelled by law to do so. AWB is threatened by lawsuits both in Australia and overseas. There are potential further restrictions on AWB's trade overseas. And AWB has cast a shadow over Australia's reputation in international trade. (Cole 2006, p. xi)

Commissioner Cole also recommended that criminal charges be made against 11 former AWB executives (Minder 2006). The inquiry also led to the resignation of AWB's CEO, Andrew Lindberg (Moldofsky 2006).

AWB could have approached the Cole inquiry quite differently. In 2005, it hired the services of an American-based crisis-management consultancy expert, Dr Peter Sandman, to give advice on the Iraqi wheat kickbacks crisis. Dr Sandman advised AWB that it would be in its best interests to admit that it had been paying bribes to the Iraqi regime and publicly 'over apologise' for its actions (McManus 2006, p. 7). In fact, he advised AWB to overstate its responsibility and set out how it was addressing the issue. But senior AWB management chose to ignore this advice, instead opting to 'tough it out'. In hindsight, it is impossible to say with certainty whether the Sandman strategy would have led to a better outcome for the firm. But the approach taken by AWB management appeared to accentuate, rather than minimise, the negative publicity associated with the scandal.

The Cole Inquiry was significant in another way: the then Prime Minister of Australia, John Howard, and two senior ministers – the Minister for Foreign Affairs, Alexander Downer, and the Minister for Trade, Mark Vaile – were called to give evidence. All claimed to have had no prior knowledge of AWB's illicit activities. While some diplomatic cables alluding to rumours of AWB's activities were found, none of these could be linked directly to the ministers concerned – the Minister for Foreign Affairs, for example, claimed not to have seen them (Holmes 2006; Silkstone 2006). Nevertheless, Australia traditionally has operated under the Westminster system, whereby government ministers are supposed to take ultimate responsibility for the actions of their departments. In this regard, AWB's transactions with the UN-administered OFFP were supposedly scrutinised by DFAT. Yet, following the release of the full evidence surrounding AWB's illicit activities, neither of the above two ministers resigned, despite the fact that A\$300 million was paid in kickbacks to the

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Iraqi government while they were the responsible ministers. Further, these two ministers had been part of the 2003 Cabinet, the executive arm of government, which agreed to commit Australian troops to the Second Gulf War.

The Cole inquiry did find that growing rumours and evidence about AWB's activities in Iraq had induced DFAT to make some internal inquiries into the matter prior to the Cole Inquiry (Silkstone 2006). But reports suggest that simple reassurances from AWB senior management were enough to satisfy DFAT officials that no wrongdoing had occurred (Holmes 2006; Silkstone 2006). Bartos suggests that this follows a pattern whereby 'there was a tacit understanding permeating the policy-making levels of government that AWB was a reliable, trustworthy partner to government, one not to be subjected to scrutiny' (2007, p. 1). Bartos further likens this to the BBC series *Yes, Prime Minister*, which invokes the 'Decent Chap Rule' – that is, 'decent chaps don't check up on decent chaps to see if they're behaving decently!' (2007, p. 6).

## ■ Aftermath

As outlined above, the negative publicity surrounding AWB's activities led to Iraq placing a ban on Australian wheat imports in 2006. Following extensive Australian government lobbying, the Iraq government subsequently agreed to receive limited imports of Australian wheat, provided they were not supplied by AWB (Pash 2006). The findings of the Cole Inquiry led the Australian government to then suspend AWB's veto power over Australian wheat exports and the government subsequently approved export applications from alternative firms; the veto power was transferred to the Federal Minister for Agriculture, Fisheries and Forestry (Minder 2006). After a long and detailed review of the industry, a new body – Wheat Exports Australia (WEA) – was created in 2008 to review and accredit applications from firms wishing to engage in the bulk export of Australian wheat (Aulich & Botterill 2007; Wheat Exports Australia 2009). AWB had lost its bulk wheat export monopoly.

Australia is a signatory to the UN Convention Against Corruption (2005) (Bartos 2007), and the Australian government agreed to follow up on the Cole inquiry's recommendations to tighten up laws to better address the contravention of UN sanctions by Australian firms (Australian Government 2007). The government further set up a task force to investigate possible criminal charges against AWB managers, and in 2007 the Australian corporate regulator, the Australian Securities and Investments Commission (ASIC), instituted civil proceedings against six former AWB executives, with possible criminal charges to follow (ASIC 2007; Fry 2007). After a long and involved examination of the evidence, the criminal investigation into AWB was dropped in 2010, but ASIC resumed its civil case against the former AWB executives in what had become a long and protracted legal battle (ABC 2010).

In 2010, AWB agreed to pay out A\$39.5 million to settle a class action from AWB shareholders, who had sued the firm for losses incurred because of the Iraqi wheat scandal – including a sharp fall in the share price. The original action was for A\$100 million (Sexton 2010; Smith 2010). AWB also remains 'one of more than 90