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Iraq's Oil

Friedemann Müller

The prospect of a military offensive against Iraq puts more than the price of oil into motion. It also causes further-reaching speculations on the extent to which Iraqi oil reserves and production capacities might serve as a motivation for the United States to intervene in Iraq. When Iraq's Foreign Minister, Naji Sabri, accuses the U.S. that its real interests lie in seeking to "destroy Iraq in order to control the Middle East oil," he is making an accusation that resonates in many commentaries from both Western and non-Western sources. Washington, in turn, strictly denies that oil represents a motive for threatening military intervention in Iraq. It does not deny, however, that such an intervention would have repercussions on international oil markets.

These repercussions could take on drastic dimensions. After all, 63 per cent of the world's proven oil reserves lie in five Persian Gulf states – Saudi Arabia, Iraq, the United Arab Emirates, Kuwait, and Iran. Iraq's share of international oil reserves (approximately 11 per cent) is second only to Saudi Arabia (25 per cent). Nevertheless, while Iraq must be regarded as a heavyweight in the oil business due to the extent of its reserves, its significance in supplying oil to world markets has diminished. To be sure, Iraqi oil production rose considerably after the Persian Gulf War ended in 1991, from 0.3 million barrels per day (mbd) to 2.6 mbd in 2000. But the Iraqi oil industry's state of disrepair (lack of spare parts) caused exports to shrink from 2.1 mbd in 2000 to 1.7 mbd in 2001. Despite the fact that the UN's "Oil-for-Food" Program would permit the export of approximately 2.2 mbd, Iraqi oil export averaged only 1.18 mbd during the first eight months of 2002. Added to this are illegal exports, which are estimated at up to 0.3 mbd; revenues from this source are used primarily for arms purchases. While Iraq's share of world oil production stood at 5 per cent in the 1980s, this figure has now declined to approximately 2.5 per cent (current world production: ca. 76 mbd).

Iraq's production volume comprises only about 25 per cent that of Saudi Arabia (which currently produces approximately 7.6 mbd). Iraq's share of the 25.5 mbd produced by the 11 OPEC states is 7 per cent. Saudi Arabia's excess capacity, i.e., its ability to increase production within a short period of time, is alone estimated at 3.5 mbd – more than twice the volume of Iraqi oil exports. A discontinuation in oil supplies from Iraq could therefore be com-

pensated without problem – provided that Saudi Arabia is willing to assume the role of "swing supplier," as it has done so often during the past three decades. Russia, for example (in contrast to insinuations by President Putin), would not be able to increase its production by even 1 mbd. No country outside the Persian Gulf region possesses excess capacity of this magnitude. Iraq claims that it is capable of developing a production capacity of up to 10 mbd, but even with massive foreign investment in production and transport, it would take five years for Iraq to regain a capacity of just 4 mbd.

The Situation of Oil Reserves

While Iraq currently plays a relatively marginal role in global oil markets, this is not the case with regard to oil reserves and thus Iraq's potential long-term significance for international oil supplies. *Proven* reserves of conventional oil worldwide are estimated at 1,050 billion barrels (bb). With 112.5 bb, Iraq possesses approximately 11 per cent of these reserves. Iraq's share of oil reserves might be even higher if *potential* reserves are included. In economic terms, the development of unconventional reserves can only be profitable at oil prices that are considerably higher than current prices. In contrast, Iraq's oil can be developed at particularly low cost. As long as OPEC maintains the price of oil approximately within its self-defined target range (between $22-28), it will be impossible to produce unconventional forms of oil (e.g., oil shale, oil sands, etc.) in an economically viable manner.

The above-mentioned five Persian Gulf states that possess 63 per cent of the world's proven oil reserves provide only 26 per cent of current world oil production. This means that their oil reserves are being depleted only gradually. The statistical lifetime of these states' reserves – i.e., the ratio of oil reserves to current annual production, or R/P ratio – now stands at 87 years. The corresponding R/P ratios for Russia, Europe, and North America are 19, 10, and 8 years respectively. Because these five Persian Gulf states command the largest potential reserves, and because they can develop their oil at far below average cost, their ability to (re)gain significant shares of global oil markets will remain considerable. Iraq's claim that it can increase its current production of 2 mbd to 10 mbd in the future should not be regarded as unfounded in terms of either reserves or costs. In the long term, Iraq could become a serious competitor to Saudi Arabia. However, this increase in production would require tens of billions of dollars in foreign investment (which, under attractive investment conditions, would certainly be profitable), and production quotas within OPEC would have to be redistributed accordingly. In order to avoid drastic imbalances within OPEC, this latter shift could occur at best over a period of ten years, provided an increased global demand for oil. It is also conceivable that a U.S.-controlled or independent Iraq might withdraw from OPEC production limits. A corresponding drastic increase in production would then cause global market prices to decline.

Developments in Oil Prices

The price of oil is commonly regarded as highly volatile. The numerous swings of the price curve during past decades would appear to support this view. Yet the broad, overall development of oil prices over the past 30 years reveals that these oscillations can be explained according to important political and economic events and developments. The 1973 Yom Kippur War caused the OPEC cartel to employ the instrument of production limits for the first time. As a result, the price of oil rose abruptly from approximately $3 to $14 per barrel and remained at this level until the end of the 1970s. The outbreak of the Iran-Iraq war in 1979 triggered the next jump in prices. By 1980, when price levels reached $39, world markets were overstrained. By then, con-

servation measures and investments in oil production outside OPEC states – policies initiated after the first oil crisis – had begun to take effect. In the first half of the 1980s, demand for OPEC oil declined faster than OPEC production limits could react. The price of oil dropped relatively steadily through 1985, to $27. And when OPEC abandoned its production limits in early 1986, prices plunged to $12. A period of 13 years followed during which old and new suppliers competed for shares of an increasing world demand in what had now become a truly free market for oil. The average price of oil during this period was $17.

During the period from 1986-1999, small increases in prices were overshadowed by one particularly large jump. During the build-up and actual combat of the Gulf War in 1990-1991, oil prices briefly surpassed the $30 mark before rapidly falling back to $17. In March 1999, OPEC became aware that non-OPEC states possessed insufficient oil reserves and that OPEC-implemented production limits could not be counterbalanced by other states' absorption of resultant market shares. The instrument of production limits became effective once again. In 2000, oil prices increased to over $30. Yet OPEC had learned from its experience in the early 1980s that excessive oil prices ultimately lead to a loss of power. As a result, the cartel delineated a target range of $22-28 for the OPEC basket price. Since the fall of 2000, OPEC has held prices within this margin, with the exception of the five months between September 11, 2001 and February 2002. On two days following September 11, prices exceeded the upper limit of this margin and then collapsed due to a drastic curtailment in demand (reduced air travel, etc.). The following conclusions can be drawn from the above developments:

- In 1999, OPEC in principle regained the power to control oil prices that it had lost in the 1980s and 1990s. In "normal times," OPEC's powers of price control are sufficient to achieve its target prices. However, in extreme events such as the Persian Gulf War, September 11, 2001, or a future war against Iraq, the instrument of production limits or increases is insufficient to control prices.
- Short-term events such as the Persian Gulf War of 1991 or September 11 cause oil prices to deviate only temporarily from their normal levels. Longer-term events (e.g., the Iran-Iraq War) or structural changes such as OPEC's effective use of cartel power can raise oil prices to another level.

Thus whether or not a military attack on Iraq will lead to a sustained change in oil prices depends on whether such an attack can be limited in terms of both time and space in a manner similar to the 1991 Persian Gulf War. If military action remains limited, one can expect a significant but short-term increase in the price of oil. Those states seeking to protect themselves from risk and willing to pay nearly any price to fill up their reserve supplies of oil will demonstrate a short-term additional demand for oil. This effect will already appear in a milder form when – as now – a potential military conflict builds up over a longer period of time. A decline in both demand and prices will follow accordingly as soon as the risk to oil supplies is no longer viewed as acute.

However, if a war against Iraq were to spread throughout the entire region and particularly into Saudi Arabia, oil prices would explode and thereby unleash a powerful shock to the global economy. Even a common effort among all remaining oil-producing regions of the world could not compensate for the discontinuation of Saudi Arabian oil production. To be sure, oil prices could scarcely rise to $100 per barrel, as is occasionally predicted, because too many users would be unable to pay even a much lower price. Nevertheless, a decline in global oil supply by the magnitude of the export volume of Saudi Arabia and Iraq, together with an increase in oil prices to $50 and upwards, would send the global economy into a downward spiral. The nations of East and South Asia, which

currently import two-thirds of the oil produced in the Persian Gulf, would be affected first. No one, however, would escape the drastic repercussions of such a supply gap. Practically all developing countries would be unable to pay, and Western industrial nations would be extremely vulnerable due to their dependence on foreign trade (Europe) and capital imports (U.S.).

Oil Companies' Interests in Iraq

Would a new regime in Iraq that was legitimized by the United States bring benefits to oil enterprises, particularly those based in the U.S.? In general, probably not. U.S. companies have not been active in Iraq since the end of the 1980s, while French, Chinese, Indian, Italian, and particularly Russian firms have engaged in business transactions or at least negotiations with Iraq since 1991. Russian firms, however, have suffered considerable losses – Iraq currently owes Russia or Russian companies approximately $10 billion. Large transactions have not yet come to fruition due to UN sanctions; nevertheless, the companies involved are waiting for the opportunity to put concluded business agreements into action.

In contrast to widespread assumptions, it is hardly possible to substantiate empirically that the U.S. is using its political power to undermine international competition for the benefit of American oil companies. As a rule, large projects are implemented by multinational consortia. This applies to projects in the neighboring Caspian Sea region as well. U.S. firms are involved in all of these projects, but they are not consortium leaders or majority shareholders in any of them. Rather, this region in particular demonstrates that the political interests of the U.S. can diverge significantly from the interests of oil companies and that Washington shows little consideration for these companies' interests. Moreover, serious turmoil would arise within the system of multinational corporations if American enterprises were to receive inordinately preferential treatment that violated the usual rules of the game. This would likely cause more harm than good to the U.S. Of course, extraordinarily lucrative business transactions could be conducted in an Iraq governed at least to some extent by the rule of law, particularly due to the favorable cost structures that would emerge. OPEC would most likely seek to slow down this process in an attempt to hinder drastic alterations in Iraqi production quotas.

Conclusions

It is indisputable that clear connections exist between military intervention in Iraq and global oil markets. Oil prices react sensitively to signs of crisis, but the security of oil supplies will be endangered if, and only if, conflict cannot be confined to Iraq. An expansion of the conflict to Saudi Arabia would have devastating consequences for the global economy. It is highly improbable that the U.S. would be driven by economic interests to intervene in Iraq. There is no conceivable scenario in which American enterprises, or specifically the U.S. oil supply, would stand to benefit immeasurably from regime change in Iraq. The globalization of oil markets and the corporations that run them is a process that cannot be easily reversed. In order to ensure the security of oil supplies at an affordable price, it would be desirable that military intervention – should it occur – achieve its goal quickly and above all not have detrimental effects on other Persian Gulf states. Otherwise a global economic crisis will occur that is far more serious than anything the world has witnessed since 1945.

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