Under reconstruction! We apologize for the absence of certain materials.

THE OIL DIMENSION OF WARFARE AGAINST IRAQ

15 February 2003

Oil used to be and in the foreseeable future will remain the strategic commodity, the base of national security and prosperity worldwide while fight for access to oil and its transit will remain the present century feature. With the current Iraq extraction rates oil resources will cover needs for nearly 130 years with oil reserves being 1.7 billion tons or almost 11% of the world oil resources. Iraq is also a major oil producer within OPEC being the key oil exporter to US what indeed evokes interest of everyone to the situation in Iraq.

The US presidential administration accounting a good number of oil professionals (once getting to oil business one will adhere to it forever) completely negates any role of oil in the Iraq crisis putting in the forefront the issue of elimination of the weapons for mass destruction. The role of the oil factor in the possible anti-Iraq war is disputable but no one has any doubt as to its presence. The oil "background" will be an attribute to any warfare in the Persian Gulf.

By starting the fight against Iraq, the anti-Iraq coalition country-members would open the Pandora box and nobody could predict the consequences of this step for the world community. Risks and damages born by the oil market in the warfare are unpredictable, but after any scenario they would be enormous and, rather than being centered around Iraq and the Middle East only, shake the entire global economy.

The proposed multiproptional prognosis of the possible course of events around Iraq would not provide 100% realizability or cover any military and political aspects of the war against Iraq: it is only an attempt to have an insight into the oil component of the crisis.

Oil paradoxes and US claims to Iraq

For a number of recent years and despite the regular US and British air strikes in the Iraq territory with the political confrontation back-up, Iraq has remained one of the major oil suppliers to the US. However, Iraq had no direct oil exports to the US. Moreover, no US company has been operating in the Iraq territory with its products supplied thereto. All Iraq oil exports to the US are made within the framework of the re-export-based UN Program “Oil converted to foodstuffs”. Namely, Russian companies purchase oil in Iraq with its immediate resell to the US.

Indeed, by a strange combination of circumstances, in the fateful September, when Islamic terrorists have attacked New York and Washington, the Iraqi oil exports to US were the highest over 30 years. In 2002, the Iraqi oil daily exports (274 thousand tons) had a share of 127 thousand tons supplied to the US (46%); in January 2003, the share of Iraqi oil exports to US was 158 thousand barrels daily (57%) what made up 13% of the total oil imports of the US.

Thus, under conditions where US prepares to open the war and Venezuela oil exports have declined as a result of the national strike, US concentrates on Iraq oil purchases which quality parameters are close to Venezuela oil (insofar as petroleum refining industry customises certain oil brands).

One could view here a perfect US-Iraq idyll. However, in addition to weapons of mass destruction, violation of the human rights, support of terrorists, for a long time US has been concerned in Iraq with a series of problems focused on oil, namely:

- enforcement of sanctions regime or imposition of new sanctions; for example, according to experts’ assessment, the illegal Iraqi daily oil exports reached 48 thousand tons over the last week in December 2002 with the daily domestic oil consumption being 55 thousand tons. Thus, over this period Iraq demonstrated a daily oil production growth totalling 377 thousand tons, i.e., this is 1.5 times higher the UN official records (255 thousand tons per day).

- Major suppliers of illicit Iraqi oil go to Syria; smaller purchases are made by Turkey and Jordan, and no doubt, these are reduced-price schemes;

- elimination of Iraqi oil sale intermediaries who get a chance to grab a tasty piece of profit for Saddam Hussein” (quoting the US senator Conrad Burns); according to Russian Journal "Expert", some small-scale Russian companies, which are granted the Iraqi oil quotas, practice the so-called "black roll-back" procedure [of unofficial partial compensation of the oil price to Iraq] measured 0.2–0.5 USD per barrel of oil purchased. In more delicate terms, international experts interpret this "black roll-back" as the overcharged insurance contributions imposed by Iraq under rates of 0.2–0.5 per barrel of oil which go directly to Iraq by-passing the UN records (the international practice ceiling assumes that the highest insurance contribution rates should not exceed 0.05 USD); over the recent six years Iraq exported more than 820 million tons of oil with one-fifth being the oil exports to Russia;

- secure stability in Iraq oil supplies to the international market including US: more than once Iraq held up oil exports for the period not exceeding one month being driven by its political considerations (oil export supplies were suspended in December 1997 and July 2001);

- granting rights for developing large oil fields to US companies (no US companies are active in Iraq); Iraq government has signed a number of international oil deposit development contracts that are ineffective, but under the imposed strict sanctions there is no room for serious commitments, at the same time, Iraq continues to practice "redistribution" of the quotas granted to the benefit of other companies in order to provide political "encouragement" of certain countries, etc.

- US has a vital interest in getting access to the Iraqi natural resources, i.e., immediate development of oil fields in Iraq to push up profits of national companies and hence to secure the higher budget revenues.

Today US has no other oil supplier as alternative to Iraq imports - Russia has low capacities both in terms of export volumes and absence of the necessary infrastructure while Caspian exports will never replace Iraq oil imports. For a low production level and short oil reserves. This will push US somehow or other in attempt to get a solution of the Iraq problem.

Did why US stopped the offensive after Kuwait liberation from Iraqi occupation on February 28 in the framework of the 1991 allied "Desert Storm" warfare? Having more numerous land forces and better political drive than in today's situation (punishment of the Iraqi aggressor), and having actually defeated Baghdad, Washington contented itself with next to nothing. (Norman Schwarzkopf, US General in command of the "Desert Storm" operation, has later admitted: «We have fulfilled our task but it left me disappointed».

Being paid the tribute, the general was forced to retire). There is no easy answer to the above puzzle. One could assume that then US had needed a "renegade" country which would disrupt unity of the OPEC member countries and serve as a counterbalance to Iran. Taking into consideration that at that time China and Russia were in hard opposition to military occupation of Iraq, it is likely that the US government was just not ready for a long stuck in Iraq, keeping back its liberation movement and averting attempts to split the country.

The conclusion can be drawn that Iraqi oil is solely the tactic task of the US warfare in Iraq. For a long time the United States were not happy about the world oil prices being regulated by OPEC. Washington has partially lost its political leverages to control oil cartel country-members which for a long time managed to keep up high oil prices. The US strategic interests call for a long-time military presence in Iraq to exert a long-term influence on the other first-rate oil exporters - OPEC member countries, namely, Saudi Arabia, Iran and some others to exercise control over the global oil prices.

Today US employing the military instruments to implement its strategic task and ensuring the long-term energy security - puts the global oil market and hence the world economy on a serious trial.

The oil swing

Since 1951 the global oil market has survived as minimum 18 oil crises. 10 stemmed in the Middle East; in this total, three-five crises were provoked by war, five crises were caused by international tension, three to five crises were born by economic tension and embargo, and five crises were the result of accidents. Four crises appeared to be crucial causing the trillion dollar world economy losses bringing as a consequence the GDP decline in many countries as a result of higher oil purchase expenditures as well as a partial production roll out, and unemployment growth.

The oil crises lead to fundamental cut in oil supplies in the world market, primarily in the US. The many-year experience through the period in crises proved for the either side - both consumers and suppliers - the economic benefit of having a lean compromise (or peaceful confrontation) rather than economic wars with galloping prices, oil supplies’ cuts and placement of embargo. It was also clear that the major driving force in oil price increase is not its deficit but effective or expected violation of the global oil market operation.

Over the recent five years the oil market featured a significant price fluctuation - oil prices increased four-fold (December 1998 and September 2000 prices were at the level of 9 to 37 USD per barrel). It should be noted that within this period there were no significant military and political shocks which could cause a drastic change in oil demand and supply. This and earlier period oil price fluctuation have caused no symmetric changes in consumption of the "black gold", as major consumers (like transport, fossil power and heat utilities) had a limited ability to switch to other types of fuel.
During 2001-2002 oil prices showed a slow but steady growth: in 2001 annual average "OPEC basket" was 23.1 USD per barrel, in 2002 - 22.4 USD. Despite some reduction of oil prices on the world market has been registered for a few days in January 2003 (the "basket" prices in January 2003 fluctuated in the range of 28.9-31.2 USD), the oil price increase continues to be a basic trend. Encouragement of the oil price growth is given by the threat of war in Iraq, as well as by Venezuela export reduction as a result of a two-months' national strike.

Governments in the west, primarily in US are not satisfied with the OPEC oil price policy in the oil market, which frequently has a distinctly negative impact on the world economy status. The role of the oil factor in regard to the world economy could be illustrated by the following examples: 10% oil price growth in terms of one barrel will result in 0.5% GDP decline in the US or 10% GDP growth in Russia.

Growth of current oil prices exceeding a 30 USD benchmark has a negative effect not only on the world economy but also the OPEC country-members' economy as a consequence of a lower oil demand in the average-run period. Today the oil cartel is not accountable for misbalance of the oil market governed by the threat of a possible war opening against Iraq.

OPEC = OIL CONTROL

In the fifties of the last century the majority of seven "sisters" (largest western oil companies) extracting the Middle East oil on conditions of concessions, earned profits exceeding 120%. Meanwhile, oil-producing countries earned only about 7% of the oil barrel cost. USSR also played into hand of the West, by throwing huge batches of cheap oil into the market. Grudge of the Middle East countries and Venezuela against such allocation of the oil revenues has predetermined creation of the oil producers' cartel. This step has been made due both to the Soviet Union throwing in a new lot of cheap oil on the world market, and the oil "sisters". Thus, in the beginning of 1959, British Petroleum dropped its oil price by 10%, as it could not withstand the Soviet competition; then in August 1960 Standard Oil also declared drop of its oil prices. The result was that oil producing countries begun to lose their moderate profits.

In September 1960 in Iraq, the Organization of Petroleum Exporting Countries (OPEC) was created to coordinate oil policies of oil-producing countries. Iraq, Iran, Kuwait, Saudi Arabia and Venezuela were OPEC founders. Qatar, Indonesia, Libya, Arab Emirates, Algeria and Nigeria joined them later. OPEC controls up to 77% of the world prospected oil resources and nearly 40% of the global oil production.

Since creation of OPEC and until 1973 oil prices varied being at the level of 10 USD per barrel in the 2001 prices, or 3 USD in the 1973 prices, what basically covered costs, allowed a sufficient profit level and settled customers. As the strength and confidence improved, OPEC started active regulation of the global oil market.

The most severe oil crisis (and oil embargo) in 1973 was aroused by decrease in crude oil daily production by 685 thousand tons by Arab countries - OPEC members. Increase in daily oil production by countries beyond OPEC membership by 137 thousand tons failed to salvage the world economics from the jump in the oil prices by 400 % during six months, though the total losses made up only 7% of the world petroleum production (or about 550 thousand tons per day).

On January 1, 1987, OPEC has officially introduced the concept of "OPEC basket", which is the arithmetic mean index of fixed prices for six oil brands of the cartel and one brand sort of the Mexico production. In conditions of 1999 with the purpose to have an effective control over the global oil prices OPEC has determined a price corridor for its "basket" - 22 - 28 USD per barrel.

The OPEC strength lies not in its control over more than one-third of the world oil trade, but in the capability of economics and petroleum industry of the countries - members to cut or increase volumes of crude oil production within a short period of time. This elasticity of crude oil production volume is conditioned by the following factors.

Firstly, proper technical feasibility, for example, in today's conditions to increase crude oil production volume by 15-17% (with the minimal cost and time spent on drilling new oil wells or conservation of the used ones).

Secondly, nationalization of the petroleum industry in the majority of countries of cartel allows its governments to make political decisions in this industry. (Under rigid conditions of antimonopoly or anticartel legislations in the majority of the Western countries, private oil companies can not make joint decisions on variation of crude oil production levels.)

Thirdly, this is a joint policy of defining the total volume of crude oil production in OPEC and quotas for each country - member (even the largest producer of oil can not influence the global market on its own).

Fourthly, the majority of OPEC countries are rich enough to withstand even medium-term drastic drop of their incomes from oil export. Finally, it is the absence of transport problems due to availability of their own sea terminals.

Under conditions of authoritarian states and absence of considerable financial debts to be settled on the external markets, the above combination simplifies the problem of political decision-making by the OPEC member countries concerning decrease or increase in crude oil production volume. Ultimately the key goal of control over the world oil prices is reached.

It goes without saying that OPEC that makes its own dispositions for the war in Iraq. The ministers of OPEC have declared that the cartel will immediately interfere, if any stoppages with oil deliveries begin. Ali al Naimi, the Minister of oil and mineral resources of Saudi Arabia, has declared that "Saudi Arabia and OPEC are ready to fill any deficit [in the global fuel market]."

During a special summit of the OPEC in Vienna on January 12, 2003, the oil ministers have agreed to increase daily-volume of crude oil production by 7% (or 1.5 million barrels) since February 1, 2003. Thus, OPEC makes attempts to stabilize oil supply and demand, as well as to keep the oil prices at the same level. The decisions made during this summit will make possible to prevent rise in oil prices, but can hardly drop them down significantly. In other words, today, on the threshold of war in Iraq, OPEC fails to compensate even loss of the Venezuelan oil. If the war affects oil production of the neighbours of Iraq, the oil market can lose up to 9 million barrels daily. Loss of such quantity of oil from the world market can not be covered by additional capacities of Saudi Arabia and United Arab Emirates (3 million barrels each).

According to London The Independent, during the OPEC session of December 2000 the top secret policy of "post-Iraq" actions has been discussed, which envisioned the option of applying the "oil weapons". Under conditions where Iraq is either released from the UNSC sanctions or leaves the OPEC (both cases resulting in the increase of Iraqi oil production level in a rather close perspective), with simultaneous increase in the oil production volume of countries - non-members of OPEC, while country members of the International Energy Agency (IEA) threaten to use their strategic oil reserves, the probability for the oil price leaving the OPEC price corridor (below 22 USD) is high.

It is quite probable that conditions for fall-off of crude oil production and introducing of partial embargo were discussed as well. OPEC already has such an experience; however, the "oil weapon" due to its low-price is likely to bring high "friendly fire" casualties. Thus, the economical recession in Asia at the end of nineties has held back the oil prices at a level below 10 USD per barrel (during the oil price collapse of 1998, as well as in 1986 when the price of a barrel of oil made 8 - 9 USD), which has evidently caused OPEC by surprise.

Apparently, OPEC is also considering an option of responding to the situation by a sharp increase in crude oil production as a critical offensive against "enemies" (independent producers) by means of a large-scale throw-in of cheap oil into the global market. With oil prices lower than 12 USD per barrel, the expensive projects of oil fields development, construction of new or already started pipelines and oil terminals will be frozen. Drastic growth of crude oil production will threaten Russia, oil producers of the Nthern and Caspian Seas, as well as of abyssal shelves (e.g., African members of OPEC) and some other producers, which cannot properly withstand a competition with cheap Arab oil.

The OPEC remains a significant reality of the new century not only as leading branch international cartel, but also as affiliation of countries (though with developing economies), which in aggregate possess financial and raw material resources of the global level. Whether the OPEC "oil weapon" will be used as a tool of international policy (and political-economical tension) depends on how acute the events around Iraq would turn out to be.

Oil scenarios

The task of converting probable scenarios of the military campaign in Iraq into oil barrels lost by the global market or points of the oil price growth is as problematic as that of resolving the Iraq crisis by the UNSC resolutions. The historical experience shows that the world community has not yet learned to prevent neither military nor oil crises, or to provide correct predictions of their consequences.

Based on the historical experience of the previous oil crises and probability analysis of manifestation of the distinguished key impact factors, it is possible to form three basic forecast scenarios for the course of events around Iraq and in the global oil market during and after the military operations (see Table).

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<th>PROBABLE SCENARIOS OF THE COURSE OF EVENTS AROUND IRAQ DURING AND AFTER THE MILITARY OPERATION*</th>
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