

You may be interested...

In response to a number of recent requests, PIRINC has prepared the enclosed brief report entitled, *The "Need" for Iraqi Oil*.

The international position of Iraq is unique. It is the only country in the world under comprehensive sanctions and arms inspections imposed by the United Nations. The sanctions are to remain in place until Iraq is in full compliance with specific UN Security Council resolutions, most prominently, the resolution dealing with the elimination of Iraqi weapons of mass destruction. Given Iraqi resistance to date, maintaining sanctions is clearly justified. They should be kept in place until such time as the international community is confident Iraq is and will remain in full compliance. However, a specific question has arisen over just how important, or "needed" is Iraqi oil. This report attempts to address this question by offering some perspectives on Iraqi oil, both in the current market, and for the longer term.

If you have any questions or comments, please call John Lichtblau, Larry Goldstein, or Ron Gold.

March 1998

Petroleum Industry Research Foundation, Inc.

3 Park Avenue • 26th Floor • New York, NY 10016-5989
Tel.: (212) 686-6470 • Fax: (212) 686-6558

The “Need” for Iraqi Oil

Introduction

The international position of Iraq is unique. It is the only country in the world under comprehensive sanctions and arms inspections imposed by the United Nations. The sanctions are to remain in place until Iraq is in full compliance with specific UN Security Council resolutions, most prominently, the resolution dealing with the elimination of Iraqi weapons of mass destruction. Given Iraqi resistance to date, maintaining sanctions is clearly justified. They should be kept in place until such time as the international community is confident Iraq is and will remain in full compliance. However, a specific question has arisen over just how important, or “needed” is Iraqi oil. This report attempts to address this question by offering some perspectives on Iraqi oil, both in the current market, and for the longer term.

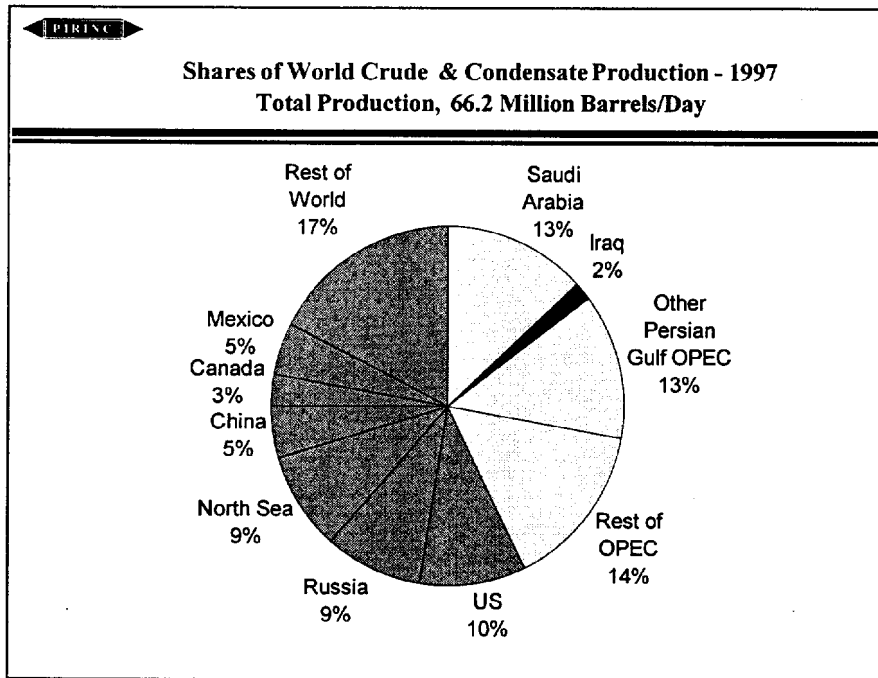
With oil prices down and OPEC struggling to contain a glut of oil on the market, it is difficult to conceive of an immediate world “need” for Iraqi oil. But the current market conditions are too narrow a focus for assessing the importance of Iraqi oil. The concept of “need” itself requires careful definition to be sure of what we mean in the context of world oil markets.

Supply disruptions and sharp increases in oil prices have contributed to the last three recessions experienced by the US and caused economic difficulties in other oil-consuming countries. These experiences suggest that a well-functioning oil market---with ample, diverse, supply and no price shocks---is needed for economic stability. Although not critical today or in the near term, Iraqi oil will have an important role to play in assuring such a market in the future. This is especially the case for the long term (beyond 2000) since, as noted in the report, Iraq has the second largest volume of proven oil reserves in the world, as well as acknowledged high potential for future additions to reserves.

Iraqi production is already impacting the market. On March 22, Mexico, Saudi Arabia and Venezuela announced their agreement to cut their combined production by 600,000 barrels a day and commitments by other OPEC and nonOPEC countries to reductions of an additional 1.1 million barrels a day. The actual cuts are likely to be lower than the announced volumes but they could well match Iraq's current exports of about 1 million barrels a day. Under existing UN policy, these exports are likely to rise to 1.6 million B/D by mid-year.

Current Role of Iraqi Production

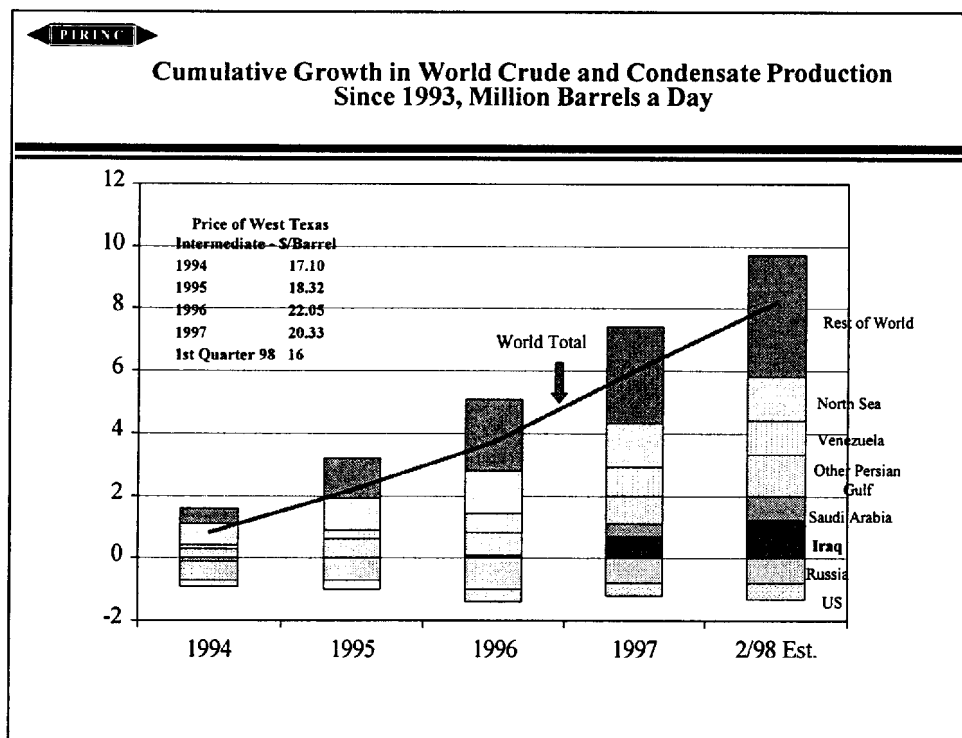
The chart below shows shares of 1997 world crude and condensate production for Iraq and other oil producers. Of those shown, Iraq's share at 2% is the smallest. Saudi Arabia and the other Persian Gulf OPEC countries produced about 26% of the world's oil, over 10 times Iraqi production.



By this measure, it is hard to conceive of Iraqi oil as “needed,” at least under current market conditions. However, longer term, one can see a somewhat different perspective of the role of Iraqi oil.

Cumulative Growth in World Oil Production Since 1993

While Iraq’s share of world production is very low, it has grown from minimal levels in a very short time. The chart below shows the cumulative growth in world crude and condensate production since 1993 and the major contributors to that growth.



As of February of this year, world production was up about 8 million barrels a day from its 1993 average. Increased production from a number of countries contributed, although two large producers, the US and Russia showed declines. Most of the gains have come since 1996, corresponding to the period of Iraq's limited reentry into the world oil market via UN-approved sales for humanitarian relief purposes. Growth in Iraqi supply accounts for about 25% of the total growth since 1996.

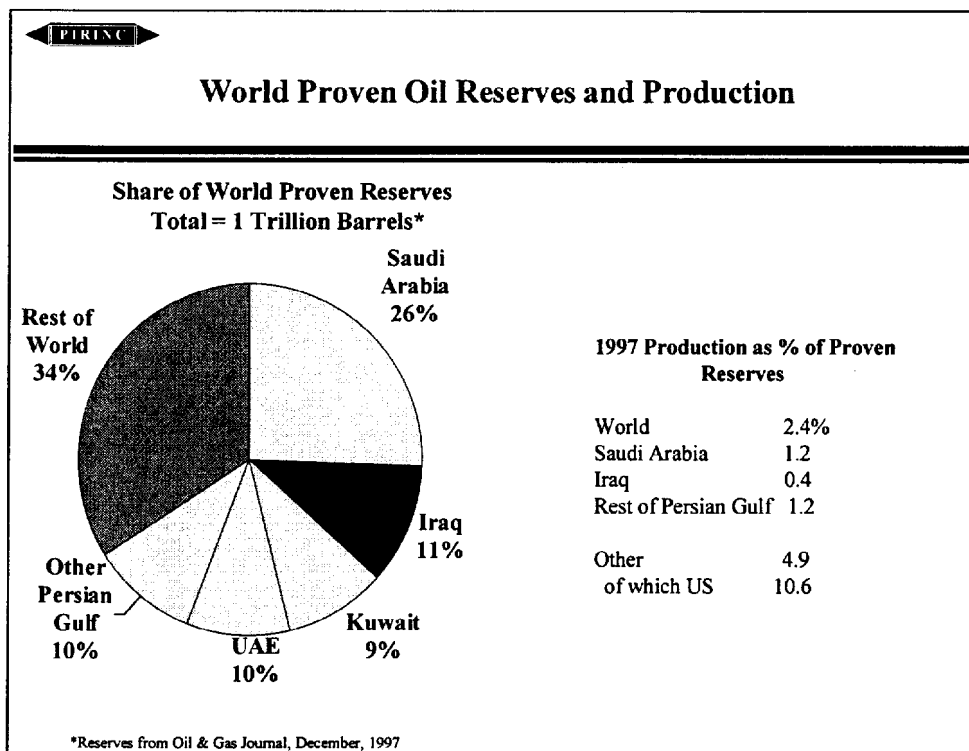
The inset table shows year-average spot prices for West Texas Intermediate for 1994 through 1997 and the averages for February and early March of this year. The return of Iraqi oil to market since 1996 corresponds to the period of declining prices of oil. While other factors have contributed---rising production elsewhere, the warm winter this year, the economic crisis in Asia---the rising volume of Iraqi oil also played a significant role.

The UN has already authorized an expansion of Iraqi oil sales for humanitarian purposes, virtually guaranteeing further growth in production. Timing and volume, however, will depend on whether Iraq gains UN approval to import needed equipment to repair oil facilities.

Higher Iraqi production does not automatically translate into lower prices. Demand growth, production decisions by other OPEC members, and inventory levels also impact prices. But higher Iraqi production improves the odds for continued moderate oil prices, even if not at the extremely low levels reached in early March.

Shares of World Proven Reserves

Although Iraqi production is a minor share of world oil today, this could change dramatically in the future. The chart below shows shares of world oil reserves and 1997 production as a share of proven reserves. Proven reserves are those that can be recovered with current technology and at current prices.



While Saudi Arabia has the largest share of the world's proven reserves, 26%, Iraq is second, with 11%, followed closely by Kuwait, the UAE and the rest of the Persian Gulf countries. Together, this group accounts for about two-thirds of the world's proven reserves. The table to the left relates 1997 oil production to these reserves. For the world overall, production amounted to about 2.4% of reserves. For the Persian Gulf countries apart from Iraq, the figure is 1.2%. Outside the Gulf the figure is 4.9%. For the US, production was 10.6% of reserves.

The figure for Iraq is far lower, 0.4%, than any of the others, suggesting broad possibilities for greatly expanded production. If Iraqi production simply moved toward the same 1.2% of proven reserves as elsewhere in the Gulf, output would reach about 3.5 million barrels a day. This would be about double the current production rate but only slightly above Iraqi production on the eve of its invasion of Kuwait in 1990 and about the same as its peak in 1979, before the war with Iran.

From a technical standpoint, there is little doubt that, given access to needed investment, Iraq could achieve such a production level in a 12 to 18 month period. This level is consistent with US government estimates of the potential level of production that could be reached by the Caspian region over the next 15 years. But the level of Iraqi production is determined more by international political considerations than technical concerns. An easing of restrictions on imports of oil-related equipment, very likely assuming no new setbacks to the renewed arms inspection process, would assure a near-term expansion of production of over 0.5 million barrels a day over the next six months. But further substantial expansion of Iraqi production awaits a normalization of Iraqi international relations that ends sanctions and promotes capital flows into the oil sector. This is unlikely to occur in 1998.

With normalization, Iraq could meet perhaps up to 40% of world oil demand growth between now and year 2000. The world could manage without this particular source of new supply, given the current comfortable supply/demand balance but for the long term (beyond 2000) Iraqi oil must be viewed as a significant potential contributor to stability in the world oil market.

Right now world spare production capacity is about 2 million barrels a day, and concentrated almost entirely in the Persian Gulf. This spare, along with current high inventories, constitutes a security blanket for world markets. But what appears to be an overhang of inventories in the current market would not appear so without Iraqi exports. Nonetheless, in the current and likely near-term oil market, the key issue is how the other OPEC members will accommodate increased exports from Iraq, rather than how much the world needs Iraqi oil.