

08-September-2003

## **IRAQ**

### **Give Iraqi Oil To The Iraqis**

By Dr Leo Drollas

*The following article was written for MEES by Leo Drollas, Deputy Director and Chief Economist of the London-based Centre for Global Energy Studies (CGES). The article represents the author's personal views and not necessarily those of CGES.*

Although the Herculean task of reconstruction in Iraq has not yet begun and foreign oil companies have still to establish even a foothold in the country, the mantra 'Iraq's oil belongs to the people of Iraq' is heard often enough. What does this phrase really mean, though? Should the Iraqi government — whatever its eventual nature — be in control of Iraq's oil industry, or should the oil be handed over directly to the Iraqi people, and if so in what way? Are not the terms 'government' and 'the people' synonymous? With oil exports worth around \$20bn annually at pre-war volumes and prices, oil is Iraq's only source of foreign exchange and state income. How can this national resource be used in the years to come to benefit all of the Iraqi people and not just the few?

In most countries oil resources belong ultimately to the state itself and are extracted either by private companies under license from the state, as in the North Sea, or by state-owned companies, as with most of the members of the Organization of Petroleum Exporting Countries (OPEC). Only in the United States does the oil belong to the owner of the land on which oil is found and produced, the US landowner/producer paying a royalty fee to the government for depleting this resource. Quite why everywhere else oil below ground belongs to the state while, for example, agricultural output belongs to the individual is not immediately obvious. It could, I suppose, be argued that oil is a non-renewable resource and its depletion denies future generations their patrimony, hence the royalty fee.

If oil belongs to the people and a democratically elected government governs on behalf of the people, why should the Iraqi government not control the nation's oil? In Iraq the government has indeed controlled the country's oil industry since 1972. Before then, a consortium of foreign companies had produced oil under concessions granted to them decades ago, as was indeed the case in the whole of the Gulf region. Oil was first found in Iraq in 1927 (the giant Kirkuk field) by British Petroleum, known then as Anglo-Persian. During the era of the oil concessions, Iraq proved an awkward host government, quarreling with the oil companies over prices, profit shares and unexplored areas. Iraq's obstreperous attitude, under monarchy or Republic, led to it being largely neglected by the oil companies in favor of other major oil producing nations, like Iran, Saudi Arabia and Kuwait.

The Iraqi experience of governmental control of oil, especially since the Ba'th Party came to power in 1968 and particularly since Saddam Husain seized the reins in 1979, was an unhappy one. Bountiful revenues earned from exporting oil were consistently diverted into the coffers of the Ba'th Party and into Saddam and his clique's pockets, a highly organized form of institutional plunder. The part of Iraq's oil wealth that filtered down to the ordinary Iraqi was handed out like sweets for good behavior. Since 1968, oil worth \$580bn (in constant 2002 US dollars) has been produced in Iraq, around \$26,000 for every man, woman and child, yet the country has little to show for all this wealth. Saddam's disastrous wars and the large-scale pillaging and squandering of resources have dissipated a large chunk of Iraq's magnificent endowment — a sad testament to one man's towering ego.

Prohibited from exporting oil under UN sanctions following the invasion of Kuwait in 1990, Iraq slid inexorably into the economic dark ages until Saddam finally accepted the UN's oil-for-aid program late in 1996. Under this scheme, Iraq was only allowed to sell oil to purchase food,

medicines and selected items. Sixty per cent of the population ended up being fed with imported food rationed by the regime. Thirteen million Iraqis had to queue for their sustenance like refugees and this in a country that had been a net exporter of wheat in the 1950s. This state of affairs suited Saddam, for control of the food lines meant a cowed, humiliated population, unable and unwilling to rise against him, while he could blame his adversaries in the UN for the dire humanitarian consequences.

Putting a large stream of oil income into the hands of bureaucrats, politicians and – especially – dictators is much too much of a temptation. Corruption and cronyism never lag too far behind, while the industry itself becomes inefficient as a result. Iraq is not alone in this, for Nigeria, Venezuela, Iran, Indonesia and other oil-producing states offer similar sorry examples of the dissipation of vast oil riches. Reconstituting the Iraqi oil industry as a state entity and handing it over lock, stock and barrel to the government of a new Iraq would thus seem like a retrograde step. Yet, that is apparently what most of the Iraqi elite are thinking and talking of right now, which is a great pity, for Iraqis have a unique chance to discard the failed models of the past and make a new beginning.

Why not give Iraqi oil directly to the people – after all, everyone seems to agree that it belongs to them? One way of doing this is by establishing an oil investment trust and distributing the trust's earnings to the people of Iraq in the form of dividends. This is what the State of Alaska has chosen to do. Set up in 1976, Alaska's Permanent Fund receives 25% of the state's tax revenues from oil and distributes each year some of the fund's earnings. It is worth at present around \$23bn and paid out last year about \$1,500 to every Alaskan (including children) meeting the state's residency requirements. There are two problems with such a solution for Iraq: it would take years for the fund to build up enough capital and it would leave Iraq's oil industry in the hands of the state, with all the inefficiencies that that entails.

Iraq's two main oil-producing areas are in the north around Kirkuk and in the south of the country, north and west of Basra. Bundling the Iraqi oil industry into two regionally based oil-producing companies, as indeed they are constituted at present, and selling these off to the highest bidder would bring in a huge cash bonanza. However, since such bidders are most likely to be foreign oil majors and since the sales receipts would accrue straight to the Iraqi government, the scheme would not be politically acceptable on the first count and truly democratic on the second.

In view of the drawbacks of these alternatives, the Russian solution – but with strict safeguards – offers the best way of handing over Iraq's oil to its rightful owners. Every Iraqi man, woman and child would receive vouchers representing their proportional entitlement to the stream of net income (after costs) that Iraq could expect to derive from the production of oil over the foreseeable future.

Since this future would stretch ahead for at least 30 years, the expected annual net income would need to be discounted to the present. The resultant present value of the future net income stream would reflect the true worth of the Iraqi oil that would be handed over to the people of Iraq. Calculations I have undertaken suggest that on this basis Iraq's oil industry would be worth – conservatively, I might add – \$165bn in the year 2006 (realistically, the earliest starting point for a newly-privatized oil industry). An Iraqi family of five would thus receive vouchers worth around \$34,000 – quite a windfall for an average UK family, but a king's ransom for a typical Iraqi family.

When the Russian people were handed their vouchers they quickly tried to sell these pieces of paper entitling them to their own resources, causing the vouchers to lose value rapidly. They were soon bought up at rock-bottom prices by astute Russian entrepreneurs with access to cheap bank finance, the origin of the so-called oligarchs' astounding wealth. To prevent such an outcome in Iraq, the Central Bank of Iraq could guarantee a minimum price for each voucher, thereby acting as a buyer of last resort. Iraqis would be free either to hold on to their vouchers, or sell them to other Iraqis – or to foreigners, be they individuals or companies. For those willing to sell, the cash received would represent seed-capital for the start-up of businesses or money to

spend on that holiday or new car they always dreamt of. Either way, Iraqis would be free to do as they wished with their own oil wealth.

What would happen to Iraq's oil industry? If the majority of Iraqis decided to hang on to their shares, then the Iraqi oil industry – run by professional managers and accountable to its shareholders – would belong to the people of Iraq in a literal sense. If, on the other hand, a large proportion – if not most – of these shares ended up in the hands of foreign oil companies, it would not be the end of the world – far from it. The people of Iraq would still have received fair value for their oil and future governments of Iraq would still obtain oil-related revenues by taxing the profits made by the privately owned oil companies operating in Iraq. Meanwhile, the companies would proceed to run the industry efficiently, using best practices in the interests of the shareholders, many of whom would be Iraqis.

What would happen to Iraq itself? Giving Iraq's oil to the people would prove to be the biggest boost the Iraqi economy could have expected to receive. A massive inflow of foreign currency in payment for oil shares would provide substantial backing for a new Iraqi currency, would support the importation of much-needed materials and equipment to aid reconstruction and, most importantly, provide the financial basis for the development of a robust private sector.

Will all of this actually happen? I do not think so. For decades oil nationalism has pervaded the region and governments of whatever hue have found it convenient to trumpet the virtues of keeping national resources under their direct control – in the interest of the people, of course! Iraq's oil is likely to remain nationalized, the ministry of oil will continue to be all-powerful and future Iraqi governments will carry on relying as much as ever on revenues from oil. All this reminds me of Peter Cook's remark, 'I have learnt from my mistakes and I am sure I can repeat every one of them'. I am afraid the Iraqis will go on waiting for their oil.