Energy and power: The role of oil in Iraq and the Middle East

Giandomenico Picco

Giandomenico Picco is the chief executive officer of New York-based GDP Associates, Inc., a consulting company to corporations seeking to operate in emerging economies. From 1973 to 1992, Picco was an official of the United Nations, with responsibilities for, among other things, the UN efforts that led to the release of the Western hostages in Lebanon. For his role in this saga, he was presented with the highest civilian honors of the US, Germany, UK, Lebanon and Italy.

In 1999 he was appointed Personal Representative of the United Nations Secretary General for the UN Year of Dialogue Among Civilizations. Since 2001 he has been a member of the UN Secretariat Policy Working Group on the UN and Terrorism. In 2003 he was appointed Advisor to the UN Secretary General. He has authored and coauthored numerous books. Picco holds a graduate degree in political science from the University of Padua, Italy; and a master of arts in international relations and comparative politics from the University of California, Santa Barbara.

The question of whether the U.S. war against Iraq was about oil overlooks an important point, said Giandomenico Picco in his address to the Forum. "It's impossible to talk about Iraq without talking about oil; they are very much one and the same."

Since the end of the fighting, the talk has turned to Iraq's potential output once the oil fields are producing at capacity, sending signals to the region that significant competition is on the way. In response, Saudi Arabia and Iran have separately announced that over the next few years they will be increasing their own production.

"The announcements by these two largest oil-producing countries in OPEC mark the beginning of the era of Iraq oil after the war," said Picco. "They are basically saying to whoever is thinking about extra production from Iraq, 'Be aware; we know the game is on and we're going to be players.'"

For Saudi Arabia and its position in the cartel, the decision to increase production means they have no intention of relinquishing their controlling role in setting the price of oil.

"Saudi Arabia has always been the determining factor in OPEC's oil prices, not just because of the quantity they produce, but because they can produce at the lowest cost possible. Consequently, they're less concerned with price than they are with retaining market share, which, in turn, determines how they play with the price."

The Iranians on the other hand fear that Iraq will one day be able to outproduce them and thus diminish Iran's standing in OPEC. "That is a matter that has to do with prestige and politics and power."

While UN sanctions technically shut Iraq out of the oil market from 1990-1995, the Oil for Food Agreement allowed Iraq to start pumping oil again in 1996. Under this program "the majority of Iraqi oil went to America and continues to come to America, lifted under the names of different companies." (Lifting refers to tankers and barges taking on cargoes of oil at the terminal or transshipment point.)

It is well known that there are abundant oil reserves in the areas around Kirkuk, north of Baghdad, and in the south, around al Basrah, noted Picco. "But the real story of the Iraqi oil industry is the western desert, which remains untouched and unexplored so far. Many, many countries and many companies have already shown a tremendous amount of interest in this area. Some say the reserves would be larger than Saudi Arabia's reserves."
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Picco speculated that if he had been a strategist in Washington a couple of years ago, he would have concluded that the potential of the western desert was a very good reason to have a more friendly relationship with a different government in Baghdad.

Betting on the future of Saudi Arabia and Iran is a gamble from a political point of view. "So, if I'm not a gambler, I go and sit in Baghdad and wait for a more benign government to materialize in Iraq." He didn't claim this was the reason for the U.S. war on Iraq, but suggested it was an interesting scenario to think about.

Reversal of nationalized oil?

According to Picco, an issue being raised in many quarters is whether the nationalization of Iraq's oil industry, decreed by Hussein in 1972, will be reversed. "Nobody knows the answer to this yet."

If it remains nationalized, it brings into question "the relationship between foreign oil companies (FOCs) and Iraq. These relationships are defined by the kind of agreements that exist: buy-backs which are usually not profitable for oil companies and production sharing agreements (PSAs)." (A buy-back occurs when the FOC provides the technology and agrees to be paid back over time a percentage of the oil that is produced by the technology. Under a PSA, the FOC acquires an entitlement to a stipulated share of the oil produced as a reward for the risk taken and services rendered.)

Whether Iraq opts for buy-backs or chooses PSAs is very important to the economic health of the country, said Picco.

Other questions relate to how exploration in the western desert will proceed -- slow and easy or at full speed; and the use of existing pipelines, which brings up the issue of ownership.

"Using the Syrian pipeline and the Saudi pipelines has a particular meaning with regard to the relationships with those countries. There are pipelines in the Middle East that are not so famous and could change the face of the region."

On what basis could that happen?

"Imagine if today you were to lift oil from Iraq and go around the Arab Peninsula. But instead of going through the Suez Canal and the Sumed pipeline in Egypt, you were to go to the Israeli pipeline from Eilat to Ashkelon, put your oil in a lot, and have somebody from Europe come and pick it up in Ashkelon, Israel. Something like this, which has not been done before, would represent a change not only in the oil industry but in the political climate as well."

A Forum guest asked about the future of the oil exploration contracts that were negotiated during the period of sanctions. "Will the authorities walk away from them?"

"I don't know the answer but it's a very tricky business," Picco said. "What do we do if we have a contract signed with a regime and then the regime changes? Is the contract canceled? Is the foreign debt canceled? Because if that is so, I'm going to arrange fake coup d'etats in every African country just to abolish the contract and the foreign debt."
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Future of Mideast oil

Looking at Iraq in the context of where the oil industry is headed in the next ten years, two major trends can be seen, said Picco. "On one side is Russia and on the other side is the huge number of countries, including China, which has made a policy choice to limit as much as possible their imports from the Middle East with the goal of diversifying their sources and reducing their dependence on Mideast oil."

Russia is gearing up to become a larger producer and will be able to ship, via projected pipelines, to China and by tank to the United States. "Russia is going to be a player in the game in the next eight to ten years. The quantity will be there," said Picco. "So if you have instability in the Middle East, Russian oil will have a great advantage coming from what everybody hopes is a more stable environment.

Capacity and stability equal a winning hand. "If you're able to put together an industry in Iraq that is productive and on top of that has a stable government, then you have a winner that none of Iraq's neighbors at the moment wants to gamble on."

Who's going to deal that hand?

"I'm not predicting that Iraq will become the 51st state, but the sense of things is that it's going in that direction," said Picco.

A Forum guest asked how Syria and Jordan might be impacted by the change in control of Iraqi oil. "What's that going to mean for their economies and how politically adaptive are they?"

"The oil pipelines in that region may have an effect on where countries are going in terms of politics. The Iraqi-Syrian pipeline was closed because of hostile feelings between the leaders. But the pipeline is still there and it's an important one. It could be used as leverage to get Syria to do a few nice things. This is a commercial transaction with high political value."

He was upbeat on the prospects for Iraq. "With a little imagination, it's easy to see how Iraq could become a fantastic country in the next few years. Even if we're not successful in bringing democracy to the area, just by using the economics of this place, we could change the entire region."

Hezbollah: A very dangerous organization

Syria's major role in the Middle East has been to host Hezbollah, "the most organized fighting force in the region," said Picco. "They number a few thousand people and are tough as nails. They know how to use weapons; they know how to use deceit." He agreed with Dan Brumberg who called Hezbollah "a very dangerous organization" fanatically opposed to the existence of a Jewish state.

Said Picco, "With technology instruction from the Iranians, Hezbollah was able to raise the level of their military expertise to the point where they would hit the Israeli Army and the Israelis would not know where the hit came from. They've never had a military operation with the Palestinians because they consider Palestinians amateurs and untrustworthy.

Comparisons could be made to the Irish Republican Army, which was dedicated to ending British rule in Northern Ireland through force and violence. But in 2000, the IRA renounced terrorism.
"I think in many ways Hezbollah is much more ideological than the IRA and much more difficult to deal with because of its objection to a two-state solution," said Brumberg. "And they will be there to undermine whatever kind of progress we make."

"In addition to their military, Hezbollah also has a strong political branch and runs a social welfare state: schools, hospitals, factories, farms, shops and so on," said Picco. "They pay salaries, pensions and rent. They have eight members of Parliament in Beirut, so they're a political party as well."

Except for their mutual hatred of Israel, profound differences separate Hezbollah, which is made up of Sunnis, and al-Qaeda, which is made up of Shiites. "Anybody who says that these organizations have a connection of some sort is putting out wrong information. It cannot happen," said Picco. He repeated, "It cannot happen."

Asymmetry rules

“Something has happened over the last few years that have been brought to the forefront in this country by Sept. 11. It was there in other dimensions before, and in one way or another we now have to accept that we live in a world of asymmetry where previously held assumptions are no longer reliable. Too many people still believe that strength rules. But in the new world we live in, asymmetry rules. Even one individual can create havoc in the entire world. That in a way has become true because everybody gets mixed up with everybody else, either economically or because we travel or whatever.

"We don't know yet how to handle the world of asymmetry. So we get all upside down because we have individuals in this world, not only in the Middle East, who actually can make a difference for better or worse. How do we handle this world of asymmetry which seems to be the predominant rule of the game? We don't know, because I think it's the first time we've had to deal with it. So we try to grab for some kind of assurance that maybe is no longer there." --Giandomenico Picco