

OIL POLICY OF THE MIDDLE EAST COUNTRIES IN THE GLOBAL OIL MARKETS AFTER IRAQ WAR

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Abstract

Our assessment is that the immediate terrorist effects Iraq has generated are not as dramatic as commonly supposed but that the long-term effects have yet to be determined. In years to come, training and tactical development in Iraq will likely be one of several factors contributing toward the growth of terrorist movements, the others being determined primarily by domestic circumstances.

One of the most significant is what can best be termed a sense of Iraq fatigue among neighboring states the belief that, while the conflict and Iranian influence in Iraq are certainly alarming, they have been superseded by more-pressing "local" concerns, particularly in the Levant. Threat perceptions of Iran also vary significantly, both across different subregions and countries and between governments and their publics.

Taken in sum, these dynamics present both challenges and opportunities for U.S. regional policy. Understanding gaps between U.S. and regional views of the conflict's consequences and implications will therefore be paramount particularly for gauging the willingness of neighboring states to cooperate on U.S. objectives. Similarly, the United States must be attentive to how the post-Iraq environment, especially altered views of U.S. power and credibility, have opened up possibilities for new paradigms of regional security cooperation, involving traditional Middle East allies but also extra regional states, such as Russia or China.

Keywords: *Middle Eastern states, Iraq War, U.S. efforts, Gulf Investment Corporation, Economic Agreement, Gulf Cooperation Council.*

Introduction. Close to seven years after the invasion of Iraq, the Middle East is a region in flux. Regardless of the outcome in Iraq, the ongoing conflict has shaped the surrounding strategic landscape in ways that are likely to be felt for decades to come.

The Iraq War's reverberations in the region are broad ranging, affecting relations between states, political and societal dynamics inside states, the calculations of terrorists and paramilitaries, and shifts in public views of American credibility. The balance sheet of these changes does not bode well for long-term U.S. objectives in the Middle East. That said, a better understanding of how Middle Eastern states and no state actors are responding to the war's aftermath can help contribute to U.S. policies that may better contain and ameliorate the negative consequences of the conflict and perhaps even increase U.S. advantage. Until the 2003 Iraq War, the regional balance of power has always involved Arab powers and Iran. Today, that balance has shifted toward Iran, although the internal unrest within Iran following its 2009 presidential election may significantly constrain Iran's maneuverability abroad. Still, the perceived removal of the Iraqi buffer to Iran following the Iraq War led to widespread concern among Arab states that Iran can more easily maneuver in the core of the Middle East, from Lebanon to Gaza. The ousting of the Iraqi leader created the perception of increased vulnerability on the Arab side, resulting in a tendency to exaggerate the specter of Iran and its associated nonstarter allies.

Statement of the task. The aim of our work is to determine how the states should develop its foreign policy after Iraq War. Encourage Arab regimes to adopt incremental yet meaningful political reform as part of a long-term push to counter radicalization and ensure the viability of key U.S. partners. To mitigate the war's effects inside key regional states, U.S. policy should focus both on ensuring that governing regimes do not abuse their newly entrenched power to crack down on domestic opposition and should take measures to prevent weakening state conditions from evolving into failed states (with all the accompanying problems that involves: shelter for extremists, a magnified proliferation danger, greater potential for massive human rights abuses). This suggests that U.S. policy should recognize the long-term security implications of continued repression and should avoid putting regional reform on the back burner, even if the focus shifts from holding elections to strengthening democratic institutions and practices.

Results of the study. This work has surveyed the implications of the Iraq conflict for the Middle East strategic landscape, showing how the full effects of the conflict are more expansive yet also more nuanced than is commonly assumed. Previous analyses of the "Iraq effect" have used a conventional balance-of-power lens that divides the new regional map too neatly between an ascendant Iran and an opposing bloc of Sunni Arab states. Others have overstated the potential for a contagion of sectarian conflict and increased terrorist incidents resulting from the conflict. We found that, while elements of these trends are certainly present, they do not reveal the full complexity of regional developments. They also at times miss more-subtle perceptual shifts among neighboring regimes, Arab publics, and nonstate actors.

Analysis of research and publications. In this work was bringing reference from foreign authors' books, articles, and reports and from internet resources. In addition, was benefited from the materials which mentioned end of the paper. A comparative analysis of regional and international situation after Iraq War was studied by scientists: Askari H.T. "Collaborative Colonialism: The Political Economy of Oil in the Persian Gulf", Fishman B.A. After "Zarqawi: The Dilemmas of the Future of Al Qaeda in Iraq", Mohamed A.T. "The GCC Economies: Stepping Up To Future Challenges", Roderic H. D. "Where is the Middle East", Gaballah K.A. "Experts: Iran Mapping the Future of the Region Together with Saudi Arabia in the Absence of an Egyptian Role".

Because of the richness in oil and gas resources, the GCC states have not developed much in the non-oil sector of their economies. Industrial development, particularly outside the oil sector, is vitally important for independent, sustained, and productive growth. The Economic Agreement sets forth the aspirations of the six members for development in industry and agriculture.

The best place to start this discussion of industrial development is with the Gulf Organization for Investment. Over the years, it has been called by such other names as Gulf Investment Authority and Gulf Investment Corporation. The basic statute of the GOI was approved on 19-20 June 1982 in Riyadh by the GCC finance and economic ministers. At the time, it was mistakenly reported that the Bahrain finance minister had said that the capital of organization would be 200 million shared by the six member states that the each state was entitled to offer 49 percent of its share to its own citizens [1, 21]. Other sources reported that no final decision on capital had been made.

Reviews the role and extent of oil revenue recycling and its implications for global financial stability. It identifies a number of policy issues relevant to the international de-

bate on current issues in money and finance relating to the six member states of the Gulf Cooperation Council. One of the distinctive features of the world economy in recent years has been the ongoing and marked increase in oil prices. The nominal price of Brent crude oil reached a historical peak in the first quarter of 2008, while its real price has roughly quadrupled since early 2002, exceeding the record level reached in 1974, though still falling short of its maximum in 1979. Hence, the scale of the present price hike is in many respects comparable to the oil price shocks of the 1970s, even if it is taking much longer to unfold. Moreover, the hike in oil prices coincided with a rise in global oil production by 9.6% and an increase in global oil consumption by 7.7% from 2002 to 2006. As a result, oil-exporting countries have experienced substantial windfall gains. It is important to note that the main beneficiaries of these windfall gains are just a handful of countries, among them the six economies of the GCC, which together hold roughly 22% of world crude oil production [2, 21].

Taking cumulative current account surpluses as a rough benchmark for measuring the pool of petrodollars available for recycling is common practice. The upswing in these balances has been remarkable. Whereas many GCC countries exhibited current account deficits during the 1990s, sizeable current account surpluses have been recorded since 2003, ranging from an estimated 7.1% of GDP in Oman to 35.7% in Qatar in 2008. The total current account surplus of the GCC region is expected to increase from USD 25.5 billion in 2002 to USD 207.3 billion in 2008. Taking a broader perspective, the rapid rise in oil-exporting countries' current account balances is even more impressive. The joint current account surplus of Norway, Russia and the OPEC member states is forecast to surge from USD 88.2 billion in 2002 to USD 412.5 billion in 2008 [3, 18].

The flipside of these huge current account surpluses is a significant redistribution of income from oil importers to oil exporters. This has contributed to the current configuration of global current account imbalances. As depicted in, external positions have widened on an unprecedented scale in recent years, with world deficits mainly concentrated in the United States and world surpluses spread across a larger number of economies, including many emerging market countries [4]. In particular, within less than a decade, oil-exporting countries have emerged as a major net supplier of capital, even outpacing the overall current account surplus growth posted by emerging Asian countries from 2004 to 2006. In the medium term, however, oil exporters are not expected to keep up with the rapidly growing Chinese position – as already corroborated by the 2007 and 2008 forecasts. If oil exporters want to deploy their oil revenues, they have two options: oil revenues can be used either for the import of goods and services (trade channel or absorption channel) or for the purchase of foreign assets in international capital markets (capital account channel). In the first case, some of the oil revenues are re-directed towards goods and services markets in other (often oil-importing) countries, which lowers the GCC countries' current account surpluses and reduces the negative effects that higher oil prices have on purchasing power (and thus growth) in oil-importing countries.

All in all, this balance of payments data evidence suggests that GCC countries currently invest roughly half of their oil revenues in financial assets. Traditionally, financial investment has been channeled through central banks and monetary authorities. Particularly in recent years, however, the fairly stable increases in the official foreign exchange reserves of the GCC region, whose stock totaled USD 76 billion in 2006, have not kept pace with the surge in its current account surpluses. Instead, there has been a

proliferation of SWFs. These funds are nothing new – one of the world’s first SWFs was founded in Kuwait as early as 1953 – but only in recent years has their rapidly growing size attracted public attention [5]. None of the GCC region’s SWFs disclose detailed figures on their assets under management, but rough market estimates corroborate that their assumed overall size already forms a multiple of recorded foreign exchange reserves, from USD 750 billion to USD 1,500 billion. It should be noted, however, that the lines of demarcation between investment by a SWF and a central bank might be blurred – as in the case of the Saudi Arabian Monetary Agency. As of 31 December 2007, SAMA reported USD 335 billion in non-reserve holdings of international assets on and off its balance sheet. Consequently, in its recent Global Financial Stability Report, the IMF included these assets in its analysis of SWFs.

When analyzing financial petrodollar investment it is essential to keep in mind the governments motives. Although the GCC countries disclose very little on that issue, three possible motivations can be identified. First, traditional foreign exchange reserves, which are generally managed by a central bank. The management is required to focus on highly liquid assets and to follow a relatively conservative investment policy. Second, stabilization funds, the purpose of which is to smooth government expenditure and decouple it from the short-term volatility of oil revenues so as to avoid boom-and-bust cycles. Though stabilization funds have a medium-term horizon, considerations of liquidity and low risk remain important because the funds may be drawn upon at relatively short notice. Last, petrodollars are “genuinely” saved, i.e. handed on to future generations [32, 199]. These funds are particularly relevant in countries where the life-span of the known oil resources is relatively short, i.e. namely in Bahrain and Oman. Their long-term horizon means that savings funds can afford to invest in a much broader range of assets and to take on more risk. Basically, both stabilization and savings funds can be managed by central banks or SWFs, but they are usually associated with the latter.

Analyzing financial petrodollar recycling in detail is much trickier than assessing trade aspects, because the related disaggregated capital flows are reported only sketchily by the GCC countries central banks, monetary authorities and SWFs. As consequence, the analysis mainly relies on counterparty information – which is rather thin on the ground owing to the limitations of official statistics [3, 13].

The BIS locational banking statistics are an important source of counterparty information. These report on international commercial banks net liabilities vis-à-vis individual countries. The GCC countries net claims against the international banking sector, worth USD 65 billion in the third quarter of 2007, amount to only half of their historical peak in 1990 [6]. Moreover, against the benchmark of the regions cumulative current account surplus, it becomes evident that the GCC economies claims reported to the BIS represent a rapidly declining percentage of their overall financial resources invested abroad – or, in other words, that the recent additional oil export revenues have mostly been invested in other asset classes. Further evidence provided by the BIS shows that of the roughly USD 450 billion stock of gross deposits made by OPEC member states in the fourth quarter of 2006, 11% was placed in BIS reporting banks in the United States, 20% in offshore centers and the lions share in Europe. These figures hint at oil exporters having a geographical preference for London as an international financial center. It can also be deduced from the data that geographical preferences seem to be unrelated to considerations of currency composition, since OPEC member states hold 70% of their

European deposits in US dollar accounts. Nevertheless, there is evidence that the currency composition of OPEC deposits in BIS reporting banks has recently been more sensitive to changes in interest rate differentials than in the past.

A second source of publicly available counterparty information is the US Treasury International Capital data, which provide a geographical breakdown of foreign portfolio holdings of US securities. The GCC regions investment in US securities has risen noticeably in past years. In a worldwide comparison, the holdings of GCC countries showed the most rapid growth during the period from June 2005 to June 2006 on a percentage growth basis, increasing by just over 50% from USD 161 billion to USD 243 billion. Thus, a considerable part of the recent additional oil export revenues has been invested in the US financial market. A more in-depth look at the breakdown of the TIC data suggests that GCC countries have diversified their reported assets over the full range of US securities [7].

Since 2002, the share of US equities has hovered at around 50% of the GCC region's US securities portfolio, while its demand for short-term US government debt has – most notably – increased from 4.4% to 14.5% during the same period. But an important caveat must be added: the TIC statistics do not track the original source of funds entering a country so that third-party purchases cannot be identified. In view of the enormous size of recent UK purchases of long-term US securities and the apparent correlation between these purchases and the oil price, it may be assumed that securities purchases via the United Kingdom represent a key channel for petrodollar investment [8]. As a consequence, the true extent of oil exporters' investment in the United States may be significantly understated in the official statistics.

A third source of counterparty information is the Zephyr database, distributed by the Bureau van Dijk, which contains flow data on M&A, IPO and venture capital deals on an international basis. Reliable data are only available from 2003 onwards, but it can still be seen that the GCC countries' appetite for these transactions is strong and picked up considerably in 2006 and 2007, with total deal values amounting to USD 37 billion in 2006 and USD 51 billion in 2007 [8].

Piecing together the information obtained from these three sources leads to the following conclusions. First, GCC countries have diversified their international investment portfolios. In contrast to the 1980s and 1990s, the importance of international bank deposits has declined. Instead, US securities and M&A make up a more significant share of the GCC regions identified net foreign assets. This rise in risk propensity is corroborated by anecdotal evidence. According to this, the regions SWFs make use of their more progressive investment mandates and of today's broader investment opportunities in order to hold instruments ranging from fixed income, shares and real estate to hedge funds, private equity and other high-yield product classes. It is also felt that GCC countries currently tend to invest in a more profit-oriented way than other major oil-exporting countries, such as Nigeria, Norway, Russia and Venezuela. Second, as indicated by both the TIC data and the currency decomposition of the BIS data, the United States is still the main recipient of GCC countries funds. Third, and in contrast to the previous episodes of higher oil prices, growing risk appetite seems to be resulting in an increasing role for emerging market investment – which is not captured in the above mentioned third-party statistics.

Gulf Cooperation Council countries have seen impressive economic development in recent years, making the region one of the most prosperous in the world. Based on

surging hydrocarbon revenues, these countries as a group have nearly doubled their nominal GDP since 2003 to an estimated USD 791 billion in 2007. The tripling of oil prices over this period has further strengthened the already prominent role played by the hydrocarbon sector, which accounted for nearly half of the aggregate GDP in GCC countries in 2006. The main export good is oil, representing, on average, 70% of GCC countries total exports over the period 2003-2007. In 2006 the GCC region accounted for more than one fifth of world oil production. Moreover, 40% of proven world oil reserves and about 23% of proven world gas reserves are located in the GCC area.

Three GCC countries are among the top ten countries in terms of proven oil reserves. On current production levels, Saudi Arabia's oil reserves are expected to last for 77 years. This paper focuses on GCC countries role as energy suppliers and trading partners from a global and regional perspective. It provides facts and figures on issues related to energy and trade and complements, which deals with economic structures and developments in the GCC region and on current issues in money and finance.

Energy requirements for water desalination and power generation are expected to raise one-and-a-half-fold. In addition, energy demand for transport, as well as for industrial use will approximately double the latter also reflecting rising energy consumption by the newly established energy-intensive aluminum industry in some GCC countries. Dependency on oil imports is high in the EU, the United States and China, and is projected to rise even further. In 2004, the oil dependency rate of the EU was 79% [9, 80]. Oil, including oil derivatives, and gas accounted for 37% and 24% of energy consumption in the EU, respectively, followed by coal, nuclear energy, and renewable energy. The EU's oil-import dependency rate is expected to reach 92% in 2030, mainly reflecting the depletion of oil reserves in the North Sea, while demand is expected to remain virtually constant. In the United States, 64% of oil consumption was imported in 2004; in 2030, this share is expected to rise to 74%, reflecting both increased demand and lower domestic production. IEA estimates also suggest that China's oil import dependency rate will climb to 77% in 2030, up from 46% in 2004. As in other dynamic emerging market economies, the increase in China's dependency on oil imports is mainly caused by a strong increase in fuel consumption.

The tripling of crude oil prices since the beginning of 2003 may necessitate a reassessment of demand and supply projections. In early 2008, the oil price hit USD 100 per barrel, bringing it close to its all-time high of 1979 in real terms. While OPEC's oil supply assessment is based on an implicit price target in the range of USD 60-70, most observers expect that the price of oil and oil derivatives will remain at an elevated level and may increase even further both in nominal and real terms [10]. This could lead to significant changes in future demand and supply patterns. At the same time, experience suggests that the price of oil, like the price of other commodities and raw materials, has a strong cyclical component. Moreover, the oil price has frequently been subject to various shocks on the supply side, including natural disasters, political developments in major oil-producing countries and geopolitical tensions.

As a result, further technical progress in energy efficiency remains key to reducing the use of crude oil, in particular, in the automotive sector. Unlike energy consumption for industrial purposes, energy demand in the transport sector is still nearly exclusively covered by oil. The IEA estimates that oil demand for transportation purposes will grow at an annual rate of 1.7% over the period 2005-2030. Since oil demand grows with higher rates of motorization, the IEA expects nearly half of the increase in oil demand

for transport purposes to come from China and India, where rates of motorization are still relatively low.

Existing oil reserves place GCC countries in a unique position in terms of covering future oil demand. According to BP, proven oil reserves comprised 1.2 trillion barrels worldwide in 2006, of which the Middle East holds 61%. Two-thirds of Middle Eastern reserves are located in GCC countries. Hence, the GCC countries own approximately 40% of the world's oil reserves. In addition, Qatar holds 14% of world proven gas reserves. While oil reserves, as well as their projected depletion rates, differ significantly among GCC economies, GCC countries as a group have by far the largest share of the world's proven oil reserves. However, these oil reserves are of lower quality and are therefore more costly to process.

GCC countries investments in the exploration and development of oil are estimated to grow significantly. The IEA projects an increase in GCC oil producing countries' investment from USD 39 billion for the period 2004-2010 to USD 90 billion between 2010 and 2020, climbing to USD 131 billion between 2020 and 2030. However, the comparatively low costs of oil exploration and development mean that the GCC countries' total investments will represent less than one-tenth of global investment over the period 2004-2030. As a result, GCC countries share in global oil supply should increase to 24% by 2030. Approximately one-fifth of GCC countries oil production in 2030 is expected to come from fields currently awaiting development; about another fifth is projected to come from reserve additions and new discoveries (IEA, 2005). The aggregate market share of the Middle Eastern oil producers is estimated to increase to 39%. This results partly from an expected strong increase in Iraq's oil production.

On a global scale, there is currently a significant lack of refinery capacity. Increasing refinery capacities are pivotal to meeting the growing demand for gasoline and other oil derivatives. In addition, existing refining capacities must be upgraded in order to meet demand for higher quality oil derivatives as China and India – among other countries – are progressively tightening their fuel quality standards and adopting Euro-standards for transport fuels. Furthermore, available crude oil is becoming heavier and sourer, while demand for light and middle distillates is on the increase. At the same time, current refinery bottlenecks are likely to remain in place for some time to come:

- Expanding distillation capacity takes time and is uncertain. The lead-time for a refinery project is from four to five years. Additionally, not every announced capacity expansion actually takes place. The Middle East is seen by OPEC to account for 2.6 mb/d out of 7.4 mb/d in distillation capacity additions over the period 2006-2012. These overall additions equate to one-tenth of current global distillation capacity.

- Implementation of planned projects to alleviate refinery shortages is subject to some degree of uncertainty. A lack of skilled labor and rising material costs could delay projects, while environmental concerns can raise investment costs significantly. Moreover, uncertainty about future returns can discourage investors as margins in the refinery business have been low in recent decades and have only recently been improving.

- The US refinery bottleneck is expected to continue. In the United States, no new refineries have been built since the late 1970s, reflecting environmental restrictions, while local demand is growing.

While the GCC countries as a group own about 23% of global gas reserves, their gas production is significantly less than one-tenth of current global production. Qatar is

the only GCC country with significant gas reserves on a global scale, accounting for 14% of the world's natural gas reserves. Saudi Arabia has a share of 3.9% of global gas reserves, the UAE account for another 3.3%. Bahrain, Oman and Kuwait together have a share of less than 2%. Annual growth in world gas production is projected to be 2.1% between 2005 and 2030, reaching nearly 4.8 trillion cubic meters in 2030, up from less than 2.9 tcm in 2005 [11, 11]. Over the period 2004-2030, GCC countries are expected to invest around USD 120 billion in gas exploration and development, with Qatar being the main investor, contributing more than half of total GCC investments. Qatar is expected to be the only net gas exporter among GCC countries in 2030; net gas exports are estimated to increase from 19 billion cubic meters in 2003 to 152 bcm in 2030, accounting for nearly 5% and 16% of world gas trade, respectively [4].

Gas is expected to withstand the worst of the rise in primary energy demand within the GCC countries. This is partly caused by the GCC economies' efforts at strengthening their position in the world aluminum market by taking advantage of their comparative cost advantage in the energy-intensive aluminum production business. While energy represents 38% of total costs for a smelter in China, the equivalent figure for Saudi Arabia is 7% given cheap domestic gas, which is mainly conveyed as a by-product Saudi British Bank as reported in FT, Special Report. In addition, gas is used for domestic power generation and water desalination.

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