

Testimony before the House Subcommittee on Energy and Air Quality

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Mr. Chairman, members of the subcommittee, ladies and gentlemen:

Let me begin by commending the subcommittee for holding hearings on the UN's Oil for Food Program. It is a subject that is both important and – particularly given the Administration's efforts to seek another UN Security Council resolution dealing in large part with the program -- timely.

Out the outset let me stress that my views do not necessarily reflect those of the Baker Institute for Public Policy; they are entirely my own. I would, however, like to thank my colleague at the institute, Amy Myers Jaffe, for her extensive and invaluable assistance in preparing this testimony.

In my remarks today, I will outline the rationale for the creation of the Oil for Food Program under UN auspices, explain how the program functioned, discuss the impact the program had on the stability of international oil markets, and conclude with some closing observations on the proper course for handling the future sales of Iraqi oil. I will not specifically address the elements of the US draft resolution currently being discussed at the UN Security Council. But my comments will make clear that I support many of the draft resolution's main features related to the Oil for Food Program.

Before I turn to these details, I would like to first emphasize several critical points that will, I hope, be useful at the subcommittee considers this important issue.

Key Points

- 1) Whatever decisions are taken on the Oil for Food Program and the resumption of Iraqi oil exports, the goal must be the prompt and adequate supply of humanitarian and reconstruction aid to the Iraqi people. Their interests must be paramount; it is the current and future well-being of Iraqis, after all, which is at stake. Any proposal on handling Iraq's oil exports must be judged in this light.
- 2) The Oil for Food Program was created for the purpose of stopping the regime of Saddam Hussein from acquiring funds to purchase weapons of mass destruction and further expand its traditional military might. With the fall of Saddam's regime, the purpose to this program no longer exists. It should be phased out.
- 3) Iraq faces daunting security and structural challenges in its efforts to resume uninterrupted oil exports. It seems possible that an interim Iraqi government or authority could be in place before oil starts to flow in significant amounts. The United States should make it a priority to help set up an interim government that would be able to handle a resumption of oil sales, while encouraging an international effort to provide relief until oil begins to flow.
- 4) Oversight of oil revenue is best handled by multinational agencies such as the International Monetary Fund and World Bank. The Fund will presumably be involved in such critical matters as rescheduling Iraqi debt in any case; the Bank will no doubt be called upon to play an important role in Iraqi reconstruction. I note that the Administration supports an oversight function for the Fund and the Bank (as well as the UN) in its proposal to create an "Iraqi Assistance Fund" to serve as a repository for the country's oil revenues.

- 5) Significant funds remain in the escrow accounts under the current UN Oil for Food Program. These funds need to be disbursed to pay for emergency aid to Iraq. It might be best to permit the UN to continue managing these funds, on an expedited and transparent basis, until the balance is liquidated. I note again that the US proposal at the UN suggests something along these lines.
- 6) The Iraqi oil sector possesses a large number of highly competent professionals and technicians, almost all untainted by association with human rights abuses under Saddam's regime. These individuals can be relied upon to conduct the sales and marketing of oil by the country and to manage the operations, maintenance, repair and reconstruction of Iraq's petroleum sector. Comprehensive involvement of Iraq's oil technocracy is extremely important for practical and political reasons. Many senior members of Iraq's oil elite are nationalistic in their attitudes. They – like many other observers in Iraq and around the world -- will be extremely sensitive to any suggestion that the United States or our coalition partners view Iraq's oil resources as “the spoils of war.”
- 7) The coalition has a vital short- to medium-term role to play in providing security to Iraqi professionals and technicians working in the oil sector, as well as protecting the actual fields and key infrastructure. The lack of security for these workers and their families represents a major impediment to resuming normal operations in the Iraqi oil sector today.

Background

UN Resolution No. 986, which was adopted by the Security Council in April 1995 and finally implemented in December 1996, enabled Baghdad to sell specified

dollar amounts of crude oil over six-month periods, in part for the purchase of humanitarian supplies for distribution in Iraq under UN supervision. In December 1999, the Security Council voted to remove limits on the amount of oil Iraq could export as Baghdad's production capacity was enabling it to reach the previously established sales ceiling of \$5.2 billion per six-month period. Roughly 72% of the total revenues from the Oil for Food program have been allocated toward humanitarian needs. The remaining proceeds help pay compensation for Gulf War victims (25% since December 2000), pipeline transit fees to Turkey, spare parts and maintenance for the oil sector, funding for UNMOVIC and administrative and operational costs for the United Nations.

UN supervision included monitoring of Iraq's crude oil supply contracts to ensure at-the-market pricing (to discourage side, kickback payments); monitoring export shipping volumes at Iraq's main port of Mina Al-Bakr and at the Turkish pipeline outlet at Ceyhan (to discourage smuggling); management of the escrow account for oil revenue receipts and humanitarian aid disbursements; and oversight of contracting for the importation of goods to ensure that no banned materials reached Iraq.

Oil sales activities under Oil for Food were handled directly by members of the Iraqi government State Oil Marketing Organization (SOMO) and had no UN involvement. Rights to sell the oil were retained by the sovereign Iraqi state and not transferred to the United Nations. The rights to exported oil were transferred directly from SOMO to the purchaser. Iraqi government officials also selected the goods and vendors for the importation of humanitarian assistance. The UN's role was limited to monitoring these activities to ensure that no transactions occurred that would allow Iraq to continue to fund and develop its weapons program.

Since the Oil for Food Program first went into effect on December 10, 1996, Baghdad has exported around 3.4 billion barrels of oil under UN supervision worth about \$64 billion dollars. About \$44 billion worth of humanitarian supply contracts including \$3.8 billion worth of oil spare parts and equipment, have been approved by the 661 Sanctions Committee and “fast-tracked” by the UN Office of the Iraq Programme. In mid-2002, around \$22.6 billion worth of humanitarian supplies and equipment had actually been delivered to Iraq, including \$1.4 billion worth of oil industry equipment, while another \$10.5 billion worth of humanitarian supplies, including \$1.7 billion worth of oil industry equipment, were in the production and delivery process. The UN says that about \$10.1 billion worth of supplies are currently in the pipeline.

Broadly speaking, the program was successful in depriving the Hussein regime of large revenues to use to fund weapons and military programs. However, government and industry estimates suggest that Iraq earned over \$8 billion in revenues since 1997 through illegal smuggling and hidden surcharges.

It is ludicrous, given the US and coalition presence in Iraq, to suggest that Iraqi oil revenues will now be used to acquire weapons of mass destruction. In addition, there is no precedent for the United Nations to monitor national oil sales to prevent “corruption.” It is my opinion that issues of transparency and accountability in handling Iraq’s oil revenues would best be handled by multinational institutions normally charged with financial matters and economic development – notably the International Monetary Fund and the World Bank.

Over the course of its existence, the politics of the Oil for Food program has served as a key driver of oil price volatility. Concerns about the reliability of Iraq’s UN-

monitored oil exports were a major factor causing swings in the market in recent years. Periods of program evaluation and renewal debate prompted severe disturbances in international oil prices as oil traders worried that unsettled UN politics might result in a sudden -- albeit temporary -- cut-off of Iraqi oil exports. Saddam Hussein also demonstrated a willingness to use the "oil weapon," sporadically refusing to continue to participate in Oil for Food for weeks or months in order to manipulate oil markets and display his personal power. It is important that Iraq's new oil regime be designed to create a transparent, predictable environment where changes in the flow of exports do not disrupt markets and where a UN process cannot influence the stability of those flows.

Ironically, Saddam Hussein's political use of Iraq's petroleum sector did not result in the kind of damage to oil field capacity that might have been expected. This was due in large part to the capability and dedication of Iraq's oil professionals, who managed remarkably well in an atmosphere marked by Saddam's Hussein's volatile interventions, an almost complete lack of foreign investment, and a crippling shortage of spare parts and maintenance equipment. This bodes well for the future prospects of the Iraqi industry. Failure to utilize Iraq's oil professionals in managing the production and marketing of the country's petroleum could result in a serious backlash in Iraq and a public relations problem around the world. Given suspicions (pervasive, if unfounded) that the United States invaded Iraq to control its oil, our actions in regard to the Iraqi oil sector must be above reproach.

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