

The Stakes in the Iraq Oil Sales Dispute

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Brief Analysis

Iraq and the United Nations are in the fourth round of negotiations about terms for implementing UN Security Council Resolution 986 -- an arrangement to permit limited and controlled oil sales to provide Baghdad with funds to purchase humanitarian goods. The talks hit a snag in late April, when the United States and the United Kingdom objected to concessions UN Secretary-General Boutros-Ghali made on two key issues: control of the money and distribution of humanitarian supplies. What is at stake for Washington?

Background: Faced with Saddam Hussein's refusal to cooperate with Gulf War resolutions and his indifference about the suffering he was inflicting on ordinary Iraqis, the UN Security Council in August 1991 approved Resolution 706, authorizing limited oil sales to pay for humanitarian supplies. After protracted negotiations resolved the technical issues, Saddam rejected the deal in mid-1992 on the grounds that it infringed upon Iraqi sovereignty. He was unwilling to see the UN closely monitor the revenue, which he would otherwise have diverted from humanitarian ends to purposes he cares about more, such as arms purchases. Faced with Saddam's obstinate rejection of resolution after resolution offering aid funds to Iraq, the Security Council decided on April 14, 1995, to try again with a more generous oil sales deal in UNSCR 986. Saddam initially refused, but on January 16, 1996, Iraqi UN Ambassador Nizar Hamdoun told his UN colleagues that Iraq was ready to talk, and negotiations began February 6.

Keeping Saddam from Diverting the Money: As Saddam knows, the key issue is who controls the money from the oil sales. UNSCR 986 is unambiguous on this point -- the Security Council "decides" how to use the funds generated by the oil sales; Saddam is not to touch the money. Paragraph two specifies that the "full amount of each purchase of Iraqi petroleum and petroleum products [be paid] directly by the purchaser into the escrow account established by the Secretary-General." Paragraph seven makes clear that the Secretary-General controls the escrow account; he is directed "to keep the Government of Iraq fully informed" about the funds. However, in the negotiations with the Iraqis, Boutros-Ghali ceded much of the control of the funds to Baghdad. He agreed to let the Iraqis decide in which bank the account will be kept. This is not some technical detail -- it is the camel's nose being poked into the tent, soon to be followed by the whole beast. Saddam's strategy is to divert funds through subterfuges, like under-reporting the oil revenue or overstating the cost of humanitarian goods. If he chooses the bank, then the next thing he will want will be a veto on which accountants are used and on who monitors the oil sales. With slack procedures typical of UN financial controls, he could easily divert at least 10 percent of the oil sales proceeds, which would be

\$400 million a year, for his military and terrorist purposes.

The Allies as Supplier, Not Saddam. The second most important point for Washington is to minimize any domestic political advantage Saddam may derive from the greater availability of food and medicine. The oil sales will give a boost to Iraqi public morale, which already soared when negotiations began. Just the prospect of the oil sales caused food prices to drop by 75 percent, with a dramatic effect on what food ordinary Iraqis could afford. Similarly, the Iraqi dinar rose from 3,000 per dollar on January 1, to 450 in early February. (The dinar has since slipped to 850 per dollar, and similarly, food prices have risen, though not as high as they were in 1995.)

The main issue is who gets credit in the eyes of the Iraqi people for the improvement in their living conditions. UNSCR 986 already gives Saddam too much opportunity to claim credit by controlling distribution of humanitarian goods. Paragraph eight specifies that Baghdad chooses which goods to import, provided that "Iraq effectively guarantees equitable distribution on the basis of a plan submitted to and approved by the Secretary-General." The one exception is that \$130-150 million is to be provided each 90 days from the escrow account to the UN Inter-Agency Humanitarian Program, operating in the three Kurdish-controlled governates of Dihouk, Arbil and Suleimaniyeh. It would have been much better had UNSCR 986 kept the procedures of UNSCR 706, under which all the aid was to be distributed by humanitarian agencies. Given the weak wording of UNSCR 986, Washington can only insist that Iraq provide concrete evidence that it will distribute aid to all its citizens.

The West needs to constantly remind the world that Iraq's humanitarian crisis is Saddam's fault. The message has not fully penetrated into the aid community. For instance, when the World Health Organization reported in March that infant mortality in Iraq is seven times the pre-crisis level, and that near-famine conditions are widespread, it did not point out that the UN places no limits on food shipments to Iraq, and the UN has made repeated offers to Iraq of ways to finance food. On the other hand, the WHO did not blame the West for the suffering, something that some private humanitarian agencies have unjustifiably done.

The Impact of Iraqi Oil: A variety of temporary factors, such as a cold winter in both Europe and the United States, has driven oil stocks to a twenty-year low. While producers are responding by increasing output, the market is still tight, and Iraqi sales could be readily absorbed. The most obvious impact of the tight oil market has been to contribute to higher gasoline prices, which are rising as much because of refinery shutdowns and increased demand, higher speed limits, and greater sales of fuel inefficient light trucks. There would be no substantive reason for Iraqi oil sales to affect retail gasoline prices in the United States, although there may be an impact due to the psychological impact on traders. That said, it can be confidently predicted that if Iraqi oil sales begin, Saddam will claim that Washington caved in because it needs his oil. To forestall any such propaganda, the United States would need to point out the fact that the sale would be less than one percent of world oil supplies.

There has been some concern in oil industry circles about the procedures set out in UNSCR 986. It specifies a dollar value for how much Iraq can export (\$1 billion each 90 days), rather than a volume. That gives Baghdad no incentive to get a good price. Even if oil were \$10 a barrel, Saddam has enough production and export infrastructure capacity to still earn his four billion dollars a year. That may tempt him to contemplate mischief. Saddam would enjoy hurting his enemies in Riyadh and Tehran by driving the oil price down. If an occasion ever presents itself to change the procedures, it would be wise to restate the limits on Iraq in terms of a volume of oil.

Keeping the Other Sanctions in Place. Saddam's hope is that the limited oil sales will be "the beginning of the end of the embargo," as the Iraqi press puts it. Any perception that the sanctions are eroding would not be a welcome development -- especially during this U.S. election year. If the limited oil sales begin, Washington may redouble efforts to ensure that the other sanctions on Iraq remain in place until Saddam complies with the relevant UN resolutions. Iraq's obligations for UN inspections of its nuclear, chemical, biological and long-range ballistic missile weapons are an entirely different matter than oil sales. Indeed, contrary to a widespread impression, no matter what

happens on oil sales -- even if full, unrestricted oil sales were permitted in line with the procedures laid out in the ceasefire resolution, UNSCR 687 -- Iraq would still require UN approval for all of its imports.

Washington supports the limited oil sales in large part because it expects that they would reduce the pressure for lifting other sanctions. The UNSCR 986 sales alleviate the acute humanitarian problems caused by Saddam's stubborn refusal to comply with UN directives, thereby depriving Saddam of his most potent weapon -- the world's sympathy for the suffering of the Iraqi people, about whom Saddam could not care less. Here, Washington could lose the gamble; the limited oil sales could start an erosion of the sanctions, rather than reducing the pressure to lift them. The odds depend in good part on whether the oil sales are done in a way that preserves U.S. and Western interests; in that case, the prospects are better that the sanctions regime will be reinforced, rather than undercut. That explains the importance of holding firm in the negotiations with Baghdad.

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