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Crisis in the Gulf: losses and benefits for the Soviet economy

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The dramatic growth in world oil prices following Iraq's invasion of Kuwait has led to some estimates that the Soviet Union will benefit greatly as a result of the conflict in the Gulf. The background for such estimates probably rests upon the Soviet foreign trade structure. The major portion of Soviet exports consists of crude oil and petroleum products and some other goods — mainly raw materials such as gas and gold, whose prices respond sensitively to the fluctuations of petroleum market prices.

Thus, Professor Goldman for the Center of Russian Studies attached to Harvard University and others have stated that if world oil prices increased by only 20 percent, the USSR hard currency annual revenues would rise by some \$5 to \$6 billion. *The Wall Street Journal* estimated that the Soviet Union will gain annually \$7.5–\$10 billion of foreign currency owing to the price factor alone. Accordingly to PlanEcon director Jan Vanous, cited in the Soviet press, every \$1 per barrel increase of petroleum prices will bring to the Soviet Union \$1 billion in additional revenues. And so on . . .

Let us take into account that up to the beginning of November oil prices increased by some \$13/bbl or by some 70 percent from the eve of the invasion. That means that Soviet hard currency receipts should increase by some \$17.5–21 billion annually, according to Professor Goldman, or to some \$13 billion, according to Mr Vanous (not taking into account oil demand price elasticity).

The few Soviet authors who have written about the economic aspects of the Iraqi-Kuwaiti conflict have not been critical when quoting these estimates. That is why readers have been convinced of the enormous benefits to this country arising from the Gulf crisis.

No enormous benefits

Let me try to shatter these illusions.

It is raw materials, mainly energy resources and above all crude oil and petroleum products, that constitute the bulk of Soviet exports (crude oil amounted to 19·1 percent and petroleum products 8·2 percent of the total in 1989). In 1989 crude oil exports amounted to 127.3 million tonnes valued at 13.1 billion roubles and exports of petroleum products amounted to 57.4 million tonnes valued at 5.6 billion roubles. The Soviet Union has been receiving almost half of its hard current earnings from liquid fuel exports and, according to American sources, four-fifths of total hard currency earnings have been received from the export of only four items — liquid fuels, gas, gold and arms.

It is evident that the Soviet Union can obtain some additional benefits as a result of the Gulf crisis only in the markets of the first three export goods mentioned.

Up to the end of last year the increase of world oil prices will influence the USSR export revenues only through the trade with industrially developed and developing countries. This oil price increase will not influence the trade with COMECON countries in 1990 because of the so-called 'Moscow formula' still applied in the accounting practice of the intra-COMECON trade. According to this formula, the annual level of Soviet oil export prices has been calculated as an average of world market prices item for the previous five years. That means that the oil price jump initiated by Iraqi-Kuwaiti conflict will be considered by the 'Moscow formula' only while determining the level of 1991 prices and only partially (by some one-tenth of the scale of price increase).

Hence, in 1990 this price jump will not affect 65 percent of Soviet crude exports (82.6 million tonnes in 1989) and 22 percent of product exports (12.6 million tonnes in 1919). But all the scale of this world market price increase will be considered in the Soviet oil export price from the beginning of 1991 because the action of the 'Moscow formula' will be eliminated from 1 January, in view of the transition of intra-COMECON foreign trade accounting to a dollar-clearing system based on world prices.

Let us take the eve of the Iraqi invasion of Kuwait as the starting point. On 1 August the price of Dubai crude which is similar to the Soviet export grades was \$17.9/bbl; on 30 October it was \$30.8/bbl. On 28 September and 11 October Dubai price hit the peak values of \$35.5 and \$35.3 respectively. The average August price was \$24.2/bbl, \$29.4/bbl in September and \$30.9/bbl in October.

If the price remains assumptionally the same until the year-end, the average Dubai price for the period August-December would be \$29.3/bbl. It follows from the above that if Soviet oil exports to the West remain at the 1989 level of 44.6 million tonnes, the USSR could draw an additional \$1.5 billion in crude oil revenues over these five months.

Fuel oil and gas/diesel oil account for some 80 percent of Soviet petroleum product exports (23.2 and 22.3 million tonnes respectively last year). Gasoline accounts a bit more than 10 percent (6.7 million tonnes). The half of the rest is accounted for by kerosene and jet fuel (2.1 million tonnes) and bunker fuel oil (1.6 million tonnes).

If we go by the same assumptions as for crude oil, it will follow that in August-December period last year the USSR could have earned an additional

Source of information	Estimate of the USSR prospective benefit	Comment
Prof Goldman (*The New York Times*), *Boston Globe*, etc	$5–6bln annually in hard currency in the case of world oil price increase by 20%	For the period August-October the prices increased by 70%. That means that USSR annual benefits should amount $17.5–21bln
The Wall Street Journal	$7.5–10bln annually due to the price factor only	
Jan Vanous (PlanEcon)	Every $1 oil price increase brings to the USSR $1bln of additional revenues	For the period August-October the prices increased by $13/bbl. That means that USSR annual benefits should amount $13bln

Figure 1: Some Western estimates of the USSR prospective benefits as a result of the conflict in the Gulf

$1.5 billion through petroleum product exports. In other words, the total increase in crude oil and petroleum product export earnings last year would be within $3 billion. But will this amount of additional revenues be received in practice?

I will give the negative answer to that question. And not for the reason that only some 60 percent (27–28 million tonnes) of the Soviet liquid fuel export to non-communist countries in 1989 was sold for hard currency and the rest was accounted for by different forms of hard currency clearing.

The main reason for this is the reduction of liquid fuels export sales, owing to the difficulties facing the Soviet oil industry. According to the USSR State Committee for Statistics (GOSCOMSTAT), compared with January-September 1989, crude oil and condensate production over the first nine months of 1990 fell by 23.5 million tonnes or by 5.1 percent. Crude oil exports fell by 6.3 million tonnes or by 6·6 percent, gasoline exports by 2·1 million tonnes or by 38.9 percent, gas/diesel oil export by 2.2 million tonnes or by 12.9 percent, fuel oil exports by 2.3 million tonnes or by 12.4 percent.

If this trend continues, Soviet liquid fuel exports would be at least 10 percent below 1989 figures (184·7 million tonnes).

Product purchases

Moreover, for the first time in the postwar period, the Soviet Union started buying petroleum products in the world market. According to unofficial figures, this country bought some 400–500,000 tonnes of gasoline whose price at the begining of October ($450/tonne) was 80 percent higher than at the beginning of August. The deal was worth some $150–200 million. Hence, a part of additional oil export revenues is spent on importing petroleum products.

The export of natural gas can bring in additional profit because its price has been tied in with the price of crude oil and petroleum products. However, the lag between the variation of the two prices is three to six months and the relationship between the price of oil and products and the price of gas is not a direct one. That is why additional earnings from gas exports caused by changes on the oil market will not be notable.

The Iraqi invasion of Kuwait had increased the price of gold by some $30 per ounce but afterwards the price returned to the level of the beginning of August. If Soviet gold exports remained at their current levels (296 tonnes in 1989 according to Western sources) this should bring this country an additional revenue of some $125 million at maximum which however has already been eaten up by the purchase of gasoline mentioned above.

On the whole, the additional earnings of the Soviet Union through the price increases in the main export markets will be considerably below $3 billion.

Soviet losses

And what are the USSR losses caused by the crisis in the Gulf? Unfortunately there are no agreed figures here either. Various Soviet specialists have published their different estimates of the UN embargo consequences for this country.

In an interview to the newspaper *Sovetskaya Rossiya* issue of 26 August, Mr Katushev, the Minister of Foreign Economic Relations of the USSR, has indicated three categories of these losses (cancellation of civil export and arms supplies to Iraq and of import of Iraqi crude) and has made estimates for the two latter. 'Elimination of crude import for the total value of 800 million roubles will lead to a loss of goods for the Soviet domestic market . . . at total value of almost 2 billion roubles', declared the minister. Referring to the Stockholm International Peace Research Institute (SIPRI) data, he has estimated the total cumulative value of Soviet arms supplies to Iraq equal to some $12 billion. But he remarked

	1988	1989
Total billion roubles, including (in percent)	67.1	68.8
Machinery, equipment & vehicles	16.2	16.4
Fuel and electricity of which:	42.1	39.9
crude oil & petroleum products	29.4	27.1
Ores & concentrates, metals & their articles	9.5	10.5
Chemical products, fertilisers & rubber	4.0	4.0
Wood materials, pulp & paper articles	3.5	3.5
Textile raw materials & half-finished products	1.6	1.6
Food products & raw materials for their production	1.7	1.6
Consumer goods	2.8	2.6

Figure 2: USSR export structure, 1988–1989 (in all destinations, in current prices)

Item	Size of decrease	
	mln tonnes	in percent
Crude oil & condensate production	−23.5	−5.1
Crude oil export	−6.3	−6.6
Gasoline export	−2.1	−38.9
Gas/diesel oil export	−2.2	−12.9
Residual fuel oil export	−2.3	−12.4

Figure 3: USSR oil industry figures in January-September 1990 compared with the same period in 1989

Source of estimate	Value of 1990 gross losses	
	on an annual basis	through the period of embargo (August-December)
K Katushev (author's recalc)	$1.9–2.1 bln	$0.8–0.9bln
A Belonogov	—	$0.915bln
A Kondakov	—	near $1bln
Ju Savinov & A Prokhorenko	—	$1.3bln
Author's estimate	—	$1.7–1.8bln
I Mordvinov	$6–7bln (?)	$2.5–2.9bln (?)

Figure 4: The USSR gross losses caused by the crisis in the Gulf according to various Soviet specialists

that, 'The Soviet-Iraqi cooperation in the military field had begun as far back as in 1958; therefore this sum needs to be distributed for more than 30 years'. Let us add to these figures the value of 1989 civil exports to Iraq and re-calculate roubles into dollars using the official exchange rate. That will give us, according to Mr Katushev, the cumulative annual value of USSR losses equal to $1.9–2.1 billion. That means that for the period August-December (embargo period), these losses will be equal to $0·8–0·9 billion.

Addressing the Committee on Foreign Affairs of the USSR Supreme Soviet, Mr Belonogov, USSR Deputy-Minister of Foreign Affairs, declared on 30 August that 'As a result of sanctions against Iraq . . . our 1990 losses will be equal to $800 million consisting of current payments and missing supplies of Iraqi oil, the latter being re-exported to India, Bulgaria, Romania and Yugoslavia. We are failing to receive $115 million from occupied Kuwait'. Hence, according to Mr Belonogov, Soviet losses during August-December period will be equal to $915 million.

Mr Kondakov made a similar estimate for the USSR losses from the crisis in the Gulf. In his articles in *Novoye Vremya* and in *Ekonomia i zhizn*, he wrote that, 'Direct losses as a result of sanctions against Iraq and the occupation of Kuwait (missing supplies of oil in repayment for the credits, available current payments, lost property and unpaid supplies in Kuwait, expenditure on evacuation of Soviet citizens) will amount to nearly $1 billion in the current year and not less in 1991'.

On 21 August a situation analysis was held in the All-Union Scientific and Research Institute of Market Studies attached to the USSR Ministry of Foreign Economic Relations entitled, 'The consequences of Iraqi invasion of Kuwait for the USSR foreign economic relations'. Its participants, Mr Savinov and Mr Prokhorenko, published the main results of the discussion in *NTR: tribuna* weekly. They estimated the direct economic losses of the Soviet Union up to the end of the year amounting to $1.3 billion ($0.5 billion is the cost of missing Iraqi oil supplies in repayment for its obligations; $0.8 billion represents total losses from the cancellation of Soviet exports to Iraq and from recall of Soviet specialists working in joint ventures).

My estimate of the USSR direct foreign trade losses up to the end of last year, published in the *Commersant*, was equal to $1.7–1.8 billion at minimum.

While commenting in the *Trud* newspaper, the issue of 23 October, Mr Mordvinov, the Head of Department of Press and Information, USSR Ministry of Foreign Economic Relations, has estimated the total value of Soviet damages, concerned with the loss of such rich clients as Iraq and Kuwait, close to $6–7 billion. However, he did not disclose the breakdown of this sum, nor the period for which those calculations were made. Let us suppose that these figures were calculated on an annual basis. That means that for the five months period (August-December), the corresponding figure will be equal to $2.5–2.9 billion.

Let us try to agree a figure. For that purpose an item-by-item accounting of the USSR direct losses is needed.

According to the SIPRI data, which was also published in the Soviet press, between 1980 and 1989 the USSR has supplied Iraq with $13.25 billion worth of arms. Taking into account the fact that in 1980–82, when Iraq attacked Iran and waged a war on the latter's territory, Soviet arms supplies were interrupted, the average annual sales of arms to Iraq over that whole period can be estimated at $1.7–1.9 billion. (Prof Goldman estimated 1989 sales of Soviet arms to Baghdad at $1.5 billion and Messrs Savinov & Prokhorenko at $3.0 billion). Thus, cancelling arms supplies to Iraq, the USSR would be missing up to the end of 1990 some $0.7–0.8 billion ($0.6 billion — according to Prof Goldman; $1.25 billion — according to Messrs Savinov & Prokhorenko).

Various official publications estimate the value of Soviet 'civil' exports to Iraq in 1989 at between 107.9 and 255.4 million roubles. Other estimates also exist. Thus, on this item the USSR direct losses may reach by the end of 1990 an estimated 45 to 105 million roubles. In terms of the official exchange rate ($1 = Rb0.6), this would amount to $75–175 million. Taking into account the triple devaluation of the rouble and the introduction of its commercial exchange rate as of 1 November ($1 = Rb1.8), the losses

Item, destination	Price, rouble per tonne
Average USSR import price of Iraqi crude oil	81.5
Re-export price of Iraqi crude oil in supplies to:	
India	75.4
Bulgaria	109.1
Romania	112.1
Yugoslavia	83.5

Figure 5: 1989 import price of Iraqi oil and its re-export price to different countries

can be estimated at $55–130 million.

Soviet imports from Iraq were estimated by official sources at 975·9 million roubles in 1989. Most of that value was accounted for by oil supplies as payments for 'special cooperation' (11.9 million tonnes at a price of 81.5 rouble per tonne). All oil imported from Iraq has been re-exported to India, Bulgaria, Romania, and Yugoslavia, as was indicated earlier. By the way, the price of oil re-exported to India in 1989 (75·4 rouble per tonne) was lower than the import price of Iraqi oil; in the case of Yugoslavia these prices were nearly equal (83.5 roubles per tonne of re-exported oil); and in the case of Bulgaria and Romania the price of re-exported oil (109.1 and 112.1 rouble per tonne respectively) was significantly higher than the import price of Iraqi oil.

Commitments

As Mr Mordvinov declared, taking into account the problems facing the Soviet oil industry, the foreign trade agency Soyuzneftexport is unable to fulfil its obligations to East European nations. That reduction will not apparently extend to India. Under the Soviet-Indian trade agreement, the USSR should have supplied 4.5 million tonnes of oil to India from the Iraqi Basra oilfield in the period between April 1990 and March 1991. The official spokesman for the Soviet Embassy in New Delhi has said that the USSR will meet that obligation regardless of the developments in the Gulf. 'Where shall we take this oil from is our own business. But India will receive this oil and 2.8 million tonnes of petroleum products also', declared, according to Reuter, Mr Granovsky, Economic Counsellor of the Embassy.

There are some possible (even if in theory) scenarios where this oil can be taken from. It can be taken from the domestic market; or through further decrease of our supplies to COMECON countries (still being carried out on the transferable rouble basis) or to Western countries (on the hard currency basis); or through the purchasing of missing quantities in the world market. Though it seems that the second scenario became preferable for decision-makers, from my point of view the loss from missing supplies of Iraqi oil needs to be calculated in any case on the marginal basis, that means in terms of world market prices. If we go by the assumptions used with respect to Soviet oil exports, the compensation of the re-export of Iraqi oil should cost the USSR $1.06 billion before the end of 1990.

	$ bln value of:		
		losses, using Rb/$ exchange rates:	
Items	*benefits*	*official*	*commercial*
Price increases in USSR export markets:			
crude oil	1.5		
petroleum products	1.5		
natural gas	negl		
gold	0.125		
Foreign markets lost due to UN embargo:			
arms sales		0.7–0.8 (0.6 to 1.25)	
civil export to Iraq		0.075–0.175	0.055–0.130
re-export of Iraqi crude		1.06	
trade with Kuwait		0·08	0·06
Subtotals	**3.125**	**1.9–2.1 (1.8–1.9–2.4–2.6)**	
Gasoline purchase		0.15–0.20	
Total	**well below $1 bln**		

Figure 6: The balance of the USSR 1990 direct foreign trade gross benefits and losses as a result of the crisis in the Gulf

Soviet-Kuwait relations

Soviet exports to Kuwait amounted to 117.4 million roubles in 1989, while imports hovered just over zero mark. The loss of that market is equivalent to USSR damages equal to $80 million, according to the official exchange rate, or $60 million taking into account the introduction of the commercial rouble exchange rate as of 1 November.

The Soviet Union could have lost a lot more from the termination of financial and economic cooperation with Kuwait. It began in 1987, when Kuwaiti banks contributed to a $150 million loan to the Soviet Union. In May 1990 an agreement was signed under which the Kuwait Foreign Trading, Contracting & Investment Company gave the USSR Vnesheconombank a credit of $300 million for seven years. As was indicated above, at this point $115 million remains outstanding, although the USSR will according to all signs receive it. The lawful government of Kuwait in exile controls the foreign financial assets of the country estimated at more than $100 billion. It believes that after the banking system of the country begins to operate under new circumstances it should meet all of its foreign obligations, that means including the deal with the Moscow bank.

Under the agreement between the two countries, Kuwait assumed the obligation to subsidise the Soviet oil industry in a number of frontier areas of Siberia and the Arctic zone and extend other kinds of financial assistance to the Soviet Union. Taking into account the Kuwait government's stand, there are grounds to believe that cooperation with Kuwait will continue, although it may be expected to decline.

Conclusion

The total losses of the Soviet Union as a result of the crisis in the Gulf, therefore, should amount to $1.9–2.1 billion in 1990 or from $1.8–1.9 to $2.4–2.6 billion if alternative information about Soviet arms supplies to Iraq is used. One must add to this the expenses incurred in evacuating Soviet citizens from Iraq and Kuwait and the cost of lost property.

Therefore, the Soviet Union is at this point not affected directly by the crisis in the Gulf since additional oil revenues are above the losses. In 1990 the difference will be well below $1 billion of net benefit, with the potential gain estimated at between $0.5 and $1.15 billion. But the size of this net benefit is not so big as one imagines at first glance, taking into account in particular the problems of the Soviet energy sector on the eve of the winter: a few purchases of petroleum products as at the begining of the autumn will be quite enough to vanish all these windfall petroleum revenues. ■

This paper was presented to the conference, 'Energy and the New Europe: the Global Dimension', convened in December by the Royal Institute of International Affairs, the British Institute of Energy Economics and the International Association for Energy Economics.