

Iraq Oil: Between The Centre And The Region

By: Tariq Shafiq

*The following article was first published in Middle East Economic Survey (www.Mees.com) on 25 May 2009. IOF reproduces it here with the author's permission due to its relevance to the debate on Iraq oil management issues. **Tariq Shafiq** was a principal drafter of Iraq's petroleum law. He is Director of Petrolog & Associates, Chair of the Fertile Crescent Oil Company, and a former Executive Director and Vice Chairman of the Iraq National Oil Company (INOC).*

No doubt many Iraqis have been following the recent declaration of the Kurdistan Regional Government's (KRG's) Minister of Natural Resources, Ashti Hawrami, published in the *Iraq Oil Report* of 14 May concerning the Iraqi government's agreement to allow the export of oil produced by international oil companies (IOCs) under the sole jurisdiction of the KRG, based on contracts which the Iraqi central Ministry of Oil considers illegal and over which Mr Hawrami also chose to attack Iraq's Minister of Oil, Husain al-Shahristani.

Under normal circumstances such a significant decision might have become a cause for celebration, as it could have led to serious dialogue to resolve the calamitous issue of the stalled petroleum law, which has become a main contributor to the stagnation of our oil industry in recent years. The issue is not a trivial one.

It concerns the source of almost all the central government's budget for now and a good many years to come. For this reason it is surprising that it has been given little attention by our governing institutions and decision-makers.

The lack of a clear public position on such a vital issue by the central government and the contradictory statements of officials from the Ministry of Oil constitute a serious accountability and transparency failure. I and other Iraq oil technocrats, as well as the unions and the public at large, may have our agreements and disagreements over the petroleum law and the present oil plans and policies of the central government, but the fact remains that the overwhelming opinion of the majority opposes the KRG's unilateral grant of oil and gas exploration and production rights to third parties and supports the central Ministry of Oil's position in this regard.

To justify its rush to enact some 25 contracts unilaterally in record time without regard for the consequences, the KRG claims that it could not sit idly by while the central government drags its feet over the draft petroleum law. The fact is, however, that it is the KRG's opposition which has stalled the petroleum law. The KRG knows that, had it not been for 'Muhasasa' (mutually beneficial concessions i.e. quotas based on ethnic and sectarian factors), the majority of the parliamentary members would have supported the country's petroleum law, perhaps with professional modification in the interest of the whole nation to optimize the exploitation of oil and gas. But, unfortunately, the KRG's oil policy is part and a parcel of its de facto confederate status, which conforms neither with the constitution nor the will of the people. It is the KRG, in fact, which has been stalling the review of the constitution which would have clarified, among other things, the articles governing the management of oil and gas assets. And it is the KRG that has taken the fullest advantage of the deliberate vagueness with which these articles were written.

MEES reportage on the issue of exporting oil produced by IOCs under the sole jurisdiction of KRG shows that:

- Dr Shahristani is still opposed to the contracts on which the KRG exports are based, with the clear implication that if he got his way no extra funds would be allocated to either operator for the cost of their investment or profit oil. "This is like accepting the baby as legitimate, but saying the marriage is illegal. He can't do that," one KRG oil industry observer argues (*MEES*, 18 May, page 1).

- Furthermore, Dr Shahrastani has always accorded a special status to the four consortia that signed KRG upstream deals prior to an aborted February 2007 agreement on a proposed hydrocarbon law (*MEES*, 18May, page 2).

I wish to stress that KRG contracts are illegal not only because they fail to comply with the constitutional principle that oil and gas are the property of all the people and not of any one faction, sect or ethnicity, but also for other reasons, mainly:

- KRG contracts were not issued under transparent or accountable competitive tenders and were never passed to the national parliament and the central Ministry of Oil, nor have they been published to this date. Indeed it is surprising that anyone can judge their value to the nation.

- KRG contracts have not yet been tested against the five primary principle objectives and criteria set out in the draft petroleum law, which are designed to ensure the conservation and optimization of oil and gas assets. This is despite the fact that these principles were fully endorsed by all members of the Ministerial Negotiating Committee of 2006/07 which, incidentally, was chaired by the Deputy Prime Minister and senior member of the Patriotic Union of Kurdistan Barham Salih.

The five principles are: 1) national control; 2) ownership of resources; 3) optimum economic return to the country; 4) appropriate return on investment to the investor; and 5) reasonable incentives for the investor to ensure solutions which are optimal for the country in the long term.

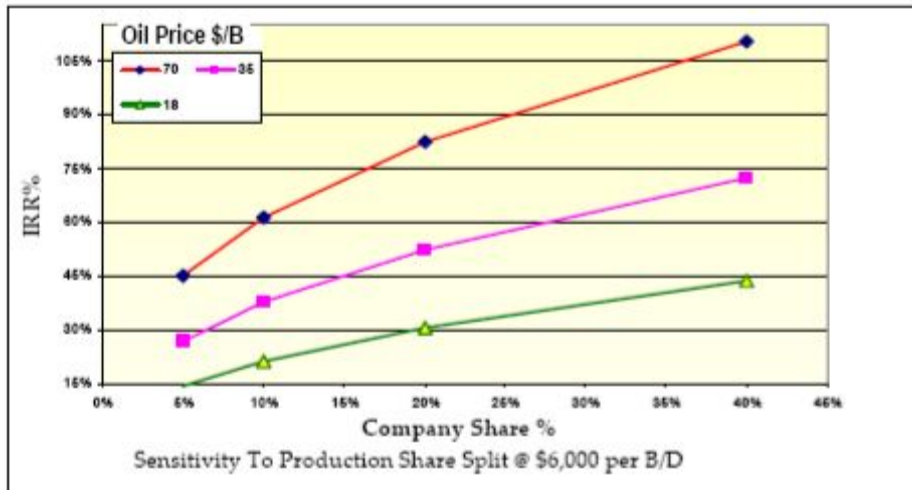
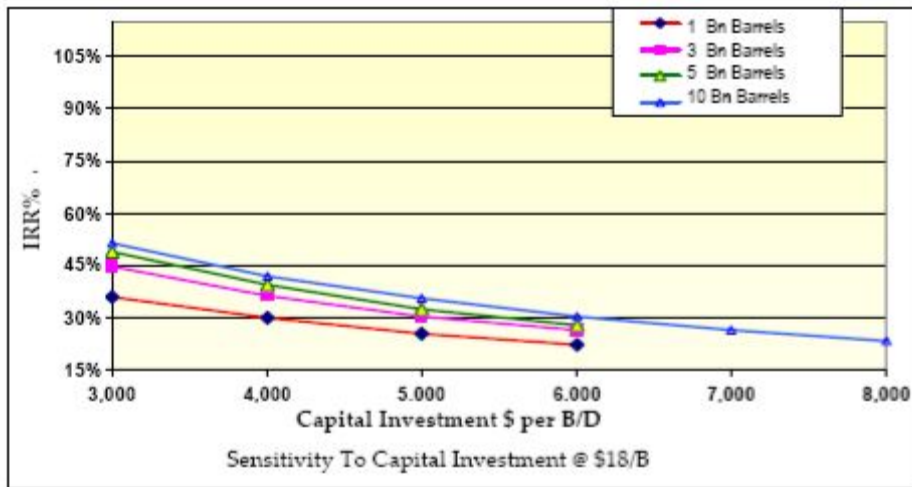
Let us now examine if the KRG's production sharing agreement (PSA) contracts conform to the above objectives and criteria:

1. National control, among other things, precludes the adoption of PSA model agreements.
2. KRG PSAs are not based on the principle that "all the nation is the owner of the oil and gas assets."
3. Our calculations reveal that it is doubtful that "the optimum economic return to the country" has been achieved.
4. In fact it is very likely that windfall profit has been granted to the investor IOCs, contrary to the requirement of an appropriate return on investment, which is shown below in the chart "Economics of Iraq Oil Fields."
5. There is very likely a high derived internal rate of return (IRR), which measures the return on the investment and which might be described as windfall profit resulting from KRG contracts. It should be stressed, however, that our calculations are based on leaked information of key economic yardsticks, such as the high front loading of cost retrieval and the company profit share. Because of Iraq's low extraction costs and its abnormal political and stability risks, a justifiable return on investment may be construed to be at the upper end of the range of 15-20%, allocating company profit share in the region of 5%. This, in fact, compares favorably with Libya's PSA contracts of the last two years, where the company profit oil has been set in the region of 7%, despite a cost of around twice that of Iraq.

The charts below summarize the results of Petrolog & Associates economic calculations.

Economics Of Iraq Oil Fields

Economics Of Iraq Oil Fields



I wish to conclude by saying that:

- The KRG's present unilateral pursuit of oil and gas management is an inevitable consequence of its confederate attitude and policy.
- KRG policy has left the Ministry of Oil no choice but to plan a policy of granting rights confined to the rest of the country and to resort to existing laws and regulations as long as the petroleum law remains stalled.
- KRG policy has contributed to the present failure to expand production capacity, wasting a golden opportunity to build capacity during an era of low investment cost and high oil prices and constituting a serious loss of income to the nation.
- There is no doubt that there is a lack of real national unity and of unified oil plans and policy, due to the current Muhasasa, the near absence of coordinated plans, policies and institutions, acts of sabotage and assassination and, last but not least, the consequences of failed state parameters. Unfortunately, Iraq's oil and its institutions have been politicized under pressure from within and without the country.

- The Ministry of Oil does not exist in a vacuum. It is part and a parcel of the state. As such, the ministry cannot and will not be immune from the above symptoms which have engulfed the country, regardless – repeat regardless – of who heads it. The solution lies in tackling the whole state and government system in order to build sound governance and institutions without ethno-sectarian policies and in a stable environment free from terror.

I must also warn that:

- It is unwise, if not damaging, to rush to enter into large numbers of long-term contracts based on the premise that there is a lack of Iraqi managerial and technical human resources which will require decades to rectify or as if there are no better alternatives and no substitute to numerous and long-term contracts with IOCs, ignoring the fact that the embryonic INOC succeeded during the 1970s in building capacity in a few years from 1.25mn b/d to 3.5mn b/d while adding reserves at the rate of 6bn barrels a year.

- Contracts without competitive, accountable and transparent bids have no legality, especially under the prevailing operational practices.

- Contracts not endorsed by parliament, the only legitimate authority representing all the Iraqi people, and in the absence of a unified petroleum law and regulations may not last their stated terms.

- The last provincial elections demonstrated that the majority of people believe in the unity of the nation and its purpose. The nation has voted, pointing the way forward. It is wise, if not mandatory, to heed the nation's will with all the due respect it deserves.

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