

## *Comments on Iraq's Petroleum Laws*

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The primary objective of a Petroleum Law for Iraq is to create favourable conditions for speeding up investments in the development of the country's rich oil reserves, and for increasing as rapidly as possible the oil revenues necessary to salvage the country from its present economic ruin and poverty.

Oil policy should not be considered separately from economic issues but rather in relation to the country's economic and social needs. It should also take into account the long-term trends in world energy and the future of oil in the world energy mix. Oil is Iraq's only hope and it is crucial, therefore, that this asset be used rationally without the preconceived ideological and non-economic notions of the past, and be replaced by a pragmatic approach that focuses on a cost-benefit approach and emphasises a strict time-frame. In this respect, certain basic facts should steer policymakers towards achieving these objectives.

- 1) The former regime with its irrational, bellicose policies, and its furtive and self-defeating tactics vis-à-vis the UN inspectors, which unnecessarily prolonged sanctions for over 12 years, caused Iraq to lose a huge amount of oil exports. These losses can be measured by comparing Iraq's actual production between 1980 and 2003 with its previous production of 14.5% of OPEC's total production, had that production continued without the intervention of wars and UN sanctions. The difference between the two magnitudes represents losses of oil exports amounting to 18.6 billion barrels of oil (or 1.9mbpd), a colossal amount of almost twice the reserves of an OPEC member such as Algeria. Based on the average monthly price, the value of those oil export losses amount to a financial loss of \$435 billion since 1980, or \$44 million a day. These production losses have been to the advantage of OPEC countries, especially Saudi Arabia which in the absence of Iraqi oil has benefitted in being able to increase its quota system from 5.4mbpd to 8.4mbpd.

Given the dependence of Iraq's economy on oil, such ruinous losses have broken the economic backbone of the country. In 1980 Iraq's *per capita* income was almost equal to that of Greece, but since Iraq's impoverishment this income is equivalent to a poor central African country, such as Burundi. This means that an oil policy for Iraq should aim to compensate for the enormous losses that have reduced Iraq to this level of poverty, i.e. a policy that would secure as well as speed up oil production and exports. Furthermore, Iraq needs a huge inflow of capital to rebuild the infrastructure with which to embark on projects and create jobs in a country where the number of unemployed now reaches as much as 50% of the labour force, and 70% of the country's youth.

Iraq's resource-base is so vast that, according to a CGES/Petrolog study, Iraq could produce at a high rate of 6-8mbpd until the end of the century before production shows signs of depletion. This means that speeding up production to that magnitude would have no effect on the life-span of oil reserves in Iraq.

- 2) The rate of growth of world demand for oil is on the decline, except in China and India which both constitute the only engines of oil-demand growth left. Demand has weakened with the huge improvements in the conservation of energy and increasing energy efficiency. This has been particularly obvious in the case of Western Europe and Japan, where the share of oil in total primary energy has been in sharp decline. In the US and even in China it has become of paramount importance to rationalize energy consumption in order to reducing the amount of oil necessary for achieving economic growth. This trend first began as a result of the 1970s price shocks. In the case of Western Europe the combined share of natural gas and nuclear power in total primary energy increased from 11% to 37.6%, obviously at the expense of oil's share of total primary energy – with the Gulf's oil exports suffering much more than Africa's.

With the price hikes of 2006 there have been increasing calls in the US, as well as the world over, for reducing dependence on imported oil. Nuclear energy phobia provoked by Chernobyl and, earlier, the Three Mile Island accident, has largely been mitigated with the urgency of government focus on reinvesting in nuclear power, especially now in the US, China, and in Europe. The pressure on oil has gained momentum from the time of Kyoto and the increasing environmental concerns expressed about global warming and CO<sup>2</sup> emissions.

In the area of power generation the share of oil has been in sharp decline globally because of alternative energy sources, nuclear energy, natural gas; and even clean-coal technology is underway.

In the area of transportation, where the alternatives to gasoline prove more difficult, it is only a question of time before the present trend of using more and more biofuels (ethanol), together with increasing projects for hybrid engines, and ultimately the hydrogen fuel cell, will become economically feasible. All this conversion to alternative energy sources should alert Iraq's oil policy formulators and finally inform all legislation so as to create the best environment for investment, above all by opening the industry to foreign investors to speed up the production of Iraq's only great asset.

- 3) Apart from alternatives energy sources, there is now, thanks to technology, a greater availability than had been envisaged of non-OPEC oil, which hitherto had been thought to have reached a plateau. North Sea oil, for example, which before was predicted to be depleted by the 1990s, still continues its production (in Norway especially) because of enhanced recovery technology. Furthermore, the rate of decline in that area will not be as steep as was previously forecast. In addition, there is now more oil from the Former Soviet Union, the Gulf of Mexico and West Africa.

- 4) The implications of all these demand/ supply trends are that the need for OPEC oil is bound to decline over time. In fact, the world is on the threshold of a major transformation in terms of global energy in the coming two or three decades. This means that growth rates in Iraq's oil production and exports will be faced with increasing difficulties in the future.

In other words, the sooner Iraqi production is underway, the better; otherwise the same fate of the millions of tons of coal that were left buried underground, will befall the vast amounts of Iraqi oil which risks being left buried underground with no market outlet in the distant future.

These conclusions about world supply/demand trends differ from the optimistic forecasts of the International Energy Agency (IEA) which predict a continuously robust growth in the world demand for oil, faced with declining non-OPEC supplies; and thus, accordingly, the need for OPEC oil will continue to increase leaving good room for the expansion of Iraq's oil industry. These IEA forecasts do not take into consideration the impact of high oil prices and technological progress affecting both supply and demand. It is always the case with IEA forecasts that they begin with high rates of demand growth which later need to be revised downwards. It is not inconceivable that the IEA adopts a position that is politically motivated.

- 5) During the 1990s, the former regime negotiated with various international oil companies from Russia, China, France, Italy, with the aim of developing some of Iraq's giant oil-fields. The Iraqi government signed agreements with Russia's Lukoil and CNOC of China, while other agreements were left unsigned – and all were based on the 'Production Sharing Agreement' formula. Nothing ever came of them because of the UN sanctions. Nevertheless, the Production Sharing Agreement (PSA) is a valid model with which to consider for future policies concerning Iraq's oil, although this does not exclude other arrangements (including joint ventures) that could hasten the production of Iraq's oil.

- 6) Examining the draft agreement for the PSA, the latter model seems a logical method for speeding up investments in Iraq's oil. Strangely, however, there has been a campaign against the PSA showing this as a means of Western pillage, which it is not.

The source of this opposition is quite evident. A major obstacle to the growth of Iraq's oil industry is the opposition from within the world oil industry itself. The last thing that OPEC and non-OPEC producers want to see is a speedy recovery of Iraq's oil. With weakening demand growth, the emergence of a substantial amount of Iraqi oil on the market would result in either a price fall or in OPEC's other members (especially Saudi Arabia) being compelled to reduce their production to allow Iraq to increase *its* production without a negative effect on the oil price. Therefore, many OPEC members will do everything possible to thwart the comeback of a large amount of Iraqi oil. In fact, the whole world oil industry regards Iraqi oil production as a potential menace, threatening world oil prices.

- 7) This underlies much of the fuss that we have witnessed in some of the Western press, warning Iraq not to get involved in Production Sharing Agreements with the international oil companies. By giving a misconceived, incorrect description of the PSA as a 'rip-off' of Iraq's wealth, *The Independent* of London published (7 January 2007) a long article on the subject, deducing that according to the PSA model the oil companies could gain as much as 70-75% of the profit! This is totally false, baseless, ludicrous and fabricated.

Equally erroneous, a certain Gregory Muttit<sup>1</sup> produces articles that continually harp on about the PSA as a means of pillage of Iraq's oil, while at the same time he professes to be concerned about Iraq's national interests! Such a "campaign" can only be motivated by those doing their utmost to prevent the rapid recovery and growth of Iraq's oil industry.

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<sup>1</sup> a co-director of *Platform*, who describes himself as a 'specialist in Iraqi oil policy'.

8) In the previous draft Petroleum Law for the Iraqi oil industry, the PSA formula was mentioned among other forms of co-operation with the international oil companies, such as service contracts for developing Iraq's oil resources. However, the latest draft amendment has replaced the PSA model with a "Development and Production Contract" (DPC), purely, it seems, as a reaction to this media hype. Details concerning this change were reported by Dow Jones on 16 January 2007, quoting a senior Iraqi official, who states that the motive for this amendment was "to avoid media fuss" yet omits any mention of the need to serve first and foremost Iraq's oil industry, and according to whom the DPC will state the following terms:

"Companies cannot book crude oil reserves of any given oil field in their own market capitalizations, as is the case with ordinary PSAs. Iraq will pay the costs of the contract in cash, rather than paying back the money through produced crude oil or products..."

All equipment brought by the company to carry out the contract is the property of Iraq. The company, however, has the right to use this equipment to carry out work in Iraq... Profit received by the company is to be agreed on by both sides, for example, one dollar on each barrel produced for a certain period of time..."

This amendment amounts to the elimination of investment incentives for major oil companies to come and invest in Iraq.

The most important thing for the companies is to be able to upgrade their access to reserves, but with this amendment there will be no incentive at all for the companies to invest. Without this access, oil companies can just as well buy crude from the market without risking any investments.

Deprived of such secure access, the new formula amounts to something similar to the "buy-back" agreement, which in the case of Iran offers very little attraction for foreign investors. The Iranian constitution forbids foreign investors to have any access to Iranian reserves. In this way, despite its substantial reserves, Iran's

oil industry continues to decline, and in Iraq's case the same will happen. Iran cannot even produce its own OPEC quota.

Another strange amendment to the Draft Petroleum Law is that Iraq will sign DPC agreements to develop only undiscovered oil fields, and not the discovered oilfields. This means that all the discoveries of the 1970s, which have added huge reserves and giant oilfields, such as the Majnoon, West Qurna etc., will have only the investment of the INOC, which has neither the financial nor technical means to develop them.

- 9) All these proposed amendments represent a regression of the initial recognition for the rapid development of Iraq's oil. Increasing oil production from the current rate of 2mbpd to 6mbpd, which is already technically feasible, cannot be achieved by the INOC without the co-operation of the international oil companies, which own the financial resources, advanced technology and extensive world markets needed. Without their input, the vast sums needed for rebuilding the country would not leave the amount of capital needed to reinvest in the oil industry and bring on production speedily enough.
- 10) Enough of the dogmas and slogans in the name of nationalism. Instead, it is far better to look at oil as a means of restoring part of the lost welfare of Iraqi society. Gone are those days when, as in the 1970s, Iraq was rich with a \$35-40 billion surplus in its current account, able to afford the service contract, and with plenty of Iraqi oil-expertise, which has now fled the country or else is cut off from the reality of what is going on in world oil.

This paper has not touched on the thorny problem of Iraq's Constitution, on the basis of which the Kurdistan authorities have entered into PSA contracts on unfavourable terms for the producer. I shall touch upon this issue in a separate paper.