

SPONSORED BY
THE OPEN SOCIETY INSTITUTE
THE LONDON SCHOOL OF ECONOMICS
29 JUNE TO 1 JULY 2005

Policy Recommendations from Discussions at the London Conference “Iraqi Oil Wealth: Issues of Governance and Development”

Summary

More than 60 Iraqi and international petroleum specialists, civil servants, policy makers, parliamentarians, activists, corporate executives, academics and journalists participated in the conference. Over three days they explored political, economic and administrative approaches to managing Iraq's oil in a way that would contribute to development and democratic transition. Following are some of the key ideas to emerge out of the conference. They do not represent the consensus of all participants but rather the general direction of the debate.

General Principles

When it comes to oil the political and social are inextricably intertwined with the economic and technical. Policies which focus on one side over the other are ineffective at best and can be catastrophic. The resource curse which refers to the fact that countries dependent on oil grew slower, were less democratic and more conflict prone than their peers is often the outcome of such lopsidedness. Conversely a holistic approach is the best way to confront the challenges of oil dependence.

Substantive rather than formal democracy is the main defense against rent seeking and the abuse of oil wealth. A system of checks and balances is necessary to allow civil society, business and government to monitor and hold each other to account.

An open, rational and informed debate about oil policy is a critical component of the checks and balances system. Debate can help produce and sustain consensus over optimal policies and mobilize constituencies to counter rent seeking.

Timely and accurate information on all aspects of the oil economy is a precondition for effective public debate. As one speaker put it 'civil society is useless without information.' Transparency is especially important when the debate is being carried out in the absence of established democratic institutions and other elements of the system of checks and balances. Transparency and accountability should apply equally to private and public actors, domestic and international.

Organization and Ownership of the Iraqi Oil Industry

After decades of abuse, wars and sanctions the Iraqi oil sector is in dire need of new equipment, technologies and skills. Immediate action is needed to generate income, prevent irreparable damage to wells and reservoirs and alleviate fuel shortages.

Iraqis have a strong sense of national ownership of their oil. Therefore a strong, independent, commercially viable national oil company may be the best vehicle to lead the development of the sector, and could also act as a locomotive for the rest of the economy.

Private enterprise, domestic and foreign companies including oil multinationals also have a role and can mobilize financial and technical resources not available within the state sector. All these actors should adhere to the principles of transparency and openness. The rules should be consistent and clear.

It is critical to involve private companies in the downstream and servicing sectors, and in the medium term, to develop a large and diversified private oil services and supply sector which could act as a transmission mechanism between oil and the rest of the economy. Large scale upstream projects with far reaching long term consequences are better left until the security and political conditions improve and the fundamental elements of the rule of law are in place.

Managing Oil Revenues

Oil revenues and all related payments should run through the central government budget, under parliamentary supervision. Transparency and integrity of the budgetary process are preconditions for successful oil revenue management.

Proper budgeting requires the provision of accurate, audited data on all oil and gas production, sales, revenues, taxes and other payments and expenses, to the Ministry of Finance and relevant parliamentary bodies.

Various options are available for the allocation of oil revenues to the regions and the respective share of these revenues managed by the central and regional governments. Distribution on the basis of production, population or needs will have to be complemented by equalization mechanisms to address the various starting positions of the regions and the legacy of the past.

There is awareness for the need for an oil fund which would help address issues of equalization, fiscal stability and sterilization of foreign currency inflows. Such a fund will have to follow the highest standards of transparency and accountability and should be part of an integrated budgetary process.

Oil revenue allocations should be governed by the principles of equity, justice and development for all. Allocations are no substitute for the hard work needed to deal with the legacy of the regime and rebuild trust among Iraq's communities and between them and the central government.

Fuel subsidies place an enormous burden on state budget, distort market relations and encourage smuggling and criminality. However, abolishing subsidies abruptly and without a mechanism that protects the disadvantaged groups from the consequences would be disastrous both socially and politically. Therefore, phasing out subsidies should be made contingent on the development of social safety net and public education.

Enabling environment

It is necessary to accelerate the adoption of the Petroleum Law, clear rules and regulations on privatization and foreign investment and mechanisms for their enforcement and implementation.

Special attention should be devoted to developing human resources in the public and private sector and civil society. Training is needed not only in technical disciplines but in areas of transparency, accountability and advocacy.

There is a need to strengthen anti-corruption institutions and initiatives including the Commission on Public Integrity and the Parliamentary Committee on Public Integrity as well as any civil society initiatives in this field. Focus should be devoted to strengthening the independence of these institutions and initiatives from the government, leadership by example and preventive approaches. Transparency and disclosure are important for anti-corruption efforts.

International cooperation is needed not only to provide technical know-how and experience but also to provide political support to ensure transparency and accountability from international state and non-state actors.

FULL CONFERENCE REPORT

Introduction and Overview

After suffering years of war, hunger, isolation, embargo, economic mismanagement, repression, looting, and personal trauma, the Iraqi people are attempting to build a democratic and prosperous society. No country with substantial oil wealth has ever accomplished this transformation. And if the Iraqis are to succeed, they must overcome terrorism, end a foreign occupation, establish law and order, build from scratch the most-basic institutions of their government, reconstruct their infrastructure and economy, and patch together a threadbare societal fabric.

The drive to meet these challenges and complete the transition to democracy will tempt the Iraqi people and their new government to deepen their dependence upon the revenues generated by the country's vast oil reserves. Indeed, given the devastation and privation left by the regime of Saddam Hussein and the United States-led invasion that unseated him, it is almost unthinkable to expect the Iraqi people not to spend their oil revenues as quickly as they collect them and not to borrow against the oil sector's huge potential future earnings. Wisdom, however, has a good chance to prevail in Iraq. From the skilled technicians who man the wells, pipelines, and refineries to the executives of the country's state oil companies and the officials who work in the ministries, Iraqis have an enormous pride in their oil sector and confidence in their ability to manage the revenues it will produce. These men and women have already built an oil industry. They have seen it abused and destroyed. They know better than any foreigner that the time to set in place Iraq's future petroleum-management system is now. And their talent, motivation, and experience represent a huge advantage.

This summary is a compilation of policy recommendations made by Iraqi and foreign scholars, journalists, union leaders, civil servants, technicians, oil company executives, and officials from international financial institutions and non-governmental organizations during discussions about how Iraq can best manage its oil wealth. These discussions took place from 29 June to 1 July 2005 at a conference in London entitled "Iraqi Oil Wealth: Issues of Governance and Development," which was sponsored by the Open Society Institute and the London School of Economics.

This conference's overarching conclusion was that the Iraqis can fashion an oil-management system to meet their country's needs and prevent it from falling victim to the resource curse. They will not be able to solve their oil-management problems by transposing any one system from another country upon Iraq. But the Iraqis can draw upon lessons learned elsewhere, and from these lessons and their own ideas, harness the country's vast natural wealth to build a better future.

Reconstruction, First Tasks

Generally

Reconstructing Iraq's school systems and hospitals, its roads and bridges, its sewers and water mains, its electrical grid and housing stock, and its oil industry cannot be delayed, even if record world oil prices dampen the willingness of donors to contribute money for these projects. Efforts to establish a sound system for managing Iraq's oil sector and oil revenues must take into account the Iraqis' urgent need for rapid reconstruction and employment growth; nevertheless, the Iraqis should not delay the development and implementation of a sound oil-production and revenues-management regime.

Oil Sector

Iraq's oil sector needs urgent maintenance and expansion of capacity as well as technical upgrading and training for its executives, engineers, and workforce. According to one of the conference participants, less than \$1 billion of the \$20 billion Iraq produces through oil exports returns to its domestic oil industry as investment. Therefore, argued some participants, foreign investment in the 10s of billions of US Dollars will be necessary to get the oil sector up and running. Attracting foreign investors requires establishing security and a sound legal structure. Others maintained that investment needs were much lower than that and that a significant part could be generated domestically.

Most, however, agreed that Iraq needed to contract international oil companies to tap their expertise and obtain new skills and technologies in an effort to rehabilitate existing Iraqi fields damaged by years of reckless exploitation. The development of untapped reserves might follow, participants argued, but not if it means rushing into contracts that would be detrimental to the long-term development of Iraq's local oil industry.

Ownership, Transparency, and Accountability

Ownership

Iraq's natural resources belong to the Iraqis. The people of Iraq are responsible for developing these resources for their benefit and the benefit of future generations. It is crucial that ordinary Iraqis feel confident that they own these natural resources and that they have a voice in how they are exploited and in how the revenues these natural resources generate will be disbursed.

For this reason, conference participants argued, the people of Iraq must engage now in a public debate about how the country will develop Iraq's oil and natural gas wealth for their long-term good. Discussion of this sensitive question must be as open and dispassionate as possible. It must define the institutions that will manage the oil wealth, the roles of international oil companies and other outside actors, and the system for collecting, investing, and disbursing

revenues from the oil industry. The people of Iraq must develop their own oil policy and their own planning, and the goal of this policy and planning should be to ensure optimal benefits to their nation, and not to enrich a few at the expense of the many.

Transparency and Accountability

In order to develop a sense that they own their country's oil wealth and have a voice in its management, the Iraqi people must have reliable information. This requires adopting a practice relatively new to Iraqi culture: transparency, the obligation of all actors in the oil sector to operate in a manner that allows for public scrutiny. Transparency is a tool that strengthens institution-building. In societies like Iraq's, where institutions like the parliament and the press, are still weak, transparency can allow for concerned citizens and non-governmental organizations to shed light on unsound decision-making; disclose fraud, waste, and substandard practices; and press government officials to account for their actions. Transparency also allows investors to gather information, which will enhance the investment climate, improve the quality of investment decision-making, and increase trust.

There is no general system of transparency that is effective for every society and culture. It is up to the people of Iraq to design and implement their own transparency model. Basic elements of transparency in the oil sector include:

- ▶ a requirement that all oil companies reveal all payments to government entities and officials and that government entities and officials make a clear statement of all receipts from oil production and have the state's accounts audited by a neutral party adhering to international standards
- ▶ a tender and licensing process that allows for significant public scrutiny
- ▶ access to significant information for citizens, opposition political parties, government agencies, non-governmental organizations, the press, companies, and foreign states
- ▶ freedom of the press
- ▶ freedom for scholars and academic research centers to study the country's oil sector and publish their findings and conclusions
- ▶ a legal framework that protects concerned citizens and institutions of civil society involved in combating corruption.

Transparency would allow for the publication, at a minimum on the internet, of the following:

- ▶ all information having to do with issuance of licenses, whether tendered or negotiated
- ▶ all contracts and all procurement information

- ▶ all bonus and royalty payments
- ▶ all tax laws and regulations affecting oil companies and their operations
- ▶ the numbers of all domestic and foreign bank accounts into which oil revenues are to be paid (so oil companies can refuse to make payments to unknown accounts that might belong to individuals)
- ▶ the identities of all partners in joint ventures
- ▶ the balance sheets of accounts into which oil and gas revenues are deposited
- ▶ all elements of the fiscal regime, including special fiscal regimes
- ▶ production statistics by field and by permit
- ▶ all prices at which the government sells its oil
- ▶ fiscal prices for calculating costs in production-sharing contracts
- ▶ statements of accounts receivable
- ▶ informative budgets that explain the cost of oil-product subsidies
- ▶ transfers having to do with oil income
- ▶ information on state oil companies and funds, including financial statements and audit reports, etc.

Political leadership as well as expertise is needed to drive the process of establishing and sustaining transparency. Without such leadership, the process may fail. Participants also said that the process could benefit from cooperation with oil companies which embrace transparency and accountability.

Some suggested that the Iraqis join the effort to press international oil companies to publish what they pay to governments and officials in exchange for oil licenses and contracts, that the Iraqis avoid doing business with any company whose officials even suggest that such payments not be made public, and that they require the companies they do business with to adhere to a code of conduct on safety, the environment, and business ethics. A participant in the conference suggested that the Iraqis consider instituting a system to rank the foreign companies operating in the country according to their transparency and accountability.

Constitution and Laws Governing Petroleum and Natural Gas

In addition to being challenging, transition offers opportunities for establishing institutions which can in the future contribute to a transparent and accountable oil revenue management regime. This requires responsible and bold decision-making. But time is short. The Iraqis' urgent need to reduce unemployment and rebuild basic utilities will drive their leaders toward decisions to spend their oil earnings and borrow against future income, and this could squander the opportunity to set in place a revenue-management system that can provide broad, long-term economic growth and reduce the risk of future repression and instability. The urgent need to adopt a constitution -- a draft is due by 15 August 2005 -- may also drive Iraqi leaders to take quick decisions that will set the future natural-resource management system on weak legal foundations and allow for the emergence of future strongmen, perhaps at the central-government level, perhaps at the level of the country's future federal units.

Iraq's leaders can seize the present opportunity and draft and adopt a constitution that will lay a solid groundwork for the kind of oil establishment the country and its people need. The constitution must lay foundations for the rule of law, protection of property rights, the sanctity of the contract, freedom of the press, and legal protections for non-governmental organizations and academe. There were different opinions on the level of detail the constitution should include regarding ownership and management of the country's oil wealth and the legal underpinnings which it should set for future laws and regulations governing the petroleum industry. There was, however agreement on the need to include safeguards in the constitution, such as requiring parliament to take all major revenue decisions in order to insulate the management of Iraq's petroleum and natural gas sector from the whims of future officials and the dictate of short-term political pressures.

In addition to a new constitutional framework, Iraq desperately needs a battery of laws to govern the oil industry, including dealings with international oil companies and financial institutions as well as the management of the revenues oil exports will generate.

Federal vs. Central Control

Iraq's future internal organization is still an open question, but there are strong indications that the new order will be federal.

Would Iraq's central government or its individual federal regions better manage the country's oil resources and revenues? Some conference participants said that, in seeking an answer to this question, Iraq should draw a distinction between oil-extraction operations and the management and distribution of revenues these operations generate and that regions might act as a check upon abuses at the level of Iraq's central government. As a country decentralizes spending, these participants argued, there is a tendency to increase scrutiny.

Other participants, however, cautioned against placing too much faith in federalism when it comes to managing the oil sector. The central government, they argued, can be more capable of managing the industry than the regions. The central government can be better at implementing development strategies that balance the oil sector with other sectors of the economy; at solving fiscal, financial, infrastructure, environmental, and social problems; and at managing the volatility of oil revenues. If the regions provide critical public services, such as schools, water, and electricity, and depend directly on oil revenues to pay for them, the volatility of world oil prices -- can lead to disruptions in these important sectors. This is of course true for the national budget, too. Regional competition over oil revenues can also foster separatist tendencies and feed corruption. Participants pointed out, for example, that the more decentralized Nigeria and Indonesia became, the more corrupt they became in the distribution of oil revenues; in fact, the oil-revenue distribution system in Nigeria led minority ethnic groups to demand the establishment of new federal states and to resort to violence to back their demands. The lack of capacity of federal states to absorb revenues from the oil sector also poses problems. In designing their federal system, the Iraqis must acknowledge that oil-producing regions have special but not exclusive claim to the revenues this production generates.

Parliament, Oil Ministry, National Oil Company, Ancillary Industries

Development of a system to manage Iraq's oil industry and its revenues requires a suitable structure of institutions, Norway is often cited as a model for such institutions although its model is challenging and not necessarily suitable to other countries. However, the general principle which govern the Norwegian model are applicable everywhere.

Conference participants suggested that Iraq's oil sector should be structured in such a way that it does not coalesce into state-within-a-state whose power would undermine democratic decision-making and law and order. As in Norway and other democratic countries the sector should be fully under the jurisdiction of legitimate public authority represented by the parliament, cabinet, and oil ministry:

- ▶ The parliament enacts legislation, approves the fiscal regime, and approves licensing policy and other major policy decisions.
- ▶ The cabinet recommends legislation, forms and implements petroleum policy, approves licenses, and approves field development plans.
- ▶ The oil ministry, which is insulated from the government's commercial interest in the oil sector, submits draft legislation, issues and applies regulations, proposes and implements petroleum policy, grants and administers licenses, approves field development plans, and approves abandonment decisions.

National Oil Company

There was almost unanimous agreement that the oil sector should be led by a strong, commercially viable and independent national oil company which would manage the state's commercial interest in the petroleum sector. The company should act in a transparent and accountable manner and focus on Iraq's long-term national welfare in maximizing revenues to the state and its people.

The national oil company should be free from bureaucratic and political meddling. One participant suggested that the state oil company's responsibilities might include:

- ▶ maximizing value to the state
- ▶ participating in licensing and operator meetings
- ▶ monitoring expenditures in licenses
- ▶ optimizing value by reducing cost and increasing recovery
- ▶ optimizing sale of the state's share of oil and gas
- ▶ considering upstream and downstream ventures
- ▶ administering contracts with other companies in joint ventures
- ▶ developing expertise in oil operations, including geological engineering and management.

Another conference participant suggested a summary of bylaws to govern the Iraq state oil company's plans and charter, which included, among others, these elements:

- ▶ The state oil company should be a fully state owned independent company, administratively and financially entrusted with the task of managing and developing Iraq's upstream and downstream petroleum industry in all its phases inside and outside the country with the exception of the manufacturing and petrochemical activities.
- ▶ The state oil company should perform its duties and obligations in accordance with the state petroleum policy.
- ▶ Iraq's present oil and refining companies should be detached from the oil ministry and attached to the state oil company.
- ▶ The state oil company should have an independent board of directors, possibly made up of board members of the existing Northern Oil Company and Southern Oil Company and the refining directorate.
- ▶ The state oil company should receive an initial capital budget from the government and be allowed to borrow on domestic and foreign markets.

- ▶ The state oil company, along with the oil ministry, should advise the government on the possible privatization of downstream and non-pivotal upstream companies.

Some participants also warned that, if Iraq establishes regional oil companies, or, in the process of becoming a federation, oil companies operated by its federal states, such companies may be less efficient and more susceptible to meddling by their respective regional or federal-state governments.

Development of Ancillary Industries

There was also support for the development of a broad and diversified oil services sector based on Iraqi-owned private companies. The participants suggested that the economic and social benefits derived from a state of the art oil services sector may be as significant as those derived from oil sales.

In Norway 4,000 private companies supply the oil sector with goods and services which helps the country avoid the destruction of its manufacturing sector as a result of Dutch Disease. This is sustained by the requirement that 70 percent of goods and services to oil companies must come from Norwegian companies. However, a large oil services sector will only deliver the promised benefits if it is truly competitive.

Other conference participants cautioned against the development of large-scale industrial projects, because grand projects tend to be the least likely to bring about significant increases in employment. Also the Iraqi private sector like all other aspects of the economy is in dire need for assistance in the areas of finance, human resources and legal enabling environment.

Oil Funds, Revenue Distribution , Oversight

Conference participants cautioned that, at the present time, Iraq's currency seems overvalued and that this may be symptomatic of the so-called "Dutch Disease." This is a condition that arises in an oil state when, among other things, the large inflow of revenues from oil exports raises the exchange value of the state's currency -- making the products of industries outside the oil sector uncompetitive in terms of price on world markets -- and reduces the availability of affordable financing outside the oil sector. The Dutch Disease eventually destroys the non-oil sectors of an economy and deepens the dependence upon oil revenues. Participants commended the Iraqi Central Bank's effort at sterilizing oil revenues through the building up of foreign hard currency reserves. At \$10BN it must be very hard for the bank to protect these reserves from other parts of the government in dire need of resources. The building up of reserves is a critical element of sterilization needed to prevent Dutch Disease. Any future oil fund could be based on these reserves as was the case in Norway. However, if the Iraqi currency is indeed overvalued as some suggested this may indicate that the central bank lacks the tools to sterilize oil revenues or other financial inflows such as foreign aid. It may also indicate that the desire to maintain a high exchange rate for political purposes is coming at the expense of economic prudence.

Oil Funds

One way of overcoming some elements of the resource curse is to establish a special fund or funds for collecting and managing oil revenues. Such funds might include:

- ▶ a stabilization fund designed to insulate the national economy and state budget from currency appreciation caused by inflows of oil revenues as well as the effects of volatility in world oil prices and revenue flows
- ▶ an investment fund designed to foster economic development outside of the oil sector.

Some participants referred to the example of Norway's oil fund, which is administered by an affiliate of the central bank and is used to separate oil revenues from the government's non-oil income and expenditures. The fund is an accounting procedure rather than a literal separation of oil revenues. As such it preserves the integrity of the budgetary process. It is a transparent communications tool. It allows the government and the public to be always aware of the size of the non-oil deficit and the amounts borrowed from or reinvested (in the case of surplus) into the country's stock of wealth. There are no particular restrictions on spending. Parliament retains the democratic prerogative to approve the budget. The fund is invested in foreign assets thus addressing the issue of sterilization and Dutch Disease preventions. But the main strength of Norway's Fund is that it is part of a coherent democratic system of governance.

Some suggested that the management of disbursements from the oil fund must be independent of the government of the day, otherwise the political leaders might succumb to temptation and begin treating the oil fund as a parallel budget.

Some participants suggested that Iraq's oil authorities work to decrease their country's exposure to volatility in oil prices (and consequent volatility in revenues from the oil sector) by applying compensation formulas that shift exposure to such volatility onto the contracting oil companies.

Participants also cited the example of Sao Tome, which directs all of its oil receipts into an oil fund account held overseas by international custodians. A single annual withdrawal, with a complicated, four-signature procedure, is made from Sao Tome's oil fund, and the revenues are then transferred to the state budget. The law forbids extra withdrawals and extra-budgetary accounts. Sao Tome's central bank and finance ministry are responsible for setting investment policy. The public can monitor the activity in the account.

The State of Alaska's oil fund makes direct dividend payments to households. Many participants suggested that Iraq should not follow Alaska's example. They cited a number of reasons. First, an Alaska-type solution assumes that a country has functioning public services and a working health-care system; Iraq has none of these. Second, Iraq's significant deficit would worsen if dividends were disbursed from the oil fund. Third, an Alaska-style solution might produce a reduction in funds needed for reconstruction.

Conference participants also argued against applying the Russian model of taxing the oil sector. So long as the oligarchs controlling Russia's oil sector were also able to influence

government policy, the tax regime was light and variable and gave them insurance against downturns in the oil price. Under President Putin, the Russian government has launched efforts to reel in large oil companies, and the oligarchs have cut back on their lobbying activity and faced higher rates of taxation that do not allow the oil companies much extra profit when the world oil price exceeds \$25 per barrel. Conference participants said this taxation method has undermined investment in the oil sector and halted increases in production.

Some participants suggested that Iraq's central authority should manage most public revenues but that the governments of federal states or regions should have the power to impose and collect certain taxes in order to strengthen their autonomy and balance off the central government's power.

Distribution

Participants agree that the use of oil revenues should always be subject to parliamentary oversight. A single state budget should reflect all state revenues and expenditures and be approved by the national assembly and be freely available to the public. The government should be accountable to parliament for all decisions, including the dispensing of national wealth.

If the new Iraq emerges as a federation, then the disbursement of revenues from the oil sector may become a matter of contention between the central government and the regions. Some participants in the conference argued that the central government is likely to be in a better position to absorb uncertainty and volatility than the governments of the future federal regions and that the central government is better positioned to foster development by diverting revenue from resource-rich to resource-poor areas. Another possibility is for the central government to hand over revenues from the oil and natural-gas sector to the regions based on population size in addition to setting up a fund to deal with equalization, savings and investments. In all cases, the government at all levels must report all spending to the public.

Regardless of the outcome of the federal debate, participants agreed that oil revenues should be distributed on the basis of equity, justice, and development for all. Some suggested that even if Kirkuk was to become part of the Kurdish federal region, oil fields in that province should continue to be managed by the central government. This model could be applied in other regions as well.

Some conference participants suggested that earmarking funds from oil revenues for a specific collective good, for example, the elementary education system, is one method of making it easier for the public to monitor the disbursement of such funds and demand that they be used more effectively. Others opposed earmarking as interfering with parliamentary authority to determine the budget.

Oversight and Auditing

Some participants suggested the formation of a petroleum oversight organization -- independent of the government and parliament -- to monitor management of the oil sector and distribution of oil revenues. Participants described Sao Tome's petroleum oversight group, which has monitoring and ombudsman functions and possesses formidable powers to investigate, obtain information, and coordinate its activities with government agencies, including the auditor general and state prosecutor. Sao Tome also has mandatory audits by the state audit chamber and an international auditing firm; the results of these audits are made public. One member of Sao Tome's petroleum oversight group must be from an opposition party, and three members from civil society.

Investment, Diversification of the Economy

Conference participants described a general relationship between wealth and democracy and how countries generally tend to become democratic as they become richer. Exceptions to this general rule, however, are countries that derive their wealth through oil. Oil wealth does not foster democracy for a variety of reasons. The United States has tended to support repressive regimes in oil states in order to ensure uninterrupted oil supply. Oil revenues give the people in power an independent source of revenues, which severs the relationship between citizens and their government and weakens the citizens' resolve to demand accountable governance. Too many people become dependent upon government handouts. Rent seeking, as the scramble to capture a larger share of oil revenues, becomes the focus of economic and political activity. The government tends to smother the private sector, and private firms tend to weaken. Other sectors, such as agriculture and manufacturing, which provide job opportunities withers.

Conference participants were unanimous in their support for the proposition that, given the political will, Iraq's oil wealth can be managed in such a way that it can foster the growth of a vibrant and diversified private sector with internationally competitive agriculture, manufacturing and services. Such development would strengthen civil society and open new pathways for women and the poor to participate in the political process.

Tenders, Bidding, Monitoring Contract Performance

There was agreement on the need to develop a transparent, fair, well-publicized, and speedy tender and bidding process. Participants also suggested that Iraq ensure that the persons authorized to administer the process are qualified, responsible, and adequately compensated.

Tenders and Bidding

The tendering of oil contracts should adhere to the principles of transparency and openness. The rules should be consistent and clear.

The tenders themselves should be comprehensive, announced to a well-defined time schedule, provide general information, and require interested companies to submit pre-bid qualifications. Iraq's oil management authorities must develop the capacity to negotiate with confidence. Participants pointed out that Libya has recently conducted what is perhaps the world's most-transparent licensing round, in which bids were opened live on television.

Some participants suggested that Iraq refrain from demanding payment for tenders and that Iraq's contracting authorities develop a roster of experienced oil companies and present tenders to them. Participants also said Iraq's oil ministry should improve its website and make the tender announcements on the website clearer.

Monitoring Contract Performance

Participants pointed out that monitoring of contracts once awarded is not less challenging than the tendering process itself. They urged the Iraqi government to honor the sanctity of the contract and refrain from pressing contractors to pay extra costs after a contract has been concluded. Licensees must know they can rely upon the rules of the game when they enter into contracts with Iraq. All contracts and joint venture agreements should be published in their entirety.

The Norwegian Model for Licenses and Joint Ventures

Participants pointed out to Norway's system for licensing international oil companies as something which may provide some benefits in Iraq. This system has the following features:

- ▶ The exploration term is six years, but it can be extended to ten years under certain circumstances.
- ▶ The contractual mode is a joint venture in which the state is a partner.
- ▶ The government insists on choosing the operator, and other licensees must sign a joint-operating agreement with that company.
- ▶ The state can decide on its share of the venture.
- ▶ The fiscal regime is straightforward taxation to the state.
- ▶ No bonuses are requested.
- ▶ Everything is spelled out in advance in the contract process except the work program, which is negotiable.
- ▶ The government insists upon a diversity of licensees for each project, including a mix of national and international oil companies, because each company brings different expertise to the project and each acts as a check upon the others.
- ▶ before it begins negotiating with oil companies, the state -- through the National

Petroleum Directorate -- carries out seismic surveys, risk assessments, and other technical studies to estimate the value of a license. When the oil companies are invited to bid, they are invited to submit their own assessments and propose their own programs.

Privatization

There are some state-owned Iraqi enterprises that could benefit from privatization. Conference participants were unanimous, however, in arguing against the rush to privatize core petroleum reserves and extraction in general, though they did suggest that downstream activities in the oil sector, including petrochemical companies, refineries, and filling stations, might be candidates for privatization.

For several reasons, participants specifically cautioned the Iraqis against adopting a “share allocation” privatization effort like the one carried out in Russia after the fall of Communism. First, in a high-crisis, low rule-of-law environment like Iraq’s, such a share-allocation method is likely to be unsustainable because de facto control of the assets would remain in the hands of one controlling group and, in the absence of strong court system, minority rights would be worthless. Second, in a low rule-of-law environment such as Iraq, a free distribution of shares can lead to disillusionment and produce a deep impression that a corrupt few have defrauded the broad population. Third, breaking up an industry into a number of competitive companies is not sufficient to reduce the danger that its owners will make a bid for power and endanger integrity of state.

Elimination of Subsidies

Reorganizing Iraq’s system for managing its oil resources and revenues will require reforming its present system of subsidizing consumer fuel prices. These subsidies burden the state budget and require selling imported fuel at a loss. They also create arbitrage opportunities which foster smuggling and black market activity. The reform process will require careful planning and sequencing. Abruptly ending subsidies, food handouts, and other benefits without having created an effective social safety net is sure to fuel widespread unrest.

Conference participants suggested the Iraqi government should relinquish its monopoly on fuel imports, gradually free the prices of domestically refined gasoline and diesel fuel, and transfer responsibility for importing refined products to private retailers who will sell their goods at world market prices without trade restrictions. These participants said the government should halve Iraq’s oil and gas imports by 2006.

Eliminating subsidies must also be accompanied by public outreach and education, by incorporating price liberalization into a wider package of economic reforms, and by implementing schemes to protect the welfare of the poor.

Smuggling and Corruption

One of the by products of the subsidies system is rampant smuggling of crude oil and products. One participant familiar with the process from the sanctions years, caused an uproar when he suggested that British troops patrolling Iraq's costal waters like the US troops before them during the sanction were getting a cut from oil smuggling. His contention was not supported by any evidence but was echoed by other participants.

The participants spoke of the lack of transparency both in the production and export of oil and in the use of its revenues during the occupation. Familiar themes were sounded about the absence of metering at the well heads and the lax contracting and accounting practices at the now-defunct US-led Coalition Provisional Authority (CPA).

Iraq Revenue Watch and OSI

It is up to the Iraqis to determine the best approach to pursuing transparency and accountability in the management of their oil wealth. Iraq Revenue Watch and the OSI stand ready to work with them in this pursuit. Areas of cooperation could include:

- ▶ Building partnerships with NGO's, think tanks, institutions and individual activists
- ▶ Facilitating future debates both in Iraq and outside it and bringing in knowledge and expertise as needed
- ▶ Bringing Iraqi ideas and proposal to Western governments and public opinion and pressuring governments and corporations on transparency and accountability
- ▶ Training and capacity building for activists, journalists, policy makers and officials
- ▶ Publication, translation and dissemination of relevant materials in Iraq.

Appendix

Conference Participants:

1. Abbas, Abud Karim
Oil Tanker Engineer, Anti-Corruption Activist
2. Ahmad, Ehtisham
International Monetary Fund
3. Amitrano, Matt
US Department of State
4. Al Anbaki, Kahtan
Consultant
5. Al Hafedh, Mehdi
CEDID, Former Minister of Planning
6. Al Jawahiri, Jamal
Iraqi Al-Amal Associations
7. Al Kasim, Farouk
Petroteam
8. Al-Mhammedawi, Emad Rehaif
Trades Union Activist, Southern Oil Company
9. Al Saadi, Sabah A Shibeeb
Legal Advisor, Southern Oil Company
10. Al-Shamma, Karim
Oil and Gas Consulting
11. Ameen, Adnan
DG Macroeconomics Ministry of Finance
12. Asadov, Farda
OSI – AF Azerbaijan, Caspian Revenue Watch
13. Bell, Joseph
Hogan & Hartson LLP
14. Boehm, Joshua
US Embassy in London
15. Butler, Nick
BP Group Vice President Strategy
16. Collier, Paul
Oxford University
17. Coolidge, Jennifer
Oxford University
18. Darby, Sefton
Department for International Development, DFID
19. Fahmi, Raed
Editor Al-Thaqafa Al-Jadida
20. Gantley, Guy
Foreign and Commonwealth Office, FCO
21. Hadi, Riadh Aziz
Dean Political Science College, Baghdad University
22. Hetherington, Michael
Foreign and Commonwealth Office, FCO
23. Hmood, Ali Faisal
Chief Engineer Southern Oil Company
24. Kaldor, Mary
London School of Economics
25. Karl, Terry
Stanford University
26. Kasim, Mudher M Salih
GD Research Central Bank of Iraq
27. Khadduri, Walid
Economics Editor Al Hayat
28. Lebillion, Philippe
University of British Columbia
29. Lissakers, Karin
Revenue Watch Board Member
30. Mandeville, Morgan
Open Society Institute
31. Marcel, Valerie
RIIA Chatham House
32. McCarthy, Julie
Open Society Institute
33. McFarquhar, Rory
Goldman Sachs Russia
34. McLaughlin, James
Foreign and Commonwealth Office, FCO

35. Meek, Tom
Foreign and Commonwealth Office, FCO
36. Meyers, Keith
RIIA Chatham House
37. Miller, T. Christian
Los Angeles Times
38. Mshayhi, Abdullah Jabar
Activist Oil Workers Union
39. O'Leary, Brendan
University of Pennsylvania
40. Olsen, Willy
Open Society Institute
41. Op de Beke, Anton
International Monetary Fund
42. Othman, Mahmood
CEDID
43. Rangelov, Iavor
London School of Economics
44. Radhi, Judge Hamza
Chairman Commission on Public Integrity
45. Rahman, Bayan
Kurdistan High Representative UK
46. Richter, Anthony
Open Society Institute
47. Ross, Michael
University of California, Los Angeles
48. Said, Yahia
London School of Economics
49. Shafiq, Tariq
Petrolog & Associates
50. Shahristani, Hussein
First Deputy Speaker of Parliament
51. Shlash, Amal
Chairwoman House of Wisdom
52. Taylor, Simon
Global Witness

Copyright © 2005 Open Society Institute. All rights reserved.

Anthony Richter, Associate Director, Open Society Institute

Julie McCarthy, Acting Director, Revenue Watch

Yahia Said, Director, Iraq Revenue Watch

Morgan Mandeville, Program Assistant, Revenue Watch

Iraq Revenue Watch monitors Iraq's oil industry to ensure that it is managed with the highest standards of transparency and that the benefits of national oil wealth flow to the people of Iraq. Iraq Revenue Watch complements existing Open Society Institute initiatives that monitor revenues produced by the extractive industries.

In many parts of the world, the lack of proper stewardship over oil resources has resulted in corruption, the continued impoverishment of populations, and abuses of political power. By prompting governments to tackle these problems early, the Open Society Institute hopes to help Iraq avoid this plight.

The Open Society Institute currently supports a recently launched initiative, Caspian Revenue Watch, which monitors the development of oil production in the Caspian basin. The goal is to promote transparency, accountability, and public oversight in the management of oil and natural gas revenues.

Iraq faces even greater challenges than the Caspian region. If Iraq is to become an open, democratic society it will need to develop transparent accountable institutions for ensuring honest management of oil revenues.

There is an urgent need for Iraq Revenue Watch given the current occupied status of the country. The Coalition Provisional Authority and the Iraqi Governing Council should establish rules that ensure complete transparency regarding Iraqi oil revenues. So doing will foster a stable, democratic Iraq, and will protect the Coalition Provisional Authority from charges of misappropriation during this period of trusteeship over Iraq's reconstruction.

The **Open Society Institute**, a private operating and grantmaking foundation based in New York City, implements a range of initiatives throughout the world to promote open society by shaping government policy and supporting education, media, public health, and human and women's rights, as well as social, legal, and economic reform.

For more information, contact:

Iraq Revenue Watch program

Open Society Institute

400 West 59th Street

New York, New York 10019

USA

E-mail: irw@sorosny.org

<http://www.iraqrevenuewatch.org/>

Designed by Jeanne Criscola | Criscola Design

