Iraqi Oil:

Baghdad Looks for a Bigger Role

by Simon Henderson **(/experts/simon-henderson)**

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ABOUT THE AUTHORS

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Brief Analysis

At the end of June, Iraq is expected to award service contracts to international oil companies in an effort to boost production at six of the country's giant oil fields. The twenty-year contracts not only are part of a development program intended to nearly triple Iraq's oil production, they also represent potentially important advances in the political development of post-Saddam Hussein Iraq. In the six years since the U.S.-led invasion, oil production has stagnated, hampered by poor security and lack of investment.

A Potential Giant

In oil terms, Iraq is a major player with the potential for becoming even bigger. Commonly accepted figures, published in the BP Statistical Review of World Energy, indicate that Iraq has 115 billion barrels, or 9.1 percent, of proven world oil reserves, exceeded only by Iran (10.9 percent) and Saudi Arabia (21 percent). Industry experts suspect that Iraq's reserves may be even higher, as much as 350 billion barrels, significantly more than Saudi Arabia's 264 billion barrels. Iraq's production during 2008 averaged 2.4 million barrels per day (b/d), of which approximately 1.9 million was exported. If Iraq can achieve its aim of increasing production to six million b/d within ten years, it would become the world's third largest exporter, after Saudi Arabia and Russia.

Iraq also has significant reserves of natural gas, estimated to be the tenth largest in the world. Since Iraq lacks the necessary infrastructure to capture the gas as a byproduct of oil production, it is wastefully "flared" or burned off. Two untapped gas fields are included in the projects open to foreign bids.

The contracts to be announced at the end of June are for the rehabilitation of six giant producing fields, with total reserves of 43 billion barrels. More than thirty companies have shown interest, including Chevron, BP, Shell, Sinopec of China, Lukoil of Russia, and Total of France. The offered deals are service contracts, which grant payment for work performed rather than ownership of discovered reserves.

Opposition to the Contracts

The proposals have upset several groups in Iraq, including the existing state-run oil-producing companies and affiliated labor unions, which think they can do the rehabilitation work themselves, as well as members of Iraq's parliament, who are unhappy with the draft contracts. It will be the first time that foreign companies have been involved in Iraq's oil industry since the sector was nationalized in 1972. Much of the opposition has been focused on the oil minister, Hussein Shahristani, a political ally of Prime Minister Nouri al-Maliki, who has argued that Iraq has neither the available investment funds nor the engineering capacity to undertake the job. (A former nuclear scientist, Shahristani was imprisoned in Saddam's time for refusing to help build an atomic bomb before fleeing to exile in Iran.)

Disputes Remain over Kurdish Oil

Running parallel to the debate about foreign participation in Iraq's oil industry has been the controversy over the development of oil and gas reserves in the Kurdish area of northern Iraq. The semiautonomous Kurdish authorities have been negotiating production contracts with foreign companies, which Shahristani has refused to recognize. The contracts are production-sharing agreements in which private companies take a share of the profit, a feature particularly disliked by the Iraqi government. But in May, Baghdad, facing budget problems because of the fall in oil prices from last year's peak, allowed Kurdish oil to flow into the main national pipeline system for export through neighboring Turkey. (Still to be resolved is whether the revenues from these sales go to the central government or the Kurdish authorities. The Kurds say the federal constitution allows them to have their own oil industry. Baghdad disagrees.)

The flow of oil from Iraqi Kurdistan has set off a scramble for access. Addax Petroleum, a small London-listed oil exploration company with operations in the region, has found itself being bid for, first by the Korean National Oil Corporation and then, in an offer valued at nearly $8 billion, by Sinopec of China. Another British company operating in the area, Heritage Oil, has announced a $6 billion merger with a Turkish group, Genel Enerji. These figures dwarf the current value of oil exports from the area, about 100,000 b/d, but reflect Kurdish claims that production could reach one million b/d by 2012.

Doubts Abound

Despite the atmosphere of opportunity and change, seldom has there been oil exploration with so many uncertainties. Chief among these are security and the safety of oil personnel, unforeseen technical obstacles that could block projected expansion in the giant underground reservoirs, and commercial risk, namely, the prospect of not being paid because of bureaucratic delay or political obstruction. The announcement of the winning bids, scheduled for June 29 and 30 but mired in political infighting, could be delayed.

An old argument that will probably reemerge is the canard that the 2003 invasion was to gain control of Iraqi oil. The oil remains Iraq's; foreign companies are merely being asked to help produce it. This fear might be deflected by the expected decision of the oil companies to form large consortia for their bids, reducing their financial exposure and giving themselves a broad international identity rather than, for example, a U.S. or British label. Iraqi nationalism, which combines hatred of the country's quasi-colonial past and pride in the nation's independence, is probably the larger issue.

U.S. Interests

The revival and rehabilitation of Iraqi oil production has been one of the main planks of U.S. policy since the 2003 overthrow of Saddam Hussein. The slowness of the recovery reflects both the post-invasion chaos in the country and the lack of investment and inconsistent policies during the Saddam era. The drawdown of U.S. forces and smaller local expenditures have affected Baghdad's budget, forcing a decision on foreign investment in the energy sector, which accounts for 75 percent of GDP and a staggering 86 percent of government revenues. One of the consequences of the provincial elections earlier this year was to move the political debate forward -- successful candidates tended to be less sectarian and more aware of local issues. Prime Minister al-Maliki needs to use this momentum to push through the new oil policy.

Nationally, the development of Iraq's oil touches on the vexing issues of Saddam's preferential treatment of the western Sunni Arab provinces at the expense of the southern Shiite provinces and the northern Kurdish areas. This tension is exacerbated by the location of the oil, mainly in the south and north rather than the west, and a Shiite and Kurdish desire to be compensated for past injustices.

Regionally, Turkey, with its own troublesome Kurds, is sensitive to Iraqi Kurds enjoying too much autonomy and to ethnic Turkomens being squeezed out of the northern oil-rich city of Kirkuk. Neighboring Saudi Arabia and Iran will also be concerned if a future Baghdad administration usurps their positions in the international oil market or in the OPEC cartel.

The bulk of Iraqi oil, both historically and currently, goes to refineries in Asia, including China and India. Gas exports are a distant dream, but have been mentioned in connection with the planned Nabucco pipeline, which could provide an alternative supply to European countries currently dependent on Russian supplies. At current volumes, Iraq has more than a hundred years of both oil and gas production. Despite the talk of the eventual emergence of a post-oil world, Iraq is looking for an increased role in the present one.

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