

Iraq economy: Now the hard part

December 14th 2009

Printer version

FROM THE ECONOMIST INTELLIGENCE UNIT

Iraq's second oilfield bid round was a resounding success from the government's point of view, with seven contracts awarded to consortia led by Shell, CNPC, Lukoil, Petronas, Gazprom and Sonangol (Angola's national oil company, which secured two deals). Combined with the three major deals awarded from the first round, this implies an aspiration to lift Iraq's oil production over 10m barrels/day in the second half of the next decade. However, realising that goal will be no easy task.

Political, legal, human and technical challenges await the international oil companies (IOCs) on top of the obvious security fears, stoked by the third major bombing in Baghdad just three days before bidding started. On the two days of the auction, the centre of the city was in lock-down, with the main road from the green zone to the oil ministry closed to ordinary traffic, and security forces lining the companies' passage. At least four Iraqi army helicopters flew overhead.

The winning companies join BP and CNPC, who together won the Rumaila field contract in the first bidding round in June, and consortia led by ExxonMobil and Eni, who negotiated deals respectively for the West Qurna Phase 1 and Zubair projects, after their unsuccessful round one bids.

The oil minister Hussein Shahristani, pointed out that contracted target production amounted to 6.4m b/d from the first-round fields and 4.8m b/d from the second. Combined with around 1m b/d of Iraqi indigenous production, this would achieve his stated target of 12m b/d—an unprecedented rate of increase in the history of the oil industry.

Reality check

In a note of realism, Thamer Ghadhban, a former oil minister and now oil adviser to the prime minister Maliki, told a conference in London prior to the bid round that he doubted that such elevated production targets could actually be achieved, given infrastructural, political and human constraints. If they were not met, investors' remuneration would be cut accordingly.

The simultaneous development of ten oilfields, including four giants and four supergiants would put strain on the service and equipment industries in any country. Drilling and seismic teams, for instance, will be in heavy demand. Once its current orders have been delivered, Iraq will have 46 drilling rigs, which would barely be capable of delivering the production increase for one of the fields, let alone ten. Prices for inputs—such as steel—

are likely to increase dramatically.

On top of these challenges, the IOCs will be working in a country ravaged by three decades of war and sanctions. Much infrastructure remains in disrepair, and roads and bridges will certainly need to be upgraded to allow the transport of heavy equipment. Three of the supergiant fields and one giant are in Basra province, which raises fears of supply bottlenecks. The oil companies also need prodigious quantities of water to conduct operations of the scale that they are envisaging, and this could prove to be a major obstacle owing to the much reduced flows down the Tigris and Euphrates.

Political minefield

Iraqi oil workers are renowned for their ingenuity, having managed to hold their industry together through the dark years. Nevertheless, since 2003 Iraq has struggled even to achieve pre-war levels of production, of 2.5m-3m b/d, hampered as much by political divisions within the industry and the government blocking investment decisions, as by security problems. It remains to be seen whether these divisions will affect the work of the foreign companies. And many of the best Iraqi experts have left the country or been pushed out. In 2007, ministry officials said around two-thirds of the top managers from 2003 were no longer in their jobs.

To assert greater control over the southern oilfields, the ministry has replaced the head of South Oil Company (SOC) three times in the last two years. Continuing this trend, the Iraqi partner with the foreign oil companies will be the State Oil Marketing Organisation, a financial rather than operational partner. Staff will be transferred from SOC, but some of the institutional management capacity may be lost. And many in the southern oil industry are far from happy. Most SOC managers opposed the first bid round, as too did the powerful oil trade union. Companies will struggle to win workers' loyalty. As one Iraqi expert noted of the ministry's relationship with SOC, "you can force the bride to marry, but consummating the marriage by force, that's something else".

If Iraq has lost much of its technical expertise, it is even shorter of lawyers, economists, accountants and regulators. The scale of the investment will likely exceed Iraq's capacity to oversee it, and to manage the revenues effectively, raising fears of the resource curse. It may turn out to be the twenty-first century's first gold rush, as companies race to extract oil from Iraq's prodigious resource, cobbling together infrastructure as they go along, and with little regulatory control.

Lawless

Yet perhaps the biggest concern for the companies is the continued absence of an oil law, three and a half years after it was drafted. Passage of that law has been a major goal of both the Bush and Obama administrations, but has been blocked by the Kurds, who believe oil policy should be decentralised, and by Iraqi nationalists, who want to see the oil remain in the public sector. It was nationalised between 1972 and 1975, after what most Iraqis see as unfair exploitation by western multinationals. If Iraqis do not see quick

concrete benefits from the oil developments, resentment is likely—as has already been seen in the first foreign oilfield project in Iraq, CNPC's development of the al-Ahdab field in Wasit province.

Mr Shahrستاني has said he is keen to sign the new contracts before parliamentary elections, which are now delayed until early March. But without an oil law, companies have little legal cover, should the new government decide it doesn't like the deals. The outcome of elections is wide open, with uncertainties over whether voters will reject sectarian parties, as they did in January's provincial elections. Resolution of disputes with the Kurdish parties is also likely to be a factor, as are security worries.

Key members of the parliamentary oil and gas committee, say that a 1967 law requiring parliament to ratify all oil contracts is still in force. Whilst the oil ministry insists that such ratification is not necessary under the 2005 constitution, the constitution itself requires an oil law to regulate the oil industry.

Mr Ghadhban, who was one of the drafters of the oil law, indicated sympathy for the view that parliament should approve contracts. A year previously, he had rejected that case, because it would be too slow but he now concedes that it has “some merits”.

These combined concerns deterred some companies—notably Chevron—from bidding in the second round. But for most, the offer of a stake in the world's last great oil province was too great to resist.

Iraq's second oilfield bid round awards

Field	Winning Bidder	Output target (b/d)	Fee US\$/b
Majnoon	Shell, Petronas	1.8m	1.39
West Qurna 2	Lukoil, Statoil	1.8m	1.15
Halfaya	CNPC, Total, Petronas	530,000	1.40
Gharaf	Petronas, Inpex	230,000	1.49
Badra	Gazprom, Kogas, Petronas, TPAO	170,000	5.50
Qaraya	Sonangol	120,000	5.00
Najmeh	Sonangol	110,000	6.00

Source: Ministry of Oil, Baghdad

The Economist Intelligence Unit

Source: [ViewsWire](#)