

Iraq's Crude Oil Production Capacity: The Way Ahead

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*The following is a text of a speech given by Thamir al-Ghadban on 7 December 2009 at the Iraq Petroleum Conference 2009 in London organized by CWC. It is reproduced here with the author's permission. **Mr al-Ghadban** is the chairman of the advisory commission at Iraq's prime minister's office and a former oil minister.*

It is a great pleasure for me to be present in this distinguished gathering and to participate in the Iraq Petroleum 2009 conference organized by the CWC. I would like to extend my thanks and appreciation to the organizers for inviting me to speak about "Iraq's crude oil production capacity" and the way ahead. A year has passed since we met here in London during which important developments have taken place.

The country as a whole and the Ministry of oil in particular is embarking on a substantial program to build up Iraq's crude oil production capacity in cooperation with international oil companies. The present environment in Iraq is conducive to carry out such task and the issue itself is of paramount importance to the country and its future. It's also a hot issue that has become a subject for debate on the national as well as the international level.

Let me just do a quick historical overview to put the current developments in context and then I will explain our current plans, the future outlook and the upstream oil policy as it relates to those recent developments. In a second part I will examine the nature of the new role envisaged for the international oil companies in Iraq of today. And finally, I will talk about the relation between Iraq and Opec that is bound to become an issue of major importance as Iraq regains its status on the international oil market.

Three Decades of Success and Disappointments

Following the nationalization of the Iraq Petroleum Co (IPC) and Basrah Petroleum Co (BPC) during the period 1972-1975, INOC drafted a five-year development plan for the period 1976-1980 which was approved by the government in 1975. It was a comprehensive plan that addressed the development of all segments of the upstream sector including exploration and appraisal and oil fields development, storage and export facilities as well as the development of human resources. The results were outstanding as witnessed by the new threshold of crude oil capacity of 3.8 million b/d reached in 1979, with a sustainable annual rate of production of 3.5 million b/d.

On the heels of this success, a second five-year plan was adopted in 1979, covering the years 1979-1983 which had for target the achievement of a production

capacity of 5.5 million b/d. The aim was to reach these levels in the fifth year of the plan.

As you all know, the second five-year plan was never completed, nor were any of the several other plans that followed over the following three decades. Three wars and 13 years of sanctions had their devastating effects on the Iraqi oil industry in general and on the upstream sector in particular.

The country's export capability was hardly hit right after the start of the Iraq-Iran war in 1980 due to the loss of export through the Arabian Gulf. Production was in the range of 1.0 to 1.5 million b/d during the first five years of the war but gradually built up after the opening of a new export outlet to the Red sea in 1985 when the first phase of Iraqi pipeline across Saudi Arabia (IPSA) was completed. Further buildup was achieved during the next five years as a result of the capacity expansion of the Iraqi Turkish pipelines as well as the completion of the final phase of IPSA. The end of the Iraq-Iran war in 1988 enabled Iraq to resume export from the Gulf offshore terminals and to achieve a peak production of 3.25 million b/d during the first quarter of 1990. Unfortunately, this comeback didn't last long, as you all know, since it was followed by the invasion of Kuwait in August 1990 and the ensuing war in 1991. The upstream sector was crippled by economic sanctions and the damage sustained by the production and export facilities, especially in the south of country when they became targets for long range missiles and smart bombs. Rehabilitation and reconstruction were carried by Iraqi engineers and workers with marvelous success and production was resumed but the UN sanctions prevented export and therefore production hovered around 750,000 b/d until the end of 1996 when the oil-for-food program was started. The country resumed a gradual build up of production reaching more than 2.5 millions b/d during the years 1999-2001. However, the sanctions that lasted 13 years had serious negative effects on the whole Iraqi oil industry. It affected manpower and facilities and resulted especially in a wide knowledge gap where technology and know how is concerned. The damage incurred right after the third Gulf war in 2003 led to a loss of almost 2.0 million b/d in production capacity, which went down from 2.8 million b/d before the war to just 900,000 b/d after the war 2003.

More than six years have passed since the end of the war and the production capacity is still below what was prevailing prior to the change of regime. A rapid build up was achieved during the first six months of the rehabilitation period when we revamped our capacity back to 2.5 million b/d capacity. However, since the beginning of 2004, production remained around 2 million b/d, and the increase that was witnessed during 2008 and 2009 was mainly due to the unlocking of the northern fields' existing capacity as a result of improved security and securing the export pipelines. It was not due to any substantial additions in oil field production capacity or new field development plans. It was for this reason that last year's production capacity of 2.92 million b/d could not be sustained through the end of the year and plans had to be revised to a more modest target of production and export capacity of 2.5 million b/d and 2.0 million b/d respectively, both to date are not yet fully met.

The New Targets

In 2008, the Ministry of oil drafted a five-year plan as well as a ten-year plan. The ten-year plan 2008-2017 aims at achieving a set of targets for oil and gas exploration and production. Those include adding some 40 billion barrels of oil and some 70 trillion SCF of gas to Iraq's proven oil and gas reserves by embarking on an extensive exploration program. According to the plan, an oil production rate of 4.1 million b/d is to be achieved by 2012, and is to be ramped up to 6.0 million b/d by 2017.

Realizing the expansion of the oil and gas production is being done through the ministry's well publicized first and second licensing rounds. Figures such as 6, 8, 10 and even 12 million b/d of crude oil production capacity resulting from implementing contracts awarded and to be awarded in the two rounds were put forward by official and non official sources, though some critics doubted a 10 or 12 million b/d capacity could be achieved.

So far the cabinet has ratified the Rumaila development contract and two others for Zubair and West Qurna-phase 1 fields are awaiting ratification. We will know the results of the second bid round, which will be hosted in Baghdad, by the end of this week and we will then be able to assess which of these figures is achievable.

It is imperative here to examine some economic indicators in order to understand the rationale behind Iraq's endeavor to reach a higher crude oil production capacity. Allocation of capital expenditure in the current annual budget constitutes about 20% as compared with 80% for operational expenditure, half of which goes towards the payment of salaries. There are some 3 million government employees constituting almost 10% of the population. Government capital expenditure was about 10% of the gross domestic product during the period 2004-2007, when taking foreign grants in consideration, while (consumption) operational expenditure exceeded 22%. Although this ratio has improved during 2008, it's still way below the required rate to accomplish the targeted growth rate. The overall investment expenditure during the period 2004-2008 is some \$35 billion. The share of oil revenue in the gross domestic product has increased from 46% in 1990 to 56% in 2008, while the contribution of most of the remaining sectors has diminished. It's not possible to talk about diversification of the economy in this context.

As things stand, the government is unable to provide enough revenues to improve services such as health, education, supply of potable water, building a sewage treatment system and providing housing, not to mention the capital intensive infrastructure such as highways, railways, airports and ports...etc. There is a deficit of 30% in the current school system and 11% of the population are living under unhealthy conditions. A recent survey revealed that 22% of the population lives under the poverty line.

New Measures

In the face of those facts, and due to the importance of the upstream industry for the entire economy of Iraq, oil policy issues and development plans as well as the current performance of the sector were the subject of numerous debates during 2009, including in the council of ministers and the council of representatives. A high level committee was formed at the end of last year to assess the status of the upstream and

its performance and to come up with recommendations to improve it and deal with bottlenecks that are preventing the optimization of its performance. This was followed by a conference in Baghdad earlier this year to which oil experts from inside and outside of Iraq were invited to contribute and enrich the discussions. Irrespective of the motivations of some of the critics of the performance of the oil sector, within Iraq and outside of it, the debate was in essence triggered by the slowness in achieving higher production and export rates in line with the plans described above, at a time when the country is in dire need of oil revenues to sustain the reconstruction effort and deal with the tasks at hand. Within the oil ministry, a different debate was taking place among the top ministry officials which had for focus a number of serious issues, namely:

- The role of IOCs versus the national effort
- The fields to be offered in the licensing rounds
- The model contract to be adopted and its duration.

Issues were also raised regarding the involvement of IOCs in oil field development by members of parliament and politicians who called for Parliament's ratification of contracts in the absence of an oil and gas law, especially that what is at issue here is long term contracts.

Observing the continuous decline in oil field potential without being able to arrest it, and feeling the growing pressure within government circles for the additional oil revenues in view of the country's rising needs, the Ministry's leadership became convinced that the national effort cannot meet the challenges to provide sustainable and substantial buildup of production capacity. An earlier effort to engage the help of IOCs through technical support contracts failed. It finally opted for contracting IOCs to help build up the production capacity starting with six oil fields, all in production, containing more than 43 billion barrels of proven oil reserves in the first Bid Round. It then followed with the second Bid Round offering 15 discovered but undeveloped oil fields, containing more than 40 billion barrels of proven oil reserves, the results of which we will see, as I said earlier, at the end of this week.

Oil Policy Issues

Besides stating the basics of an oil policy adopted by any host country such as jurisdiction over its hydrocarbon resources and the fact that cooperation with international oil companies is one of the options during the exploitation of hydrocarbon resources, it's to be emphasized here that in the case of Iraq a number of key elements are cornerstones to any viable policy. They are as follows:

- Maximization of oil revenues in the short and medium terms
- Rapid build up in production and export capacity.
- Enhancing the national capability in managing and administering the upstream oil industry, whether by direct national effort or through cooperation with IOCs. This requires capacity building of Iraqi oil personnel, updating of all managerial and technical skills and practices, empowering management of operating national oil companies and finally the reestablishment of INOC.
- Avoid relying on national financial resources in view of the huge investment required and substitute it with foreign direct investment to develop some of the oil fields and required infrastructures.

- Utilization of natural gas as much as possible, which requires a halt to flaring and satisfying the country's need for gas as fuel and feedstock, as well as enabling the country to become a gas exporter in view of the size of its gas reserves.
- Embark on an exploration and appraisal program to add up to the proven oil and gas reserves and convert some of the probable reserves into proven reserves.

In line with those principles, a high level committee established by the council of ministers to assess IOCs offers in the first bid round, came up with a set of recommendations regarding oil policy and the organization of bid rounds. Some of the recommendations which were recently adopted by the council of ministers were as follows:

- Where oil production and export capacity is concerned: it pointed to the need to take all necessary measures that ensure their rapid and substantial growth.
- Regarding the first bid round and contract awards: it recommended the approval of the Rumaila oil field development contract with BP/CNPC and the two contracts for Zubair and West Qurna-phase 1 once finalized by the ministry of oil.
- Regarding the national oil companies, it recommended that full and immediate support should be given to NOC, SOC and MOC to grow and contribute to the development of the sector including giving them the option to cooperate with IOCs. This requires introducing new and flexible financial and administrative means to enable the three regional companies to pursue the development of the producing fields not contracted in the first bid round - Kirkuk, Bai Hassan and Missan - as well as bringing new fields on stream, while targeting higher production plateaus than those previously pursued.
- It stressed the need to work with the Council of Representatives to conclude the legislation of INOC draft Law that was passed by the Council of Ministers in order to create a competent national entity that would manage all the extractive oil operations
- It further recommended that any bidding rounds beyond the first and the second are not justified except where exploration activity is concerned.

A New Role for IOCs

Working with IOCs in oil field development is not new to Iraq. In the 1960's and 1970's before and after the nationalization of 1972-1975, a number of contracts were signed with foreign companies such as the service contract with France's Elf, the work of which resulted in the discovery and development of Missan oil fields. Another example is the service contract with Petrobras that led to the discovery of Majnoon. There were also negotiations with some 80 conducted during 1990's, and the award of three development and two exploration contracts. It's worth mentioning here that all those contracts were ratified by laws. The current calls for similar ratification of new contracts have merits especially in the absence of the Oil and Gas Law. No doubt such ratification would further ensure stability of such long term contracts, which is in the interest of both sides. The arguments of the ministry of oil for not opting for this course of action and for being satisfied with cabinet ratification are well documented. It's based on the argument that this is not stipulated in the

constitution of 2005, in contrast with the constitution of 1970 that required such ratification.

Of course, there is a major difference here from past contracts. Here we are dealing with producing oil fields, including super giants such as Kirkuk and Rumaila. The size of the reserves of the fields tendered in the first and second bid rounds together amounts to more than 70% of the country proven reserves.

The government's desires are clearly reflected in the model contracts. The IOCs are to carry a number of well defined tasks starting with providing investment, further develop the oil fields in accordance with approved development plans and shoulder the responsibility for meeting production targets. Transfer of technology, capacity building and training of Iraqi personnel in all facets of skills required for the management and oil operation as well as providing work opportunities for Iraqis and utilization of the national content, are all included. Model contracts in both bid rounds are based on a service type agreement and it's clearly understood that all the IOCs shall work as commercial contractors under the rule of Iraqi Laws.

In view of the importance of the oil and gas resources to the nation as a whole and the controversy associated with the re-entry of the IOCs, it would be of critical importance that all obligations be met on time in accordance with the contracts. I would also recommend that IOCs take social corporate responsibility seriously as it will always be conceived by the population as a yardstick for measuring the success of the contracts awarded. The local communities, as the companies will witness for themselves – I think one company, CNPC has already had the first experience with this in Al Ahdab – have expectations which I advise taking into consideration as companies go over their investment plans.

Iraq and OPEC

I am not surprised at all by the attention given to the future role of Iraq in OPEC and the issue of its quota. Several articles have appeared in specialized oil publications and in newspaper assessing Iraq's future production capacity and some of them talking about an imminent conflict within OPEC. Before expressing my opinion I would like to remind the audience of the different thesis that circulated after the fall of the regime. I recall it started with Iraq leaving OPEC and went further claiming that the Iraqi oil industry will be privatized and that oil is actually flowing into the Kirkuk- Haifa pipeline – even though that pipeline was scrapped many decades ago. With all due respect to the opinions expressed by the different analysts and experts, and many are reputable and their analysis is enlightening, I tend to differ.

No doubt that whatever contracts have been signed and going to be signed with IOCs shall lead to a substantial build up in production capacity. However, building up the country's production capacity is far more difficult and a much more complex process than summing up numbers. With all due respect also to the IOCs and their technical expertise, I believe that some of the plateau figures that were bid on certain fields in the first bid round are inflated and most likely unsustainable for the stated plateau period of seven years. My statement is based on thorough examination of the geology of the fields, their production profiles, and other similar criteria. The plateaus bid were motivated by the IOCs eagerness to win contracts and the fact that the scoring formula used to assess offers, encouraged that by giving an unbalanced

preference to the production rates in comparison to the remuneration fee. I have stated earlier that the prime objective of the national oil policy is to maximize revenue and therefore the country is not after a market share and definitely not in a position to spend billions of dollars to acquire idle capacity. The build up is going to be gradual and the plateau capacity is not going to be equivalent to the sum of plateau rates as expressed by the IOCs in the first bid round. Logistics, mobilization of equipment and manpower, harmonization of working conditions between Iraqi and expatriate manpower in the producing oil fields, socio-political as well as security conditions, all shall have their role in influencing building up and sustaining the production capacity.

In view of the country's need for greater revenue to satisfy its people's needs and its desire to improve the living conditions after the long years of deprivation; the lost capacity over the past three decades which benefited other producing countries many of which sit on hundreds of billions of dollars in sovereign funds; forecasts of future supply and demand and the expected decline in the output capacity of some member countries, I am of the opinion that we're not facing an imminent problem with regard to Iraq's efforts to regain its rightful place in OPEC. I think it's more constructive to look at the bright side of Iraq becoming again a main contributor of oil supplies, and hopefully natural gas as well, to world markets in the near future and its contribution to market stability.

Conclusions

In conclusion I would like you to go away with a few thoughts on where Iraq is and where it's heading, as much as one can talk in confidence about the future.

- We are progressing but we still have challenges ahead, however they are manageable when compared with what has been achieved so far.

- Crude oil capacity expansion is of paramount importance to the future of the whole nation and it occupies top priority in governmental strategies and plans.

- The country and its political leadership is determined to go ahead to regain its rightful place in world energy market and to play a constructive and effective role within OPEC.

- We see ourselves as part of the regional and global system not outside of it or on the margin and we want to take our part of responsibility in contributing.

- The national interest shall always be upheld and the Iraqi oil industry shall be managed as always by Iraqis for the good of the nation.

- Cooperation with IOCs is one of the means to expand the development of the oil industry and shall not be a substitute to our national efforts.

- We are confident of success for the good of all not just for us.