

**Iraq's Upstream Industry**  
**The Building Blocks of an Oil Giant**

Thamir A. Ghadhban  
Chairman of the Advisory Commission,  
Prime Minister's Office  
Iraq

**IRAQ PETROLEUM 2011**  
**LONDON**

Mr. Chairman,  
Distinguished participants,  
Ladies and gentlemen

It is a great pleasure for me to be present among this distinguished gathering and I hope we have fruitful discussions over the next two days.

I would like to start by a brief about the current status of the economy and its future outlook with the government's strategy for reform of the economy. The rationale behind the reform stems from constitutional obligations. Article 25 of the constitution of Iraq states that "The State shall guarantee the reform of the Iraqi economy,..., to insure the full investment and diversification of its sources, and the encouragement and development of the private sector". The diversification of Iraq's economy has been and shall continue to be a great challenge. The upstream oil sector shall continue for years to come as the main contributor to the GDP and to the annual budget. The government realizes the implications of this restraint and has taken measures to rectify this, including using the federal budget as a tool for economic reform. It has done this in the draft 2012-2014 budget strategy where it proposed to maximize the capital investment expenditure with a growth rate of 20%, while keeping growth rate of current expenditure at a level of 7.5 % over the same period. The target is to allocate about 40% of the total annual expenditure in 2014 as compared with 30% in 2011, and using the expected substantial increases in oil revenues for the development of the economy.

Other measures include improving the business climate, promoting foreign investment and giving a much larger role to the private sector. On the legislative front, a number of legislations targeting reform and regulation of various aspects of the economy have already been promulgated. They include Customs Tariff Law, Consumers Protection and the Protection of National Products, followed by a number of important draft Laws such as the Law for Economic Reform, the draft Law for the development of Small and Medium Enterprises and a draft on land reform. Institutional work has been ongoing to reform and restructure State-owned Enterprises, and the banking sector and introduce tax reform as Iraq prepares for accession to the WTO. The government

has given its blessing to a new Partnership arrangement with the International Donors Community and a program for Public Sector Modernization has started.

The increase in oil production this year, mainly from the three major oil fields of Rumaila, Zubair and West Qurna phase 1 in Basrah, in addition to the sustained production from Iraqi Kurdistan has resulted in a production rate of more than 2.7 mm b/d, and an export rate close to the planned 2.2 mm b/d, for the first time since 2003. The latter included an export rate between 80 thousand b/d in February to 180 thousand b/d in June from Iraq's federal region of Kurdistan. This, together with the high selling price of oil, resulted in surplus revenues as compared with the forecast annual budget. The average selling price of Iraqi crude oil is in excess of \$100 per barrel compared with an assumed average budget price for the year 2011 of \$76.5 per barrel. The total revenue for the first half of the year is about \$41 billion, giving a surplus of some \$9 billion. A remarkable growth rate of about 12% in the GDP is expected this year, and even a higher rate is forecasted for the year 2012.

As you know, the country has embarked on a substantial program to build up its crude oil and gas production capacity as well as export capacity, in cooperation with international oil companies. Now, after lots of speculation and doubt about the country's implementation capacity and the exaggerated problems surrounding logistics, it's evident that implementation of the eleven technical service contracts signed during the first and second bid rounds for the development of the well known Iraqi oil fields is going very well. The three producing oil fields contracted in the first bid round namely; Rumaila, Zubair and West Qurna phase one, have already reached their 10% contractual threshold months ago, and two out of the three contractors have already lifted crude oil in settlement of their contractual rights. All other contractors working in the green fields contracted in bid round two, are already mobilized on the fields with a number of them having active oil field operations consisting of seismic surveys and the drilling of wells. First production from Al Ahdab oil field is expected to be inaugurated this month signaling the transformation of Wasit province into an oil producing region for the first time.

Furthermore, two gas field development contracts out of the three awarded in the third bid round have already been signed and the third shall follow soon. Development of the three gas fields shall enhance a very much needed gas production capacity. The overdue gas deal for the

utilization of associated gas in Basrah has finally been initialized today. A fourth Bid Round for exploration has already been launched aiming at the discovery of new gas finds and the enhancement of oil reserves.

Similarly, work on the export system in the southern region is at an advanced stage for laying two major offshore pipelines and two single point mooring (SPM) which would increase the country's export capacity by 1.8 million b/d most likely some time in 2012, followed by an additional 1.8 million b/d by the end of 2012. Additional export ramp up is in the making through a Japanese government loan which will add another sea line and one SPM with a similar capacity of 900,000 b/d. This expansion, together with the phased reconstruction of the Fao onshore terminal, would provide ample loading export capacity in the Arabian Gulf commensurate with oil capacity development.

Those activities have positively impacted the lives of citizens in Basrah - albeit not to the desired extent - by providing employment and engaging the private sector in carrying various oil field operations such as laying down of pipelines, construction of camps and oil bases...etc. The industry is still in need of skilled workers, especially in the case of the green fields, contrary to the case of the brown fields where a huge number of skilled employees have been provided by the South Oil Company, in accordance with the contracts. A new and modern College of Petroleum is to be built in Basrah in cooperation with Colorado School of Mines. The project is partially financed from allocations for training in the oil field development contracts.

No doubt there are many challenges still ahead, and the outcome will have an important impact on the regional and global energy scenes.

The main remaining challenges related to building up and sustaining Iraq's future production capacity, are the execution of a large scale water injection project, gas gathering - processing and utilization - and of course the finalization of an integrated evacuation system for oil and gas all over the country, including a multi-outlets export system.

One of the pending issues that was talked about and questioned, and may be considered as a challenge, is the future level of Iraq's production capacity. Conflicting statements have been issued recently by a number of governmental sources. No doubt the country has committed itself to a major expansion program and it's cooperating with reputable international oil companies. It's well understood that those contracts

require timely planning, not just as far as building facilities and meeting production targets, but also in terms of the investment commitment. It's imperative to say that clarity regarding future production capacity is very much needed and of course it's the government's responsibility to clarify that. I believe the right answer should be derived from a thorough examination of all related factors and shouldn't be based on personal judgment or personal opinion. After all, this is a national issue of paramount importance. The government has taken steps in that direction by setting out to draw up a long term strategy for the energy sector as a whole, entitled the Iraq National Energy Strategy. A number of production capacity scenarios of 13.5 mb/d, 9.5 mb/d and 6.0mm b/d are being studied in terms of cost, revenue and cash flow using classical profitability indicators such as IRR, NPV ...etc, with risk assessment. Issues like the development of the gas industry, refining and the diversification of Iraq's exports of oil and gas products are also assessed. This is the best tool that can be made available to the country's leadership enabling it to take the right decision. The medium to long term vision is to develop the energy sector in a coherent, sustainable and environment-friendly manner to meet domestic energy needs, foster the growth of a diversified national economy, improve the standard of living of Iraqi citizens, and position Iraq as a major player in regional and global energy markets. From my own assessment, I think that the study is proceeding rather well and shall cover all aspects of energy in Iraq; oil and gas, electricity and the linked industries such as petrochemicals. The Iraq National Energy Strategy should be completed during the first quarter of 2012.

Now that I have outlined the major challenges, I would like to touch on the legislative dilemma we have faced under the former government, and the legislative reform that needs to go hand in hand with the unprecedented transformation of our oil and gas sector.

Let me remind you of the package of four draft legislations, in particular the draft oil and gas law that became subject of debate during 2007, inside and outside of Iraq. Those drafts were prepared to regulate the upstream sector of the Iraqi oil industry and to achieve a fair and equitable distribution of revenues. There was a stalemate in the previous council of representatives regarding the legislation of the Oil and Gas Law since 2007 and similarly with INOC Law since 2009.

The Oil and Energy Committee in the Council of Representatives is taking a step by step approach to resolve the legislative dilemma. It

started with the first reading of INOC draft law in March of this year. Recently, the Council of Minister requested that the COR start debating the draft Oil & Gas law and a formal letter was sent to parliament to that effect. It's evident that a more conducive political environment regarding oil and gas legislative reform is now prevailing. The Oil and Energy Committee hosted a number of oil and gas experts on July 3 to discuss the possible amendments to the current draft on the recreation of INOC. The speaker of the COR stressed in his opening speech of the session on the need to create a National Oil Company. The majority of those present expressed support to the reestablishment of INOC. It has to be said that members of the Oil and Energy Committee in parliament were very enthusiastic and came up with very interesting and valuable comments and questions. But still we have two divergent views regarding the creation of INOC:

1. One that maintains that the present draft should be amended so as to give more powers to INOC by expanding its scope of work to cover the whole upstream sector, including exploration and drilling operations, and to increase its capital significantly in line with that. Furthermore, the Law should ensure the financial and administrative independence of the company.
2. The opposing view maintains that the proposed law does not make any additions of substance to the existing status of the present regional operating companies such as SOC or NOC and thus there is no need for the reestablishment of INOC.

Based on the experience and lessons learnt under the previous government, whether during the negotiations on the draft oil and gas law, the negotiations between federal and provincial authorities on the devolution of certain powers as stated in the constitution, and more importantly during the extensive work conducted to introduce economic reform in the country, it has become evident that federal ministries resist change and will not give up any part of the powers they enjoy, which is a result of long decades of centralized power. Various studies conducted in Iraq showed that federal ministries are engaged in the four customary activities; policy, regulation, operation and commercial activity. Ministries like the ministry of oil that own operating companies, control to a large extent the affairs of the operating companies, whether producers such as SOC or commercial such as SOMO, contrary to the

rules of Law No 22 of 1997, by which those state owned enterprises were established. What we need is corporate type enterprises run on commercial basis, each working as a cost center on a win-lose basis, with fully empowered management overseen by an independent board of directors, in line with modern international and successful trends. Moreover, the constitution stipulates that Iraq is a federal state and powers of the authorities are classified as either exclusive to the center, shared with the regions or exclusively regional. Hence, old legislations that once regulated the oil industry are not adequate anymore, and do not address the new conditions in Iraq. Another motivation behind the need for new legislation is the need for good governance, which entails among other requirements, the separation between regulatory, commercial and operational tasks. This applies to the ministry of oil as well as others.

It goes without saying that a number of important points got to be addressed at one point, such as ensuring competitiveness when a single INOC is to manage the whole business, compatibility of a centralized enterprise within a federal regime and of course the timing and linkage of INOC law to the remaining laws within the famous package of four draft laws

I expect that once the law is passed, with amendments such as those mentioned above, INOC would take the responsibility of all the upstream operations. The law authorizes INOC to become a holding company, owning all of the existing oil operating companies in addition to exploration and drilling companies from day one. The company would be one of the largest NOCs in the world.

Furthermore, passing the oil and gas law would provide the overall and guiding framework for regulating the upstream sector. The formation of a Federal Oil and Gas Council with full powers, and the representation of all players on its board, as stated in the draft oil and gas law, would provide an effective tool and a streamlined process for awarding contracts, in addition to defining the right policies, and providing planning and supervision.

Similarly, the passing of the MOO law would result in the reorganization of the Ministry of Oil, in such a way that it would

concentrate on being more of a regulatory and policy body, as far as the upstream sector is concerned.

I firmly believe that passing the four legislations would end the legislative stalemate and provide seriously needed modern legislations as far as the energy sector is concerned.

In conclusion, I would like to say that I'm very optimistic about the future of Iraq, and my high expectations can be justified in the following points:

- I expect a permanent and amicable solution to the disagreements between the federal government and the KRG to be at hand once the legislative dilemma is over to the benefit of all.
- Furthermore, I expect the cooperation between the IOCs and the government would result in a rapid build up of production capacity elevating Iraq to its rightful position among world oil producers, with rapid growth of revenues that are going to be utilized in the economic development of the country and off course resulting in the transformation of Iraq's oil industry into a modern and very dynamic one. It is in the interest of the government of Iraq and the IOCs, to insure a beneficial relationship on the long term.
- The political tensions observed in recent months are only a manifestation of the nascent democracy but rest assured that this is a process in the making and Iraq is on the right track.

Thank you for your attention and I would like to thank The CWC for having us here in London.