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Iraq

The benefits and the curse of oil

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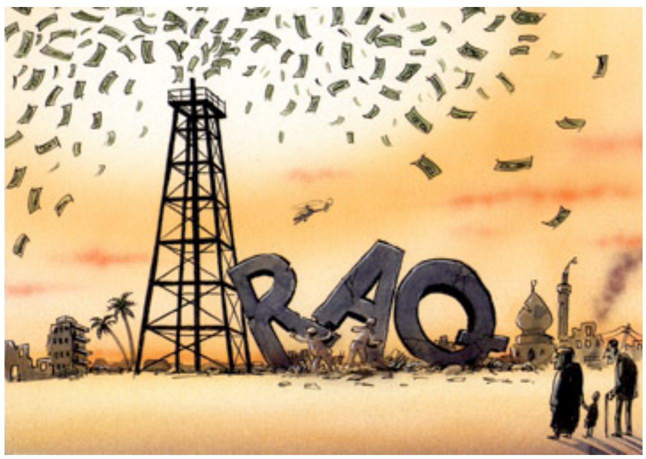
The country is awash with oil money but still lacks a proper plan

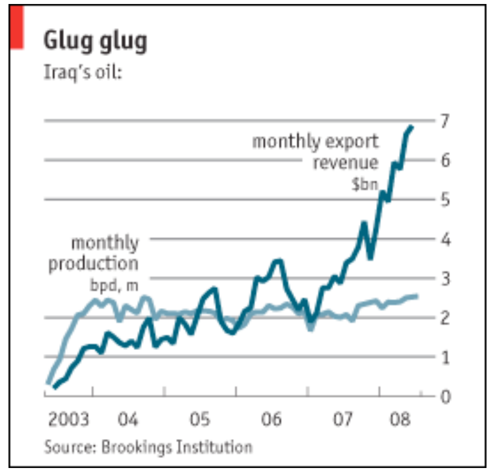
Illustration by Peter Schrank



IN THE second quarter of the year, an American military auditor recently reported, Iraq's oil production averaged over 2.4m barrels a day, the highest level since America invaded Iraq in 2003, and a marked improvement on last year's average of around 2m b/d (see chart). Rising output, along with the high (if now falling) price of oil, should pump up Iraq's oil revenues to almost $80 billion this year. That, in turn, has allowed the country's parliament to boost this year's budget from $48 billion to $70 billion in a supplementary spending bill approved earlier this month. As security improves, the government has a lot more cash to spend than it did a year ago. Will it make the best of it?

For one thing, revenue from oil should go up more sharply still. Iraq produced 3m b/d as recently as October 2001, despite the crippling UN-enforced sanctions at the time. Iraq's oil minister, Hussein al-Shahristani, has spoken of raising output to 6m b/d. In theory, that is possible. Iraq's proven reserves, of 115 billion barrels, are the world's third-largest after Saudi Arabia and Iran. Yet Iraq ranks just 13th in terms of production, suggesting there is plenty of scope to pump more. Russia, for example, produced almost 10m b/d last year from reserves of 80 billion barrels. Only 27 of the 80 or so fields that have been discovered in Iraq have ever been tapped.

What is more, there are probably new fields to be found. Thanks to almost 30 years of war, strife and sanctions, Iraq has never been thoroughly explored. Geologists point to hundreds of promising subterranean structures where no wells have been sunk. Indeed, only 2,300-odd wells have ever been drilled in Iraq, compared to 1m in Texas alone.



Best of all, Iraq's oil is cheap to extract. Most of it lies close to the surface in relatively porous reservoirs. Tariq Shafiq, a former executive at the state-owned Iraq National Oil Company (INOC), says that expanding Iraq's output from existing big fields should cost $1-3 a barrel, leaving over $100 per barrel in profit at present prices. "Geologically," says Sarah Haggas, of IHS, a research firm and consultancy, "Iraq is perfect for oil exploration."

Still beset by arguments

Politics, however, is another matter. Insurgents have made a habit of attacking the oil infrastructure; the recent rise in output is due chiefly to improved security. In particular, the United States has paid for a project to reduce sabotage to a pipeline that links the Kirkuk oilfield, one of the country's biggest, to the main outlets for exports —ports in the south and a pipeline north to Turkey. The Kirkuk-Baiji pipeline (see map) is now protected on either side by a ditch, a dirt barrier, a fence topped with razor wire, and three more rolls of razor wire on the ground. There are two guardhouses at every road crossing; the government has recruited local tribesmen suspected of mounting many past attacks to man them and conduct patrols. Oil has flowed freely since the construction of these defences began last summer. The American army says that, as a result, exports in the 11 months to May went up by 91m barrels, worth an extra $8.2 billion.

Iraq's government hopes to improve output by more conventional measures, too. It is negotiating contracts with the biggest Western oil firms, including Exxon Mobil, BP and Total, to refurbish five of the country's biggest oilfields. It hopes this will raise output by 500,000 b/d. Though Mr Shahristani said the deals would be signed "within weeks" in January, they have yet to materialise.

In any event, it is uncertain how effective these deals will be. David Kirsch of PFC Energy, a consultancy, argues that INOC would not have the capacity to transport all the extra oil even if it could be produced. There is some doubt about whether the contracts would last one or two years, calling the production target into question. And the oil giants would not station any staff in Iraq, as it is still too dangerous; they would send only equipment and advice.

Meanwhile, critics in Iraq and abroad have denounced the government for failing to assign the contracts by public tender. Suspicions abound that the authorities, under American pressure, will be too generous to the oil firms, though no terms have been published, so it is hard to tell. Four American senators have asked for an investigation. Dennis Kucinich, a congressman, has proposed a law to ban American oil firms from seeking contracts in Iraq.

Perhaps spurred by this fuss, Mr Shahristani said last month that Iraq would let 45 firms bid for another round of contracts, which he hopes to award next year. Details are scant but it seems these would last for as long as ten years; unlike the short-term ones, they would require participants to team up with an Iraqi partner.

Are foreigners stealing again?

The government says both types of contract will comply with the present oil law, which does not allow deals that confer ownership of Iraqi oil on foreigners. It has resorted to these arrangements only because a new oil law approved by the cabinet last year has run aground in parliament. Its critics say it would give foreign firms too much control over Iraqi fields, an incendiary claim in a country where the nationalisation of the oil industry in 1971 is still seen as a moment of triumph. They view the law's "exploration and production contracts" as thinly veiled production-sharing agreements, whereby firms win the right to a fixed proportion of the output of fields they develop. Other critics say the government has modified it to give too much power to the regions.

But the leaders of Iraq's autonomous Kurdish region disagree. They want as much control as possible over the oil industry in their area, for fear that neglectful or hostile bureaucrats in Baghdad may otherwise hold back their development. Though oil revenue from the fields INOC runs is meant to be distributed across Iraq in accordance with population, the Kurds want to benefit more directly from the development of new fields in their area and from future exploration. Specifically, they want the federal government to honour the 20-plus contracts their regional government has signed with foreign oil firms. But the government in Baghdad refuses. Instead, it has barred the firms involved from bidding for contracts in the rest of Iraq.

Foreign oil firms may still be wary of investing amid such political uncertainty. Yet huge sums are needed: oilmen say tens of billions of dollars are required to overhaul existing infrastructure and fields, and much more to expand output dramatically.

Thanks to oil, Iraq is not short of cash. But its oil ministry manages to spend only a small fraction of its investment budget every year. Iraqis complain that the brightest employees have long since gone; many of the remainder are corrupt and overworked, and the ministry is riven by political shenanigans. Workers at the South Oil Company, an INOC subsidiary that controls the majority of Iraq's production, have been protesting against the proposed oil law. The government, in turn, has reassigned several prominent employees and split the firm in two—hardly a top priority for the industry. Until a comprehensive oil bill is signed, Iraq will continue to lose huge sums it would otherwise earn from the investment it so badly needs.