December 14, 2009 Inquiry & Analysis Series Report No. 572

Saudi Concerns About Iraqi Oil (Revisited)

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Introduction

In a MEMRI dispatch issued shortly after the invasion of Iraq in 2003, we wrote the following:

Saudi Arabia is the largest oil producing country among the members of the Organization of Oil Producing Countries (OPEC) and, as such, it is the dominant force in the organization. Changes in the supply equation that could diminish its role and influence in the international [oil] market and, more significantly, the future of the cartel, concern Saudi Arabia greatly. The possible entry of Iraq, in a considerable way, into the market is more than a matter of concern for the Saudis – it may even develop into an economic nightmare.[1]

Six years later, the nightmare looms larger. It is not surprising that the Saudi regime has shown open hostility toward Iraq to the extent that King Abdullah bin Abd Al-Aziz has refused to meet with Iraq's prime minister Nouri Al-Maliki. Oil is not the only issue. As an earlier MEMRI dispatch noted, Saudi hostility toward Iraq has three intertwined *roots* – religious, political, and economic.[2] There is the aversion of the dominant religion in the Kingdom of Saudi Arabia (KSA), the Wahhabism, toward the growing dominance of Shi'ism in Iraq and the legitimate concern that Iraq, dominated by Shi'ite Iran, could pose a strategic threat to the Kingdom's eastern region where most Saudi oil is found and where the Saudi Shi'a minority, estimated at 2 million or about 10 percent of the Saudi population, is demographically dominant but politically marginalized.

The Saudi ruling family is concerned that a rise in the Shi'a tide, or what King Abdullah of Jordan referred to as the Shi'a crescent, would embolden their own Shi'a minority to seek political, social and economic benefits that it has largely been denied. Muhammad Mahfoudh, an editor of a cultural magazine in Al-Qatif in the eastern part of the Kingdom, has written, "What is happening in Iraq today raises the political ambitions of the [Saudi] Shi'a because democracy and popular participation in the instruments [of power] …would help the Shi'a to obtain their rights and achieve their ambitions."[3] The Saudis are equally concerned that a resurgent Iraq with enormous potential of crude and aspiration to produce of 10-12 million barrels of oil a day (b/d) within the next few years could dislodge Saudi Arabia from its perch in OPEC and, concurrently, reduce its influence and role as one of the key power brokers in the region. Saudi Arabia may also be concerned that a Shi'ite coalition in OPEC, comprising Iran and Iraq, with the latter expanding oil production, could replace Saudi Arabia as the decisive voice in the cartel.[4]

One should also keep in mind that the rise of Iraq as an oil power could be anathema to Iran. Not only will Iraq displace Iran as the second largest producer in OPEC, but, according to one observer, higher production could give the "Arab country, Iraq" the resources to challenge Iran's influence in the Shi'ite world.[5] Iran must also be concerned that China, its main client, may find that its service contracts with Iraq should have priority over any other transaction with a sanction-ridden country.

The Iraqi Oil Reserves

Every available estimate puts Iraqi oil proven reserves at 115 billion barrels of oil, based on geological surveys carried out 30 to 40 years ago but there is a growing belief that the proven reserves are higher; how much higher falls in the domain of speculation. Speaking in London, Dr. Barham Saleh, Iraq's former deputy prime minister and the current prime minister of Kurdistan Regional Government said the proven reserves are 350 billion barrels, three times higher than the figure mentioned earlier, and larger than Saudi Arabia's proven reserves of 264 billion barrels. [6] A trade journal estimates Iraqi reserves at 215 billion barrels and perhaps even more, possibly "the largest of any country in the world." The same journal underscores the fact that the finding cost is "a fraction of a dollar per barrel," while the estimated finding and development costs are between $1.50 and $2.25 per barrel, "among the lowest in the world."[7] The low figure for both finding and production is because Iraqi oil fields are on land and close to the surface. By contrast, the cost of developing off-shore oil is about $10 a barrel. Equally significant is that Iraqi oil is "high-grade crude."[8]

Proven reserves figures are not precise. Because OPEC's production quotas allotted to its members are based on "proven reserves" – hence, the higher the "proven reserves," the bigger the quota – members of the Organization of Petroleum Exporting Countries (OPEC) do not hesitate to exaggerate their proven reserves estimates. Given that almost all OPEC members rely on oil revenues for their recurrent and development budgets, it is not surprising that the members seek bigger quotas, which translate into higher revenues.

Iraq's case is different. Thirty years of wars and U.N. sanctions have deprived the country of modern geological 3D seismic surveys to update old figures and cover new areas, particularly in central and western parts of the country. Some experts estimate oil reserves in these areas to be as much 100 billion barrels. What lends optimism to the high estimates of oil reserves in Iraq is the fact that out of 73 known oil fields only 15 fields are currently producing oil. What's more, their production is below potential capacity because of the U.N. sanctions which followed Iraq's invasion of Kuwait in 1990 and which restricted the country from importing new oil equipment to replace old or deteriorating equipment and crippled Iraq's capacity to provide adequate repair and maintenance of its producing oil fields.[9] Following the invasion, some of the remaining equipment was destroyed or sabotaged and pipelines to carry oil for export were deliberately damaged. As a result, oil production has declined to below 2003 levels. Even if not a single new barrel of oil were to be found, the current Iraqi proven reserves of 115 billion barrels will allow Iraq to sell 6 million b/d for the next 60 years.

Prior to the U.S. invasion of Iraq in 2003, Iraq entered into production agreements with Chinese, French, Russian, and German companies, all from countries that opposed the invasion.[10] The provisional government of Iraq declared all these agreements null and void, and it is only in 2009 that Iraq has taken major steps to revitalize its oil sector – an activity which will require vast investments in the billions of dollars and a huge amount of technical assistance.

Current and Future Production (Estimates)

Iraq is currently producing approximately 2.4 million b/d of crude, of which 1.8 million b/d are designated for export, placing the country third among OPEC members, behind Saudi Arabia with a little over 8 million b/d (and with a spare capacity of another 2 million b/d) and Iran with 3.7 million b/d with a decline in production capacity because of sanctions. Iraq is determined to increase its crude production sharply. In a statement before parliament, Oil Minister Dr. Hussein Al-Shahristani spoke of a ministry plan comprising two parts – a short-term plan to increase production to 4-4.5 million b/d within 3-5, years and a long-term plan to increase production to 11-12 million b/d.[11]

The question is how quickly Iraq can boost production and how it will do so. The answer depends on how fast the multiple service agreements recently negotiated will be approved by the government; by which government, the one currently in power or the one that will be formed after the next general elections which are now scheduled for early March; and how fast the various political parties and factions can agree on a new ruling coalition.

Auction of Service Contracts

After months of preparation, and amidst public relations fanfare, Iraq invited 31 pre-qualified oil companies to bid, at a televised public auction, for service contracts for six oil fields and two natural gas fields. Braving a severe sandstorm in June of this year and braving personal risks as well, senior oil executives arrived in Baghdad to participate in what was meant to be the auction of the century for oil service contracts. The terms set by the Iraqi Oil Ministry were quite stiff, and were characterized by oil executives as totally unrealistic. At the end of the auctioning exercise, a consortium of British Petroleum (BP) and China National Petroleum Company was the sole winner of the giant Rumaila oil field in southern Iraq with estimated reserves of 17 billion barrels of crude.[12] Most international oil companies initially refused to bid under the stiff conditions set by the Oil Ministry, but have come back in droves for the second auction, which took place in Baghdad on December 11-12. The major oil companies have concluded that this is a last chance for them to have access to huge oil fields still available for development. As a result, not waiting for the second phase of the auction for service contracts, a number of Majors [leading oil companies] have negotiated service contracts under terms they earlier rejected. By early November, oil companies signed two more upstream deals that could boost production to about 4.8 million b/d:

Zubair Eni (35%), Sinopec (20%), OXY (25%), Kogas (20%)

Iraq's First Licensing Round Awards

Project/Winners (Phase 1)	Proven Oil Reserves	Proven Gas Reserves	Remuneration Fees	Initial Production Floor	Production Plateau
Rumaila BP (66.67%), CNPC (33.3%)	17.767	10.0	$2/B	956.550	2.850
Zubair Eni (35%), Sinopec (20%), OXY (25%), Kogas (20%)	4.080	3.0	$2/b	195,000	1.125
West Qurna – 1 ExxonMobil (80%), Shell (20%)	8.584	7.7	$1.90/b	258,505	2.325
Total Incremental Production					4.847

Source: Middle East Economic Survey, 9 November 2009. In terms of nationality: BP (British), CNPC and Sinopec (Chinese), Shell (Anglo-Dutch), OXY and ExxonMobil (U.S.), Kogas (Korean)

None of these service contracts has been signed by the Iraqi government. When a senior oil official was asked about the timing for signing the contracts, he replied, "Before the end of the year, Allah willing."[13]

In addition to these three contracts, the Iraqi government has an existing agreement with CNPC, going back to pre-invasion, but renegotiated last year, for the production of 160,000 b/d from the Ahdab oil field near the city of Nassiriyah, south of Baghdad. The Chinese company is already working to develop the infrastructure for the oil field. Mention should also be made of the oil fields in Kirkuk which have not been included either in the first or the second phase of the auction because of disagreement with the Kurdish Regional Government on how the revenues should be split and how owns the new fields in contrast with existing producing fields.

More Service Contracts Awarded

In the second round of contracts, 10 oil fields with estimated reserves of about 4.2 billion barrels and a production capacity of 4-5 million b/d were auctioned. Two of these fields, Majnoun and West Qurna-2, each with reserves in excess of 12 billion barrels, were under production sharing agreements with the French oil company TOTAL and the Russian oil company Lukoil, but both agreements were nullified after the invasion and before the companies could initiate any development in their respective oil fields.

Forty four pre-qualified companies took part in the auction, with sealed bids submitted by the competing companies in a purely competitive and transparent system broadcast live on national TV. The competition was so keen that the winning bidders reduced the charges for development below that of the first phase. Unlike the contracts signed for the three previous oil fields, the new oil fields, referred to as "The Green Fields," are not producing fields, and the winning bidders are committed to produce additional 4.76 million b/d on top of the estimated production of 4.85 million b/d envisaged under the first phase of the auction, starting in 2013 and reaching a plateau in 2020.

The Winners in the Second Phase

European and Chinese companies are the big winners in the second phase. Lukoil (Russia) and Statoil (Norway) won the service contract for the 12.9 billion barrels of West Qurna 2; Royal Dutch Shell and Petromas (Malaysia) won the contract for the second largest oil field of Majnoon with reserves of 12.6 billion barrels. A consortium of CNPC (China), Total (France) and Petromas won the contract for Halfaya oil field with reserves of 4.1 billion barrels. There were additional small contracts won by Sonangol (Angola), Japex (Japan) and again Petromas.

Two observations regarding the second phase are essential: first, aware of the violence in certain areas of Iraq, companies have refrained from bidding on East Baghdad oil field with estimated reserves of 8.1 billion barrels of crude and on fields near the city of Mosul in the north where Al-Qaeda of Iraq is active. Nor did the government offer fields in Kirkuk because of the disagreement of the Kurdish regional government regarding the distribution of revenues and regarding that government's own contracts with foreign oil companies. In the future, oil fields in northern Iraq could add another 2 million b/d.

Second, and politically significant, is the fact that no American company won a contract under the second phase. Although major American oil companies were present they were unable to compete with mostly government-owned companies who were able to offer very low fee for production without much concern about the bottom line. The failure of the American companies to win service contracts will undermine the argument of those who claim that the invasion of Iraq by the U.S. was designed to take control of the Iraqi oil. In fact, the biggest winner in this case was the Chinese national oil company.

Implications Regarding Iraq's Re-emerging as an Oil Power

Recently, an Iraqi oil commentator referred to his country as "a sleeping energy giant."[14] This giant appears to be awakening and the implications for OPEC, in particular, and for the Middle East, in general, will be far reaching. Let us consider these implications:

First, excluding Iraq, OPEC projects the spare capacity of its members to rise to 6 million b/d by 2013. If Iraq should add another 2 million b/d by 2013, oil prices could come under pressure unless demand rises above current projections. Alternatively, and if spare capacity persists, the cartel will have to cut the quota across the board. In both instances, to the discomfort of the other members of the cartel, revenues will decline. Iraq is no less sensitive than its neighbors to oil windfall and will be desperate, like all the others, for high oil revenues for many years to come.

Second, Iraq has been exempted since 1995 from the OPEC quota system because its oil exports were subject to control by the U.N. under the Oil-for-Food Program. This exemption will be laid to rest, and Iraq will be allotted a quota for production like all other members. The quotas, however, are based on proven reserves. Under OPEC's formula for establishing national production quotas, Iraq is entitled, under its proven reserves of 115 billion barrels, to a production quota of 3.14 million b/d.[15] If Iraq's proven reserves are determined to be higher, Iraq's quota will increase proportionately. Iraq is bound to move ahead of Iran and be rated as second only to Saudi Arabia as producer. It is hardly surprising that both Saudi Arabia and Iran meddle heavily in Iraqi affairs to prevent the inevitable from happening any time soon.

Hurdles to Overcome

Before Iraq can reach its full potential of oil production, certain conditions must prevail: a) political stability; b) the security environment at the oil fields; and c) the passing of the oil law.

Political Stability

The service contracts were signed shortly before the general elections for parliament. While Iraqis agree that these contracts are vastly different from the agreements signed with the international oil companies in the 1920s under colonial conditions, there are those in Iraq who do not wish to see the return to Iraq of the international oil companies which were expelled after the oil sector was nationalized in the early 1970s. It is not surprising that not a single service agreement has, so far, been approved by the government, let alone signed. The oil companies themselves may harbor genuine concern that a new government formed after the elections might seek to reopen the negotiations with the oil companies. But many Iraqis do recognize the reality that to develop Iraq's vast oil fields there will be heavy requirements for investments and technical capacity which Iraq currently lacks. Writing in the government daily *Al-Sabah*, Razzaq 'Adai put the political issue in the right perspective:

Those who object to the [service contracts] rely on the past colonial memory regarding agreements signed in 1920s, ignoring that international relations in the framework of economic, investment and political agreements follow a new international reality. Agreements are reached between equal partners and within mutual benefit. They do not mean control and hegemony. It is therefore imperative that the discourse and the complicated slogans must change.

'Adai concludes with an implicit warning about the possibility of creating alternative sources of energy which could diminish the value of Iraqi oil.[16] It is truly a case of "use it or lose it."

Security Environment at Oil Fields:

The development of the oil fields will require the installation of often highly sophisticated and expensive drilling, production and monitoring equipment. It will also require the presence of foreign specialists. Unless there is a high degree of safety for both people and material, the oil companies will be reluctant to carry out the tasks that would entail the investments of billions of dollars. The sabotage of oil equipment and pipelines since the U.S. invasion of Iraq will be a constant reminder of things that can get out of control.

The Oil Law

A draft oil law has been lingering in parliament for two years. There are two key issues that would be of concern to foreign oil companies: a) the nature of the privatization of the oil sector and how it will be translated in practice and, b) the role and the share in revenues of the provinces in the oil sector. Most objections to the oil law are rooted in Article 111 of the Iraqi constitution, which stipulates that oil is the property of the Iraqi people. The interpretation of property rights remains an issue.[17]

While these challenges are formidable, the contracts represent an historic development. In the words of an Iraqi oil specialist Ruba Husari,

The year 2009 will go down in history at the year when Iraq opened again for business to Big Oil, just as 1973 was the year the door closed behind the last of the Iraq Petroleum Company (IPC) partners as they were pushed out in the wave of nationalizations of the 1970s.[18]

Not surprisingly, both Iran and Saudi Arabia are engaged in various ways to keep Iraq weak and destabilized. Saudi Arabia, in particular, which saw its production quota augmented at the expense of Iraq and Kuwait following the invasion of Kuwait by its northern neighbor, may be reluctant to surrender a big chunk of its quota to Iraq. Ruba Husari, who edits *Iraq Oil Forum*, put the Iraqi-Saudi conflict in the proper perspective:

When it comes to Saudi Arabia, the stakes are much higher than for anybody else where Iraq's potential return as a force on the market is concerned, not just because of the possible renewal of the old debate over who took over Iraq's market share in the early 1990s, but more so because of the uneasy relationship between the two neighbors since the ousting of the Sunni Ba'th regime in 2003 and the advent of Shi'ite-ruled government since.[19]

Clearly, the national elections in Iraq scheduled for end of February or early March will be critical for the oil sector, because the new government that will emerge after the elections will have to make important decisions affecting the oil sector and welfare of the Iraqi people for decades.

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Endnotes:

(All links were live at time of writing.)

[1] MEMRI Inquiry and Analysis No. 137, Nimrod Raphaeli, "The Saudi Nightmares about the Iraqi Oil," June 12, 2003, http://www.memri.org/report/en/0/0/0/0/0/0/855.htm.

[2] MEMRI Inquiry and Analysis No. 540, Nimrod Raphaeli, "Saudi-Iraqi Relations, the Iraqi Perspective,", August 14, 2009, http://www.memri.org/report/en/0/0/0/0/0/0/3569.htm .

[3] www.m-mahdi.com/forum/archive/index.php/t-1901.html.

[4] Al-Rafidayn (Iraq), December 10, 2009.

[5] Al-Rafidayn (Iraq), December 10, 2009.

[6] Times Online, May 20, 2008.

[7] *Oil & Gas Journal*, January 19, 2009.

[8] www.globalpolicy.org/Iraq/political-issues-in-Iraq/oil-in-Iraq.html?t

[9] www.islamonline.net/servlet/satellite?c=ArticleA_C&pagename=

[10] Islamonline, op.cit.

[11] www.parliament.iq/Iraqi_Council_of_Representatives.php?name=a of June 7, 2009. The new production target of 12 million b/d was set by Al-Shahristani at the conclusion of the second phase of the auction of service contracts in Baghdad on December 11-12. *Al-Zaman* (Iraq), December 12, 2009.

[12] *Al-Zaman* (Iraq), July 1 and July 2, 2009.

[13] *Al-Sabah Al-Jadid* (Iraq), Iraq, December 5, 2009.

[14] *Al-Sabah* (Iraq), December 5, 2009.

[15] Kitabat.com, July 9, 2007.

[16] *Al-Sabah* (Iraq), July 29, 2009.

[17] Abdul-Hussein Sha'ban, "Iraq's Oil and the Nature of Conflict," www.Iraq4allnews.dk/new/PrintNews.php?=23970&cat=8, July 20, 2009.

[18] *Middle East Economic Survey*, November 9, 2009.

[19] From an editorial by Ruba Husari, "The Rush for Oil: Iraq's Oil Capacity Potential and Regional Geopolitics," *Middle East Economic Survey*, November 9, 2009.