



Managing Iraq's Petroleum

Iraq Revenue Watch: Workshop

Beirut,
Phoenicia Intercontinental Hotel
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Executive Summary

On April 8-9, 2006, Iraq Revenue Watch (IRW) hosted a workshop on Managing Iraq's Oil Industry which brought together leading petroleum experts, activists, economists and policy makers from across Iraq's regions and political spectrum. Held in the margins of the World Bank's Fifth Middle East and North Africa Development Forum (MDF5) in Beirut, Lebanon, the workshop sought to elaborate mechanisms for managing Iraq's oil wealth within a federal framework in the hope of reducing future conflict and opening the way for compromises in other contentious areas.

As competition for Iraq's vast oil wealth continues to provoke political and sectarian tensions in the country, participants identified transparency and accountability as bulwarks against such abuse and the main instrument for avoiding the 'resource curse'. Following the executive summary below is a report detailing outcomes from the workshop. Topics covered at the workshop included the need for clarifications and potential changes to the Constitution, discussion of a national strategy for exploration and development, designing a sound investment regime, and establishing unassailable legislation and efficient institutions.

❖ Principles

The participants shared a commitment to developing Iraq's oil industry in an efficient way that maximises the benefits to the Iraqi people. Participants expressed commitment to a federal framework which balances the rights and aspirations of regions and provinces with efficiency and national cohesion.

❖ Constitution

There is a need to address the ambiguities, omissions and contradictions contained in the articles of the constitution relating to petroleum. In addition to enabling legislation, changes to the constitution may be necessary to avoid harm to the industry or contradiction with the principles of transparency and accountability while maintaining the decentralising spirit of the document.

❖ Strategy

When discussing a strategy for going forward, participants agreed that conditions need to be created for the development of the petroleum industry at national and sub-national levels (including private and public companies). The right mix of exploration and development will need to be determined through strategic coordination. A common strategy will ultimately be based on an agreed rate of depletion of Iraq's oil reserves and would include a scheme for apportionment of output which would take into account international market conditions and OPEC requirements. Participants also discussed the need to prioritise the downstream sector, in particular refining capacity, in order to address the severe shortage of petroleum products and to substitute for imports.

❖ Investment

Despite disagreement on the level of private and foreign investment required, participants did identify the need to develop an investment regime which would remove legal and administrative obstacles, as well as uncertainties for foreign investment in the petroleum sector. A sound investment regime would include model agreements, bidding and contracting procedures to ensure transparency and

consistency in negotiations and improve Iraq's bargaining position with foreign partners. Agreements will not be limited to one or the other model but would vary by field and project.

There is an urgent need to cultivate local human resources in order to effectively engage international partners in the development process; as it pertains to Iraq's petroleum industry, participants identified contract negotiations and project monitoring as two areas where capacity building would be useful.

❖ Joint Areas

Participants generally agreed that there are areas in the oil industry which will only work with a high degree of coordination and centralization and should thus be managed at the federal level. These include for example, pipelines, refineries, depots, export terminals and databases. There was general agreement that the central government will need to manage exports.

❖ Legislation and Institutions

Politics should not be allowed to impede efficient development of the oil sector. Strategic planning; policy making; regulation; and operations should be treated as discrete functions. Ideally the oil sector and the civil service as a whole should be run on a merit based system.

Participants agreed on the urgent need to develop hydrocarbon legislation and regulations and to establish mechanisms and institutions with clear lines of jurisdiction and responsibilities for developing and managing the oil sector. There is also awareness however that urgently needed work, especially downstream should not be made contingent on the development of such laws and institutions.

Proposed Petroleum Institutions include:

- *Supreme Petroleum Council* to oversee strategic planning at the level of the Council of Ministers. The council will include political leaders from both national and regional levels.
- The *Ministry of Oil* will elaborate policies and draft legislation. Policies will be developed together with the regions and provinces and in consultation with industry experts.
- *Independent Regulator* to be in charge of setting, monitoring and enforcing standards and regulations among all actors.
- A *National Oil Company (INOC)* will be an administratively and financially independent holding company with a board of directors representing (horizontal) regional operating companies and (vertical) infrastructure and downstream operators. Regional and provincial governments will be represented at the boards of the relevant operating companies as well as INOC itself

The participants also recommended the formation of an *independent expert group* which could evolve into an Iraqi Petroleum Think-Tank. The group should include representatives of the Ministry of Oil and other policy making and regulatory bodies in Baghdad and the regions, as well as operating companies, petroleum experts and

activists from the private sector, academia, media and civil society. The expert group would elaborate policies on the basis of the public interest and guided by the main principles outlined above, and subsequently present them to policy makers and the public for consideration.

❖ Transparency

In an effort to improve the transparency of Iraq's petroleum sector, participants generally agreed that it is necessary to accelerate the installation of metering equipment to minimise siphoning, improve accounting for domestic use of petroleum and petroleum products, and to improve accounting by ministries for the way they spend oil revenues. It was also suggested that petroleum subsidies need to be phased out in an intelligent and socially sustainable way.

The expert working group proposed by the meeting will follow up on the Extractive Industries Transparency Initiative (EITI) and make recommendations to Iraqi policy makers in Baghdad and the regions.

❖ Fiscal Federalism

Although it is necessary to move away from the current system marked by excessive fiscal centralization, there is also recognition of the need to provide all levels of government with secure and sustainable sources of revenue which would allow for sufficient execution of their civic obligations. The integrity of the budgetary process should be maintained with no revenues or spending taking place outside the budget.

Meeting Report

Competition for control of Iraq's vast oil wealth is contributing to growing political and sectarian tensions in the country. Designing and implementing a mechanism for managing Iraq's oil wealth in an efficient, equitable, and transparent way, and within a federal framework, could reduce conflict and open the way for compromises in other contentious areas. This was the main theme of the workshop which brought together leading petroleum experts, activists, economists and policy makers from across the political spectrum and Iraq's regions. (See Appendix 8 for a list of participants)

The participants started out by trying to agree on a set of principles which should govern any Iraqi petroleum policies before moving on to more contentious issues regarding strategy, foreign investment, institutions and most importantly the constitution. This approach helped set a constructive tone to the debate by emphasising from the beginning that all participants despite their differences are working towards the same objective.

Principles

The participants shared a commitment to developing Iraq's oil industry in an efficient way that maximises the benefits to the Iraqi people. Transparency and accountability were identified as bulwarks against the abuse of oil wealth and a way to prevent the 'resource curse'. The participants expressed commitment to a federal framework which balances the rights and aspirations of regions and provinces with efficiency and national cohesion.

The deteriorating security situation and sectarianism were identified as the main obstacles for the development of Iraq's oil wealth and a threat for the future of the country. The participants provided an example of the alternative approach by engaging in a constructive professional dialogue on the issues. Not once in two days of discussions did anyone refer to ethnic or sectarian identities or party political affiliations.

Constitution

Despite certain ambiguities, it is clear that decentralization is at the heart of the new Iraqi constitution. Apart from a limited number of areas which fall under the exclusive domain of the federal government (Article 110), the regions and, in the case of oil, producing governorates have the final say (A115 and 121.2) both in areas listed under shared (A114) and regional (A121) jurisdiction. The articles of the constitution relating to oil (A111 and A112) while not attached to the federal, joint or regional areas of jurisdiction contain language which puts them in the joint category. Article 112 refers to the joint management of 'present fields', implying that exploration and development of new fields is expected to fall under the exclusive domain of the regions albeit following strategies developed jointly with the federal government (A112.2). Also relevant to the issue of the management of petroleum wealth is the omission of a direct reference to the right of the federal government to raise taxes

although the design of fiscal policy is listed among the federal government's exclusive prerogatives (A110.3)¹.

Views on the constitution's provisions concerning the petroleum sector are divided: Some call for substantial revisions to the relevant articles to reverse the decentralization implied. They argue that decentralised control of petroleum resources would lead to competition and conflict among Iraq's provinces, duplication of functions and waste of precious human resources. Iraq's negotiating position with foreign investors would be weakened. These critics of the constitution argue that decentralization will leave the central government and authorities in non-petroleum rich regions without sufficient resources to carry out their obligations. They call for the sector to be placed in the exclusive domain of the federal government as the most efficient way to manage the industry. Proponents of centralized management of Iraqi oil and gas will maximise returns from the sector which could then be shared by the regions and provinces under a revenue sharing formula.

Others argue that the decentralization provisions of the constitution reflect the desire of Iraq's regions to manage their own affairs and control resources on their territory. Decentralisation they argue is necessary to prevent the abuse of petroleum wealth by the central government and insures against the emergence of another oil-fuelled dictatorship. They question claims that decentralisation may lead to inferior performance in the petroleum sector, pointing to the inefficiencies that plagued the centralised system both before and after the fall of the regime of Saddam Hussein. They consider changing the constitution both undesirable and impractical. Instead they call for petroleum policies that take full advantage of decentralisation but mitigate possible negative consequences through strategic coordination and central management of certain functions such as transportation and export.

A compromise position which seemed to gain the support of most participants at the workshop calls for the elaboration of ambiguities, omissions and contradictions contained in the articles of the constitution relating to petroleum. This position allows for changes to the constitution to avoid harm to the industry or contradiction with the principles of transparency and accountability while maintaining the decentralising spirit of the document.

One of the most contentious points in the constitution is the concept of 'current fields' which according to article 112/1 should be managed by the federal government together with the regions. 'Current field' is not a standard technical petroleum industry term and is consequently open to multiple interpretations. One school holds that 'current field' refers only to the 20 or so fields which are currently producing oil and gas and contain (depending on interpretation) between 40-80bn bbl² of reserves, leaving the rest of Iraq's vast oil reserves to decentralized control. Another school holds that 'current fields' refers to all discovered structures in Iraq, producing or not –some 80 fields with some estimated 115 bbl of reserves, giving the central government influence over a much large share of the country's petroleum resources. (Former Iraqi oil officials believe there may be another 100-200 bbl. of as yet un-proven reserves.) Section 112/2 of the constitution stipulates joint strategic

¹ The relevant paragraphs of the constitution are attached in Appendix 1

² Al-Mehaidi, Kamil, Geographical Distribution of Iraqi Oil Fields And Its Relation with the New Constitution, IRW Forthcoming

planning with the central government of new fields or fields not designated 'current' but is silent on management and revenue sharing. The narrower interpretation of 'current fields' would seem to be consistent with the decentralizing thrust of the constitution, but the lack of agreement on what the term means leaves the door open to continuing disagreements over the future management of Iraq's petroleum resources and the role of a state oil company.

There are other objections to the term 'current fields'. Oil fields do not follow administrative boundaries. Arrangements for the use of structures that cross national boundaries can be contentious. Conflict over alleged Kuwaiti encroachment on the Rumaila field was one of the triggers of Saddam's invasion in 1991. Indeed, mapping of oil structures is imprecise.

Strategy

Iraq produces approximately 2.1 million barrels per day (MMbbl/d) down from 2.2-2.6 before the invasion and an all time peak of 3.5 in the early 1980s. Most current output comes from the ageing fields in Kirkuk, ~ 0.3 MMbbl/d (0.6MMbbl/d capacity) and Basra, ~ 1.8 MMbbl/d (1.9MMbbl/d capacity)³. These fields have been abused in the past, especially during the lean sanction years and are currently producing inferior, sulphur rich oil which sells at a lower price than higher quality oil. Sabotage to the pipelines, especially those linking Iraq with Turkey, as well as leakage, theft, smuggling and inadequate infrastructure means that Iraq is exporting 1.4MMbbl/d on average which comes almost exclusively from the southern fields.

The situation is even more severe in the downstream sector. Iraq's refining capacity meets less than half of its domestic needs. Only 400,000bbl/d were processed on average in 2005⁴. Demand for fuels surged by 40% since 2003 due to the lifting of sanctions and the import of a large number of cars and household appliances; and interruptions to electricity supplies are forcing many middle class households to depend on wasteful kerb-side generators. Significant price subsidies encourage energy waste, black market activities and smuggling. Iraq imported anywhere between US\$4bn and US\$6bn of fuel in 2005^{5,6} and the World Bank estimates that fuel and food subsidies together are nearly 50% of GDP⁷.

Over the past three years the US government has invested approximately US\$1bn out of a total Congressional allocation of US\$1.7bn on oil projects⁸, while the Iraqi government spent US\$4bn on the oil industry. However, last year, only US\$0.7bn out of a total government budget allocation of US\$2.2bn for operating expenditures for the sector was utilised⁹. Delays in investments and rehabilitation were caused by a combination of factors including lack of security, corruption and inefficiency. Restrictions on spending by the operating companies and the Ministry which are

³ Special Inspector General for Iraq reconstruction (SIGIR), April 2006, p70

⁴ Platts, Iraqi statistics for 2005 leave 60 million barrels unaccounted for, May 8, 2006

⁵ GAO, Rebuilding Iraq: Governance, Security, Reconstruction, and Financing Challenges, p28.

⁶ IMF, Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding December 6, 2005 p.13

⁷ World Bank, Rebuilding Iraq: Economic Reform and Transition, February 2006 p.6

⁸ SIGIR ibid

⁹ IMF ibid

meant to limit the scope for corruption, as well as constraints on financial transactions necessary to prevent seizure of Iraqi assets by creditors have had a dampening effect on investment and account for the sector's inability to carry out approved and funded projects.

The Iraqi government has committed itself according to the Stand by Arrangement with the IMF signed in December 2005 to increase output to 2.3MMbbl/d in 2006 and is aiming to reach the target of 3.6 by 2010¹⁰. The government has committed itself to spending US\$3bn of its own resources to meet investment needs in 2006. It is not clear where the remainder of the US\$26bn of investments the government estimates would be necessary to meet the 2010 target will come from.

Most agree on the urgent need to ramp-up production in order to generate badly needed revenues. There is, however disagreement on the level of investment needed, the extent to which Iraq can generate the needed capital internally and the proportion of investments that should go into new exploration rather than development of already discovered fields.

Some participants favoured concentrating primarily on the development of the 115bn bbl of explored but untapped reserves as the most efficient way to increase total output. This will have the added benefit of taking pressure off the older fields damaged from over-production.

There is also understanding for the need to conduct exploration work in order to replenish reserves and to redress the uneven development of the sector across regions. There is disagreement however on the level of priority to be given to exploration which by definition is more resource intensive and more dependent on cooperation with international oil companies.

The right mix of exploration and development will need to be determined through strategic coordination by the central authorities and the regions. A common strategy will ultimately be based on an agreed rate of depletion of Iraq's oil reserves and would include a scheme for apportionment of output which would take into account international market conditions and OPEC requirements. There is also agreement on the need to prioritise the downstream sector, in particular refining capacity, in order to address the severe shortage of petroleum products and to replace fuel imports which consume a significant portion of government expenditures and is a driver for smuggling and corruption.

The participants believe that conditions need to be created for the development of a national and local petroleum industry, including private and public companies, while at the same time admitting that Iraq's domestic companies today may not yet be in a position to carry out large development programmes on their own.

¹⁰ IMF, Iraq: 2005 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Iraq, p23

Foreign Investment

Decades of neglect, abuse and sanctions have set the Iraqi oil industry back in terms of both technological and human resources. Recovery rates of less than 20% are far behind leading industry rates of 50%, and there is a clear need for foreign know-how, technologies and investments.

There is a disagreement on the levels and ways of engaging with foreign investors. Some argue that while Iraq will need of foreign technology it can develop its discovered reserves with only limited recourse to external financing. They argue that as little as US\$10bn is needed to ramp up output to 3.5MMbbl/d. Investments could thus be carried out under service or buy back contracts with the bulk of the rents accruing to the Iraqi government. Opponents of giving private and foreign investors a large role argue that Iraqi oil is too profitable, with some of the lowest exploration, development and production costs in the world (in peace time) and too important, generating over 90% of government revenues, to be let out of the control of the state.

Others argue that significantly more is needed to develop Iraq's oil reserves than what is available in the country. They point to the failure to properly invest even capital made available to the industry over the last three years as indication of Iraq's need for foreign investors as strategic partners. Iraq according to this line of argument is not only in need of financing and technologies but also managerial know-how necessary to carry out large petroleum development projects. Accordingly the terms of cooperation need to be adjusted to attract new technologies, know how and capital.

Despite disagreement on the level of private and foreign investment required, there was agreement among participants on the need to develop an investment regime which will remove legal, administrative obstacles and uncertainties to foreign investment in the sector, insures transparency and consistency in contracting and improve Iraq's bargaining position with foreign partners. The investment regime would include model agreements, bidding and contracting procedures. Agreements will not be limited to one or the other model but would vary by field and project.

Participants also discussed the urgent need to develop human resources in order to more effectively engage international partners during negotiations and project monitoring processes.

Joint Areas

There was general agreement that some areas in the oil industry could be adversely affected by decentralisation because transportation, storage, processing and export networks cross regional boundaries. Oil from different fields is blended in both transport and refining processes.

Participants agreed that there are areas which will only work with a high degree of coordination and centralization and should thus be managed at the federal level. These include for example, pipelines, refineries, depots, export terminals and databases. There was broad agreement that the central government will need to manage exports.

Legislation and Institutions

One of the main concerns voiced by participants at the meeting was the politicisation of the petroleum industry. With oil accounting for over 90% of government revenues and two thirds of GDP it is bound to be political. However, there was a feeling that decisions and policies from the application of relevant constitutional articles to appointments at the Ministry and operating companies, are being taken on the basis of ethnic, sectarian, party political and even individual interest. Such practices are not always viable from a technical/economic standpoint and can sometimes be quite harmful. One consequence of political interference in the working of the ministry is the demoralisation and exodus of many competent civil servants, people with great institutional knowledge and expertise who are critical for the rehabilitation of the sector.

Participants were in agreement on the need to prevent the political nature of oil from adversely affecting the industry's efficiency. One way to approach that is by separating areas of strategic planning; policy making; regulation; and operations. It is also necessary to develop a code of conduct which would enshrine a merit based system not only in petroleum institutions but throughout the civil service.

There is agreement on the urgent need to develop hydrocarbon legislation including laws, regulations and mechanisms for implementation, identifying executive agencies and institutions and defining their jurisdictions, addressing issues of the relation in this context between the various institutions and tiers of government. There is also awareness however that urgently needed investments, especially downstream cannot wait for the completion of this legal, regulatory and institutional transformation.

There are detailed suggestions for the structure of the industry in the presentations made by Thamir Ghadhban and Kamil Al-Mehaidi (appendix 3 and 4) Following are some of the main institutions proposed and some general parameters for their work:

- *Supreme Petroleum Council* to oversee strategic planning at the level of the Council of Ministers.
- The *Ministry of Oil* will elaborate policies and draft legislation. Policies will be developed together with the regions and provinces and in consultation with industry experts.
- *Independent Regulator* to be in charge of setting, monitoring and enforcing standards and regulations among all actors.
- A *National Oil Company* (INOC) will be an administratively and financially independent holding company with a board of directors representing (horizontal) regional operating companies and (vertical) infrastructure and downstream operators. Regional and provincial governments will be represented at the boards of the relevant operating companies as well as INOC itself

The participants also recommended the formation of an *independent expert group* which could later evolve into an Iraqi Petroleum Think-Tank. The group should include representatives of the Ministry of Oil and other policy making and regulatory bodies in Baghdad and the regions, as well as operating companies, petroleum experts and activists from the private sector, academia, media and civil society. The expert

group would elaborate policies on the basis of the public interest and guided by the main principles outlined above, and subsequently present them to policy makers and the public for consideration.

Transparency

Corruption is one of the main threats to the Iraqi petroleum industry. Delays in installing meters, inadequate accounting of internal oil supplies, use of barter transactions, significant leakages and resistance to phasing out fuel subsidies are indicative of the network of interest involved in defrauding the Iraqi people of their wealth. Crude petroleum and refined products are siphoned from depots, refineries and pipelines and smuggled by truck or ship from both legal but un-metered terminals or from makeshift illegal ones. According to some estimates ~60mmbbl of crude went missing in 2005 depriving the Iraqi government of US\$3bn¹¹.

Petroleum product subsidies amounting to US\$4.2 billion in 2005 sustain a price differential of up to 20 times compared to neighbouring countries even after the latest price hike. This price differential is creating an arbitrage opportunity for illegal activity including black market sales, smuggling of domestic and re-export of imported fuel. Apart from the direct loss to the state budget and exacerbating shortages beyond what is justified by the shortage of refining capacity, the abuse is inflicting lasting damage on the state apparatus and particularly the ministry of oil and its relationship with the public.

Currently all Iraqi proceeds from the sale of petroleum have to be deposited at the Development Fund for Iraq established under a UN Security Council Resolution 1483 of 2003. DFI funds are monitored by the International Advisory and Monitoring Board and are subject to independent audit. DFI offers Iraqis the opportunity to monitor the bulk of Iraq's oil revenues and to hold the executive branch to account for their use. However, the efficiency of such mechanisms depends greatly on monitoring and control of oil before it is officially exported and after the proceeds leave the fund.

Illegal exports, inadequate accounting of domestic oil consumption and mismanagement of oil revenues by the Coalition Provisional Authority or by successor Iraqi Governments reduces but does not nullify the value of this mechanism. DFI makes it possible for the Iraqi people to see for the first time in history how much revenue is being generated on the basis of their wealth. The DFI did not and could not stop abuse but it made it possible today to identify sources of abuse and on occasion to prosecute those responsible.

However, abuse of DFI assets by non-Iraqi actors further complicates the quest for transparency. There is disagreement about the meaning and benefits of transparency in oil. Some argue that it may weaken Iraqi officials' bargaining positions with international actors. Others argue that it is up to the West to embrace transparency before it can ask Iraq to follow suit. The prevailing position, however, is that transparency first and foremost in the interest of the Iraqi people and is something to be pursued regardless of the international context.

¹¹ Pratt, *ibid*

The DFI will expire in a year's time. Iraq is committed according to the Stand by Arrangement with the IMF to develop a successor regime which would insure that all Iraqi oil revenues flow through a central point where they are subject to audited monitoring. The Extractive Industries Transparency Initiative (EITI) offers such a model and could address some of the shortcomings of the DFI. EITI requires the government to provide audited and accessible information on all payments received from petroleum transactions including royalties and export revenues. This information is reconciled with data on payments from private and international partners. The whole process is conducted in an open and transparent manner with the involvement of civil society at all stages. This process applies equally to all parties, domestic and international, public and private. It removes the factor of discretion and un-equal treatment and protects officials from political pressure and corruption. It also gives Iraqis not only access to information but a stake in the whole process through civil society engagement. Finally, as an international mechanism EITI can be equally applicable to all levels of government throughout Iraq.

On the one hand it is necessary to accelerate the installation of metering equipment to minimise siphoning, and to improve accounting for domestic use of petroleum and petroleum products, and on the other hand to improve accounting by ministries for the way they spend oil revenues. Petroleum subsidies need to be phased out in an intelligent and socially sustainable way.

The expert working group proposed by the meeting will follow up on EITI and make recommendations to Iraqi policy makers in Baghdad and the regions.

Financial

The government of Iraq has full discretion over the spending of oil revenues apart from 5% allocated for Kuwait war reparations and the 17% allocated to the Kurdistan Regional Government. Most funds are allocated and spent by line ministries and their regional affiliates. A small but growing proportion is allocated to provincial governments. Fundamentally this could change depending on the interpretation of the constitution which stipulates that revenues from currently producing fields (which are equal to current government revenues at least in the short term) are to be allocated to the regions and governorates according to their population with a special temporary allowance for disadvantaged regions (Article 112.1). The constitution also established a commission to oversee the fairness of oil revenue allocations (A106) and leaves the rest to be elaborated by legislation.

There are a number of ambiguities in this framework particularly as far as the revenues and expenditures of the central government are concerned, and especially in the long term when output from 'current fields' begins to decline.

There is agreement in general on the need to move away from the current system marked by excessive fiscal centralization. At the same time there is recognition of the need to provide all levels of government with guaranteed and sustainable sources of revenue which would be sufficient to carry out their obligations. Federalism should not undermine the integrity of the budgetary process – All revenues and expenditures should flow through the budget monitored by Parliament.

Conclusion

The Iraqi professionals, civil servants and activists meeting in Beirut demonstrated as this report shows that it is possible to move away from zero-sum, divisive politics and achieve consensus on petroleum policies which would benefit all Iraqis. They did this by working within an open and inclusive framework and through their dedication to the public interest without a claim to power or regard to ethnic, sectarian and party political affiliation. Sustaining this model for generating policy ideas and proposals in the future; flushing out and elaborating some of the main recommendations and ideas outlined above; and promoting them with decision makers and the public at large are the best ways to follow up on an interesting and productive meeting.

Appendix 1: Relevant Constitutional Articles

Article 24:

The State shall guarantee freedom of movement of Iraqi manpower, goods, and capital between regions and governorates, and this shall be regulated by law.

Article 62:

1. The Council of Ministers shall submit the draft general budget bill and the closing account to the Council of Representatives for approval.
2. The Council of Representatives may conduct transfers between the sections and chapters of the general budget and reduce the total of its sums, and it may suggest to the Council of Ministers that they increase the total expenses, when necessary.

Article 106:

A public commission shall be established by a law to audit and appropriate federal revenues. The commission shall be comprised of experts from the federal government, the regions, the governorates, and its representatives, and shall assume the following responsibilities:

1. To verify the fair distribution of grants, aid, and international loans pursuant to the entitlement of the regions and governorates that are not organized in a region.
2. To verify the ideal use and division of the federal financial resources.
3. To guarantee transparency and justice in appropriating funds to the governments of the regions and governorates that are not organized in a region in accordance with the established percentages.

Article 110:

The federal government shall have exclusive authorities in the following matters:

1. Formulating foreign policy and diplomatic representation; negotiating, signing, and ratifying international treaties and agreements; negotiating, signing, and ratifying debt policies and formulating foreign sovereign economic and trade policy.
2. Formulating and executing national security policy, including establishing and managing armed forces to secure the protection and guarantee the security of Iraq's borders and to defend Iraq.
3. Formulating fiscal and customs policy; issuing currency; regulating commercial policy across regional and governorate boundaries in Iraq; drawing up the national budget of the State; formulating monetary policy; and establishing and administering a central bank.

4. Regulating standards, weights, and measures.
5. Regulating issues of citizenship, naturalization, residency, and the right to apply for political asylum.
6. Regulating the policies of broadcast frequencies and mail.
7. Drawing up the general and investment budget bill.
8. Planning policies relating to water sources from outside Iraq and guaranteeing the rate of water flow to Iraq and its just distribution inside Iraq in accordance with international laws and conventions.
9. General population statistics and census.

Article 111:

Oil and gas are owned by all the people of Iraq in all the regions and governorates.

Article 112:

1. The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields, provided that it distributes its revenues in a fair manner in proportion to the population distribution in all parts of the country, specifying an allotment for a specified period for the damaged regions which were unjustly deprived of them by the former regime, and the regions that were damaged afterwards in a way that ensures balanced development in different areas of the country, and this shall be regulated by a law.
2. The federal government, with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment.

Article 114:

The following competencies shall be shared between the federal authorities and regional authorities:

1. To manage customs, in coordination with the governments of the regions and governorates that are not organized in a region, and this shall be regulated by a law.
2. To regulate the main sources of electric energy and its distribution.
3. To formulate environmental policy to ensure the protection of the environment from pollution and to preserve its cleanliness, in cooperation with the regions and governorates that are not organized in a region.
4. To formulate development and general planning policies.

5. To formulate public health policy, in cooperation with the regions and governorates that are not organized in a region.
6. To formulate the public educational and instructional policy, in consultation with the regions and governorates that are not organized in a region.
7. To formulate and regulate the internal water resources policy in a way that guarantees their just distribution and this shall be regulated by a law.

Article 115:

All powers not stipulated in the exclusive powers of the federal government belong to the authorities of the regions and governorates that are not organized in a region. With regard to other powers shared between the federal government and the regional government, priority shall be given to the law of the regions and governorates not organized in a region in case of dispute.

Article 121:

1. The regional powers shall have the right to exercise executive, legislative, and judicial powers in accordance with this Constitution, except for those authorities stipulated in the exclusive authorities of the federal government.
2. In case of a contradiction between regional and national legislation in respect to a matter outside the exclusive authorities of the federal government, the regional power shall have the right to amend the application of the national legislation within that region.
3. Regions and governorates shall be allocated an equitable share of the national revenues sufficient to discharge their responsibilities and duties, but having regard to their resources, needs, and the percentage of their population.
4. Offices for the regions and governorates shall be established in embassies and diplomatic missions, in order to follow cultural, social, and developmental affairs.
5. The regional government shall be responsible for all the administrative requirements of the region, particularly the establishment and organization of the internal security forces for the region such as police, security forces, and guards of the region.

Appendix 2: Selected Data

Data from the Stand by Arrangement with the IMF (US\$Bn)

	2006
GDP	41.48
Government revenues	40.27
Government expenditures	44.00
Budget deficit	3.73
Oil revenues	28.07
Oil export volume (MMbbl/d)	1.70
Oil output (MMbbl/d)	2.30
Oil investments	3.53
Import of petroleum products	2.80

Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding December 6, 2005 p.13

	2004		2005		2006	2007	2008	2009	2010
	Planned	Actual	Planned	Adj.					
Oil derivative imports	2.10	3.22	2.40	4.00*					
Sector operating expenditures	1.86	0.53	2.16	0.68	0.91	1.26	1.46	1.71	1.89
Sector investment expenditures	1.26	1.46	3.00	3.66	3.5*	4.28	5.06	6.64	7.36

IMF, Chapter IV Report August 2005 Table 3, p31 and Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding December 6, 2005 p.13

** Letter of Intent, Memorandum of Economic and Financial Policies and Technical Memorandum of Understanding December 6, 2005 p.13*

Daily Averages and Losses (bbl p/d)

	Output	Refining	Re-injection	Export	Discrepancy
North Oil Company	328,000	196,000	91,000	41,000	-
South Oil Company	1,753,000	221,000	-	1,366,000	166,000
Total	2,081,000	417,000	91,000	1,407,000	166,000
Loss in US\$bn at US\$50 p/bbl					3.0

Platts, Iraqi statistics for 2005 leave 60 million barrels unaccounted for, May 8, 2006

Appendix 3: Presentation by Thimir Ghadhban

CONTENTS

1. Principles.
2. Objectives.
3. Reforming The Oil Industry.
4. Tasks Of The Supreme Oil & Gas Council.
5. Reorganization Of The Ministry Of Oil.
6. Tasks Of Ministry Of Oil.
7. Reforming The Upstream, Midstream
& Downstream Sectors.
 1. Cooperation With IOCs

MAIN PRINCIPLES FROM CONSTITUTION

1. 108

- Oil & Gas are the property of all the Iraqi people in all regions and governorates.

2. 109 (explained)

- Federal Government and regional states and producing governorates manage current fields and shape strategic policies for the development of Oil & Gas wealth.

MAIN PRINCIPLES FROM CONSTITUTION, Contd.

- Equitable distribution of Oil & Gas revenues in proportion to the population, plus allocating a portion for a limited period, to adversely affected regions to ensure equitable development.
- Ensure highest benefit to the Iraqi people based on the latest market principles, and promotes investment.

MAIN OBJECTIVES OF AN OIL POLICY

1. Government has jurisdiction over hydrocarbon resources.
2. Secure & maximize a reliable & steady source of revenue
3. Develop a modern petroleum industry.
4. Promote Iraqi private sector.
5. Promote cooperation with international community.
6. Encourage competition / interaction between international & national enterprises to improve efficiency.

SHOULD AN POLICY ENSURE?

- ❖ That petroleum revenue is used for creating long-lasting benefits to society.
- ❖ The responsible use of petroleum resources to meet long-term requirements of the nation.

1. SHORT TERMS OBJECTIVES (2006-2007)

1. Enhancement of operational efficiency of oil fields & production facilities to meet production targets.
2. Special emphasis on providing oil products for domestic use / power generation.
3. Security improvement of pipelines & oil facilities.
4. Speed up reconstruction projects.
5. Complete projects for custody transfer all over country (metering off shore ..etc).
6. Commence reform of oil industry.

1. MEDIUM TERM OBJECTIVES (2007 – 2010)

1. Boost oil production & export capacity.
2. Achieve substantial increase in proven Oil & Gas reserves.
3. Maximize utilization of gas & commence gas export.
4. Satisfy increasing demand for oil products & quality improvement by upgrading refineries & expansion.

1. LONG TERM OBJECTIVES (2010 +)

1. Iraq to become a worldwide leading producer & exporter of oil.
1. Iraq to become Gas exporter.
1. Self sufficient in domestic oil products with international specifications.
1. Modern and dynamic Petroleum Industry

REFORMING THE PETROLEUM INDUSTRY

MAIN TASKS

1. Legislation of a petroleum law.
2. Establishment of Oil & Gas Supreme Council at ministerial level.
3. Achieve separation of the roles currently performed by ministry,
through a step by step reorganization
4. Reestablishment of INOC for Upstream sector.
5. Formation of national companies for refining & gas industry.
6. Privatization of the distribution sector.
7. Encouragement of private sector.

LEGAL FRAMEWORK

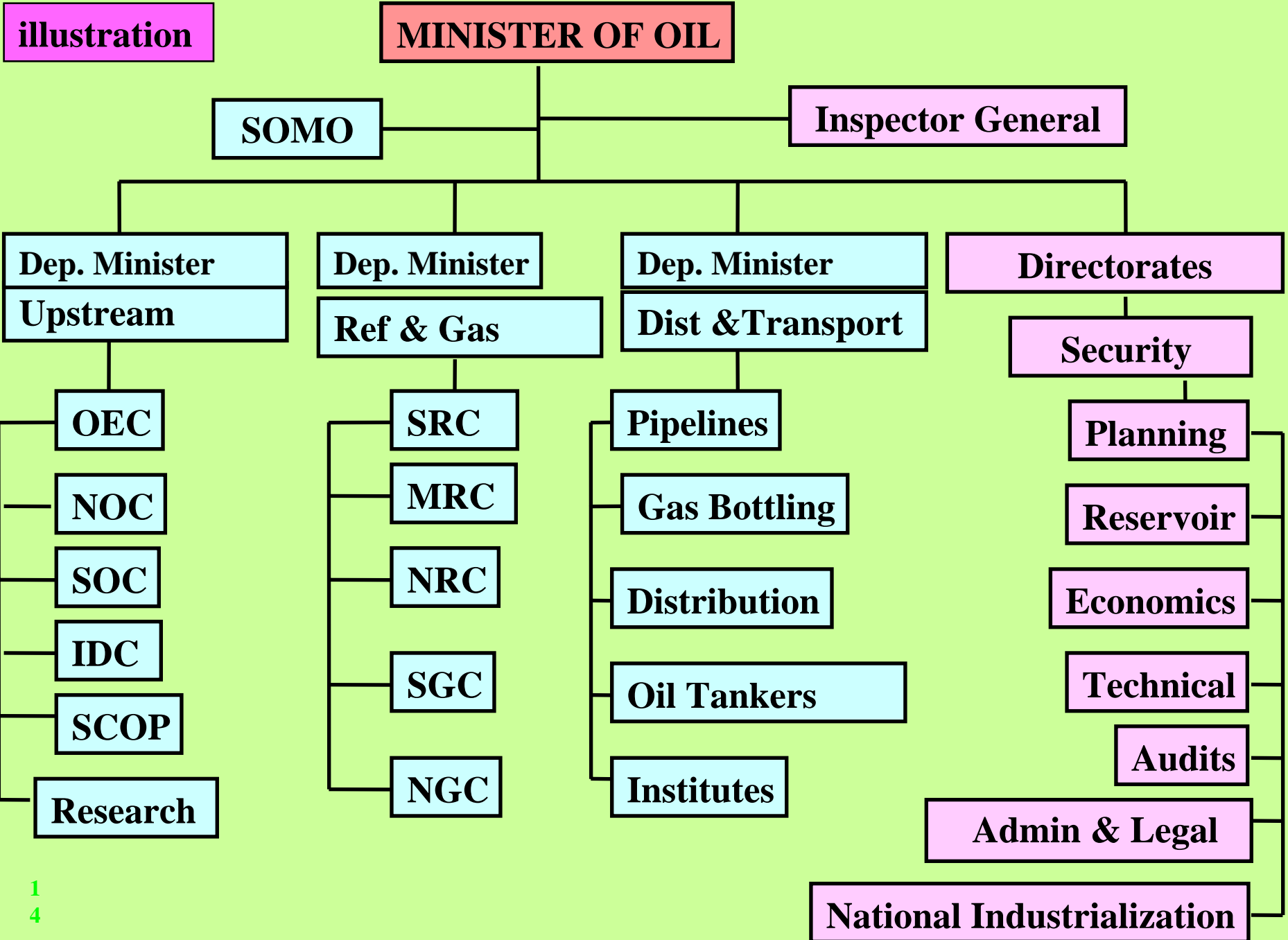
Basic Components

1. Constitution.
1. Petroleum Law.
1. Petroleum Regulations.
1. Model Agreements.

TASKS OF THE SUPREME COUNCIL

1. Shaping the general policy for the management of hydrocarbon resources and their optimum utilization, the development of the national petroleum industry & supporting & dependent industries to maximize revenues and provide best services to Iraqi people .
1. Oversee matters of strategic nature such as medium & long terms plans, investments & large scale projects, agreements & contracts with foreign partners, crude oil marketing policy, oil products pricing and employment regulations in the Ministry of Oil and the Oil companies.

REORGANIZATION OF MINISTRY OF OIL



illustration

MINISTER OF OIL

Operation /
Production /
Commercial

3

Policy / Legislation / Planning /
Licensing/ Economics &
Finance/ Research &
Development/Security

1

Monitoring/
Supervision/
Regulation

2

1- Ministry
2- Oil Directorate
3- Operating Cos

MINISTRY TASKS

1. Drafting Policies.

(Role of Provincial States)

1. Drafting Legislation.

(Ministry proposes draft legislation to Supreme Oil & Gas Council, followed by Cabinet recommendation to Parliament).

1. Implementation of legislation & policies.

2. Planning

(Annual, medium & long term plans, depletion policy, production targets, supply & demand, capacity expansion & projects required).

MINISTRY TASKS contd

1. Licensing Authority

(Ministry proposes licensing policy to Supreme Oil & Gas Council, followed by Cabinet recommendation to Parliament)

1. Regulatory Authority

(Handling of Technical & Operational issues, Supervising petroleum operations, Issue of guidelines, standards & objectives for petroleum operations & Supporting Ministry in legislation & planning).

DEPLETION POLICY

Factors:

1. Revenue requirements
2. Social and Economic Development
3. Logistics
4. Price Stability

Production Targets: (Pre April 2003)

1. INOC (3.5-4.0) MMB/D
2. IOCs (2.0-2.5) MMB/D

1. REFORMING THE UPSTREAM SECTOR

To consolidate & improve efficiency of existing institutions but not to dismantle or weaken them.

Nature & Role of INOC

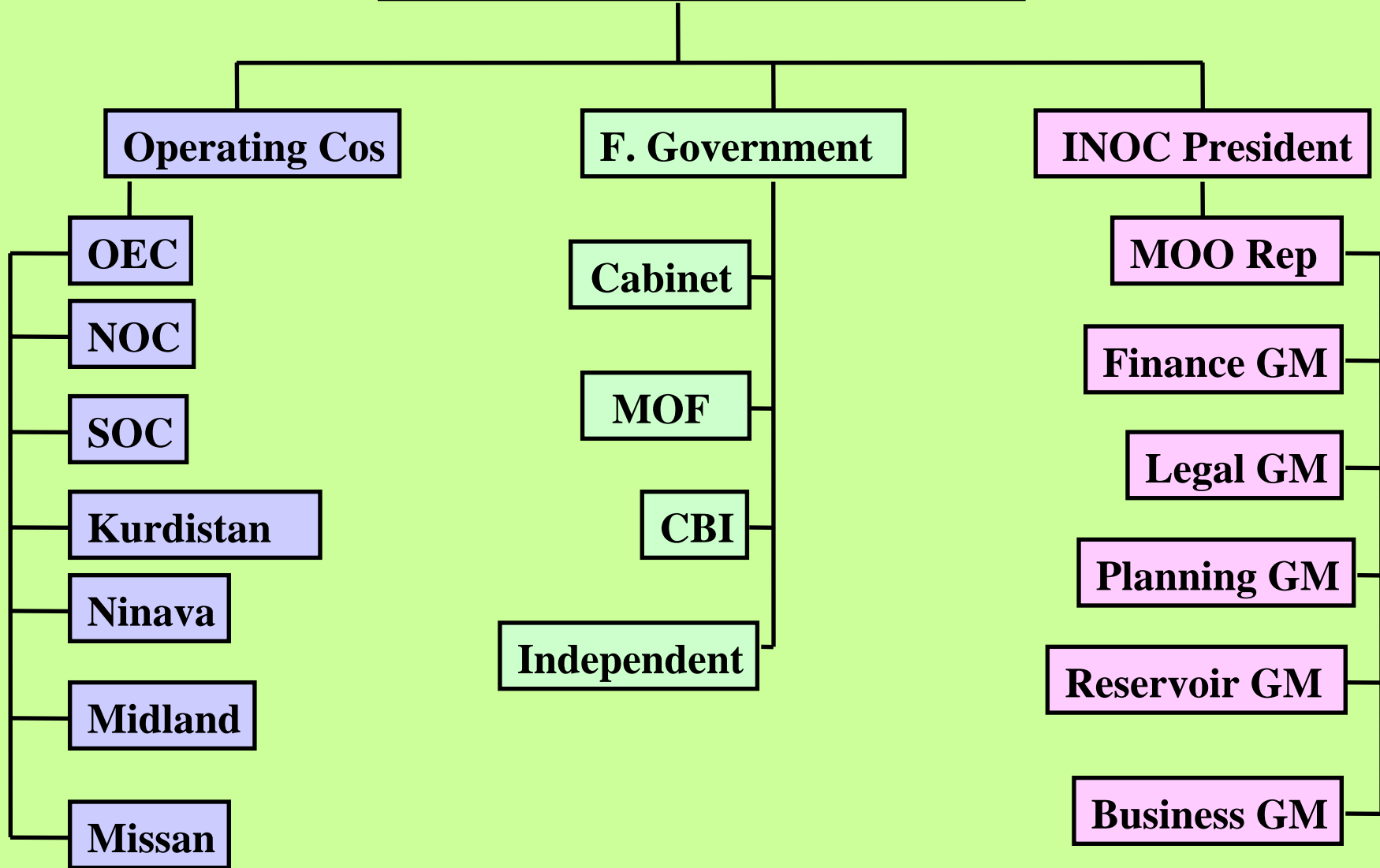
- ❖ An upstream Holding Company.
- ❖ Administratively & Financially independent state owned enterprise.
- ❖ Management of current Oil & Gas Fields through subsidiaries.

NATURE & ROLE OF INOC Contd.

- ❖ Exploration tasks up to (x %) of exploration potential in the country.
- ❖ Guided by a BD in which Federal & Provincial states are represented.
- ❖ SOMO stays with Ministry for a period of time & to be overseen by BD

illustration

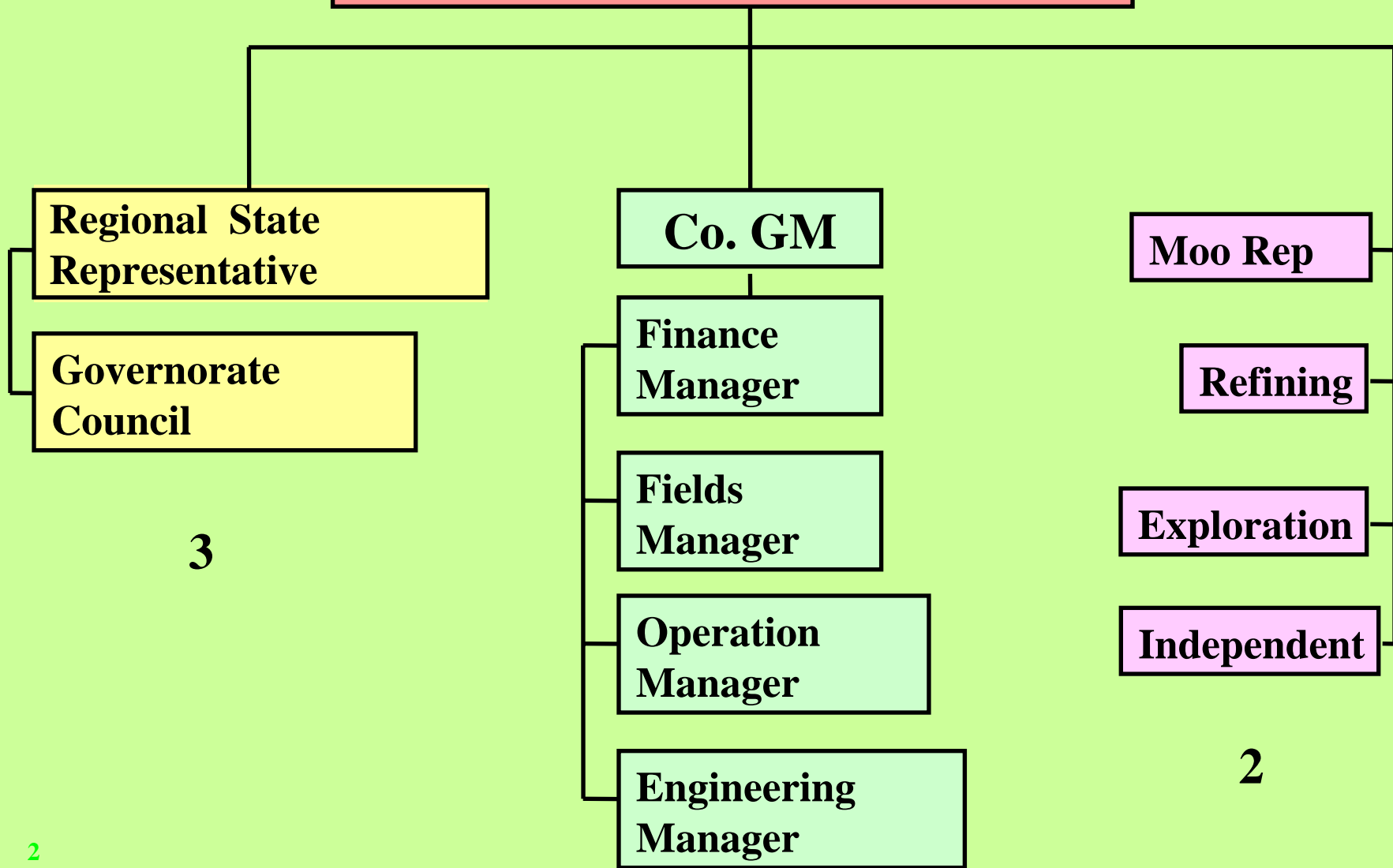
CHAIRMAN OF THE BOARD
INOC BOARD OF DIRECTORS



illustration

BOARD OF DIRECTORS

PROVINCIAL OPERATING COMPANY



3

2

1

2
2

UPSTREAM OPERATING COMPANIES

1. Range of Operation:-
 - Provincial:-
 - Existing (SOC, NOC)
 - New (Kurdistan, Missan, Midland, Ninava..)
 - Federal (OEC)
 - IDC to be transformed into profit making enterprise.
2. Guided by a BD in which Federal & Provincial states are represented.

SUBDIVISION OF RESPONSIBILITIES

Task	SOGC	MOO	INOC
Directives	A		
Policy	B	A*	
Licensing		A*	B
Negotiation		A*	B
Monitoring E & P	B	A	
Crude Oil Pricing	B	A	
Data Base Management			A
Reservoir Management			A
Regulating Pipeline Use		A	B

²
⁴ * With Participation Of Provincial States & Producing Governorates.

FUTURE OUTLOOK FOR INOC

1. Corporate type of management & structure.
2. Independent management & oversight.
3. No governmental & regulatory role.
4. Benchmarking of operational & financial performance.
5. Profit & Loss calculation for each business unit.
6. Transparent financial statement.

1. REFORMING THE MIDSTREAM SECTOR

Stage One:

- Establishing a National Refining Holding Company with three subsidiary refining companies (current South, Midland & North refineries) .
- Establishing a National Gas Holding Co. with South & North Gas companies as subsidiaries.
- Similar organization/relationship to INOC.
- New refineries depending on size & location could become subsidiaries or part of a subsidiary.

REFORMING THE MIDSTREAM SECTOR, Contd.

Stage Two:

- Allow building new refineries, gas processing plants by JV, BOT arrangement.

Stage Three

- Transformation into state owned corporate enterprises with shares(?) up to (20%) owned by employees.

1. REFORMING THE DOWNSTREAM SECTOR

- ❖ A gradual withdrawal of government from sector and increasing role of private sector.
- ❖ Permit private sector to import, store, transport & sale products (wholesalers).
- ❖ Pipeline company to provide services for private sector paying a transportation fee.
- ❖ Pipeline company with its assets of depots, pump stations & pipelines network to be jointly owned by state and major private wholesalers.

REFORMING THE DOWNSTREAM SECTOR, Contd.

- ❖ Jointly owned pipeline company to continue expanding pipeline network & storage depots.
- ❖ Sale of petrol stations to private sector companies.
- ❖ Continue price reform to moderate consumption growth & combat smuggling.

1. COMPLEMENTARY REFORMS

1. A decision to be taken on the future of IOTC, either to continue then modernize or stop then liquidate.
2. SCOP to be transformed/split into:
 - ❖ An engineering center.
 - ❖ A construction company.
3. OEC to be transformed/split into:
 - ❖ G & G research centre.
 - ❖ Geophysical company.
4. Invest into Research and Development.
5. Encourage formation of JV or privately owned service companies (logging, drilling, construction...etc)

COOPERATION WITH IOCs IN UPSTREAM

1. Provider of investment.
2. Speedy development of oil fields & increase of oil production capacity.
3. Enhancement of oil recovery.
4. Incremental production from difficult or marginal field.
5. Exploration in frontier provinces.
6. Assist in the development of national technical & managerial skills

COOPERATION WITH IOCs contd.

1. Pre-qualification of companies.
2. Practice bid rounds (time frame?)
3. Let them compete to get better terms.
4. Diversify to reduce risks, improve quality, reduce cost, improve performance & prevent dominance .
5. Encourage consortia formation.
6. Ensure transparency & clear procedures to prevent corruption.

COOPERATION WITH IOCs contd.

AREAS OF COOPERTION:-

1. Exploration.
1. Difficult & marginal fields/reservoirs.
1. Giant fields requiring large investment.
1. Enhanced oil recovery projects in mature fields.

COOPERATION WITH IOCs contd.

MODEL AGREEMENTS

1. Service contracts.
2. Development & Production contracts.
3. Production Sharing contracts.
4. Exploration Risk contracts.

(Formation of JV companies company per specific project)

Ministry, Supreme Council for Oil & Gas / Cabinet to propose to Parliament modes of cooperation with IOCs as part of government oil policy.

NATIONAL PARTICIPATION IN CONTRACTS WITH IOCs

(An important tool for exercising National control,
development of National expertise / capabilities and
maximization of economic return to the country)

NATIONAL PARTICIPATION IN CONTRACTS WITH IOCs, Contd.

1. Policy & Legislation should emphasise on the National participation in oil field development contracts & other projects with oil companies through equity shares, maximization of employment of national man power, utilization of national industry whenever if competitive & cooperation with national institutions.
2. Encourage the formation of JV companies between National & International companies.

MANAGEMENT OF PETROLEUM REVENUE & FINANCING THE PETROLEUM INDUSTRY

1. Regulate the use of revenues among sectors and regions through legislation.
2. Petroleum revenue is paid directly to the treasury.
3. INOC to be self financed from oil sales, it's annual operation & investment budget to be provided in accordance with certain arrangements (production fee at x\$ per barrel, x% of annual revenue).
4. All operating companies are self financed based on sound financial basis.

Annex:

Oil and Gas in the Constitution

The constitution

Article 108

“Oil and gas reserves are the property of the entire Iraqi people in all regions and governorates”

Article 109

1. “The federal government manages the produced oil and gas in the current fields together with the regional governments and producing governorates, and distributes their oil revenues equitably in proportion to the population in all parts of the country, plus allocating a portion, for a limited period, to those adversely affected regions that were deprived of such revenue by the previous regime and those that were adversely affected after that, so as to ensure equitable development in various parts of the country. This is to be governed by a law.

2. “The federal government, together with the regional governments and producing governorates, will shape the strategic policies to develop the oil and gas wealth in a way that ensures the highest benefit to the Iraqi people based on the latest market principles, and promotes investments.”

Appendix 4: Presentation by Kamil Al-Mehaidi

Towards an optimum oil industry in Iraq

Kamil Al- Mehaidi

April 2006



Since the drafting of the new constitution in 2005, and due to the importance of oil in supporting the economy of the country, much interest has been shown in the articles of the constitution related to oil. These notes are an example of such interest. They aim at participating in the development of thoughts and ideas on how to best manage this vital industry, and what are the main factors, relevant to achieving this objective?

It is believed that unless this valuable industry is freed from the ethnic and sectarian considerations on the one hand and from mediocrity and corruption on the other, the future outlook for this industry, and hence for the economic development of Iraq, will be bleak.

The main factors pertinent to the objectives are believed to be as follows:

1. The new constitution
2. Division of tasks and responsibilities between the Center and Provinces
3. Organization of oil sector
4. Oil policy

1. The new constitution

From oil standpoint the new constitution seems to have been designed to achieving two main goals, the first is to distribute known oil wealth among all Iraqi regions in proportion to population density. The other is to insure that new exploration and production (E&P) will be the sole responsibility and property of the regions and provinces. Additionally, the constitution aims at giving regions and provinces more say in the management of present fields.

Much criticism has been leveled against the oil Articles of the Constitution, the most important of which are as follows:

1.1 The Constitutional Articles related to oil involve ambiguity, contradiction, overlap of responsibility and marginalization of Federal Authority (Center).

1.2 The ambiguity may result in disputes between provinces and between provinces and Center as to what is, for example, meant by "Present fields" and how to manage "joint fields".

1.3 The contradiction is obvious from comparing Article (111), which states that (Oil wealth is the property of all Iraqi people), with the other Articles which allow the new exploration and production (E&P) to be fully in the hands of regions and provinces, excluding the Federal Government from taking part in these activities.

1.4 The marginalization of the Federal Government as regards new (E&P) will have negative consequences, as regards:

- The unity of the country.
- The unity of the Oil sector.
- The negotiation ability with (IOC's).
- Accountability and control.
- Attraction of foreign investment.

As the present situation in the country is characterized by complexity and polarization, it is thought that radical changes in the constitution may not be possible. The best that can be hoped for is a constitution with minimum amendments leaving details to subsequent laws and regulations which are needed to organize the industry. The proposed amendments are as follows:

Present Constitution

Article 111: Oil and gas are the property of all Iraqi people in all provinces and regions.

Proposed Constitution

Article 111: Oil and gas are the property of all Iraqi people in all provinces and regions. The Federal Government, being the sole representative of all the Iraqi people, stands to supervise this wealth and distribute it's income fairly among all.

Present Constitution

Article 112.1: The Federal Government stands to manage the oil and gas produced from present fields, with the governments of producing provinces and regions, provided that its income is distributed fairly in proportion to population distribution in all the country, with a limited share for a limited period, for the provinces which suffered from previous regime, so as to insure balanced development in all areas. This should be regulated by a law.

Proposed Constitution

Article 112.1: The Federal Government stands to supervise the oil and gas exploration and production with the governments of producing provinces and regions, provided that its income is distributed fairly in proportion to population distribution in all the country, allowing an additional share to the producing regions and provinces, not exceeding (%) of its production returns. This should be regulated by a law.

Present Constitution

Article 112.2: The Federal Government and the Government of producing provinces and regions, stand to draw the strategic policy necessary for the development of oil and gas wealth, so as to achieve maximum benefit for the Iraqi people using up to date technological principles and investment encouragement criteria.

Article 115: All that was not stated as the exclusive duty of the federal authority, will be of the authority of provinces and regions.

Proposed Constitution

Article 112.2: As is.

Article 115: As is or omitted.

2. Division of Tasks and Responsibilities

According to the new constitution, the division of tasks between the center and the regions is that the Federal Government, the producing Provinces and Regions share the responsibility of managing "Present Fields", while new (E&P) will be the responsibility of producing Provinces and Regions. This division of tasks involves the following disadvantages:

- The administrative and legal matters are unnecessarily complicated by the involvement of all parties (the Center, Provinces and Regions) in managing "Present Fields" without a clear leadership.
- The Federal Government is obviously marginalized regarding new fields which runs contrary to the principle that the oil wealth is the property of all Iraqi people.

To overcome such weaknesses and improve management position, many have suggested the re-establishment of an independent Iraqi National Oil Company (INOC), as a framework for managing the Iraqi oil industry. The proposed function of INOC is that it will be responsible for (E&P) operations in the whole country, assisted by branch operating companies in the producing areas. The board of directors should include representatives from producing provinces and regions to ensure a fair participation and representation of all producing areas

The role of the ministry of oil (MoO) is that it will be responsible for formulating policy and legal matters through consultative council comprising representatives from all producing areas.

Alternatively the Federal Government (Center) is to be transformed into a think tank, responsible for policy making, legal matters, contracts, studies, planning and the general supervision and follow-up of all (E&P) operation. Branch or satellite companies could be formed to undertake the responsibility for the physical operations and the execution of projects.

Functions of joint nature, such as marketing and oil transportation and loading, should also be managed by the Center.

This compromise or happy medium alternative favours the re-creation of INOC, but does not insist on it. Therefore, the duties of the Center can either be split between INOC and MoO or concentrated in MoO if INOC is not re-established.

The advantage of this alternative proposal, is that it frees the Center from the time consuming operational duties, and thus saving time to concentrate on the vital functions of studies, contracts and the formulation of plans and strategies.

3. Organization

The proposed alternative organization is shown in Figs. 1, 2 and 3.

- Fig. 1, shows the preferred organization for (MoO).
- Fig. 2, shows the favoured organization for INOC.
- Fig. 3, shows the proposed organization for a branch oil company. A similar branch gas companies should also be established to run the gas industry downstream the producing fields
- A branch refining companies are also required if it is decided to include the refining sector within INOC.

Furthermore, it is suggested that four satellite independent companies are established. It is also suggested that the operational boundaries of these companies should be based on the geographical rather than actual administrative boundaries of regions and provinces, except for Kurdistan, so as to avoid possible ethnic and sectarian sensitivities.

The proposed satellite oil company could be as follows:

- Northern National Oil Co. (NNOC), operating north of 3800 UTM line.
- Middle National Oil Co. (MNOC), operating between 3800- 3600 UTM line.
- Southern National Oil Co. (SNOC), operating south of 3600 UTM line.
- Kurdistan National Oil Co. (KNOC), operating within the present administrative boundaries of Kurdistan.

4. Oil Policy

In Sept. 2004, the interim government of Dr. Alawi made a good start in formulating draft broad lines for a new oil policy. However, it is regrettable that this initiative, was not followed up by the subsequent transitional government, for one reason or another. Thus a valuable time was lost, but has to be substituted quickly so as to be able to formulate a prudent oil policy, and a balanced oil law through reconciling the following main factors.

4.1 Production Target

The prudent or optimum production target, as estimated from available reservoir data, is 5.5- 6.0 mb/d, compared with a present oil availability of some 2 mb/d. Therefore, it is required to build up a new production capacity of about 4mb/d. This additional capacity can be obtained from the further development of present producing fields as well as from the development of several new already discovered fields. The cost of building up a new capacity of about 4 mb/d is estimated at c. \$20 billion.

Therefore, the new oil policy should involve a clear vision as to how to develop the fields and who will finance the development?

4.2 Re-establishing INOC

As mentioned earlier, most opinions favour the re-establishment of INOC, as a holding (mother) company, independent financially and administratively and having satellite operating companies where needed in the producing regions and provinces.

The function of INOC is to manage, together with the other branch companies, oil operations including fields development to raise production potential to 5.5- 6 mb/d.

4.3 Foreign Investment

A new foreign investment law is being prepared and may be promulgated sometime this year. The law should aim at encouraging foreign investment on the bases of fairness to both parties, Iraq and the foreign companies.

4.4 Types of Contracts and Agreements

Production sharing agreements (PSA) seem to be acceptable to all parties concerned. However, in view of the size of money involved, the Iraqi negotiator should ensure that (PSA) contracts should be fair and equitable to both sides, taking into consideration the degree of risk factors and the price of oil in the market.

It is worth mentioning that Iraqi negotiators have drafted a (PSA) in the nineties with Lukoil of Russia. This agreement involved a "profit oil" of 9.6% of production for about 23 years, at a time when the price of oil was \$18 per bbl. The price of oil now is 3 times more. Hence, the "profit oil" for new contracts should be reduced proportionately.

Fig. 1

MoO Proposed Organization

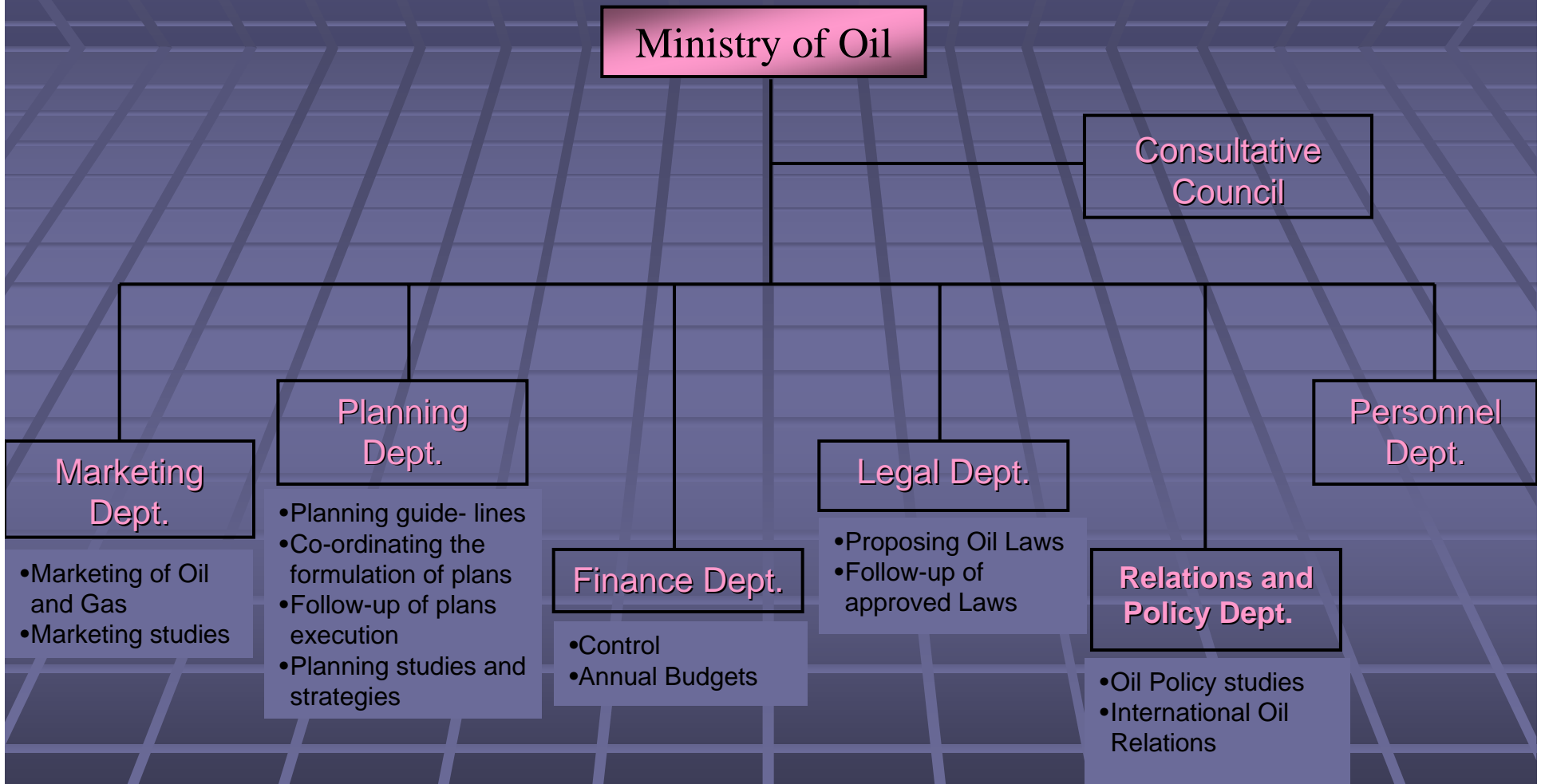


Fig. 2

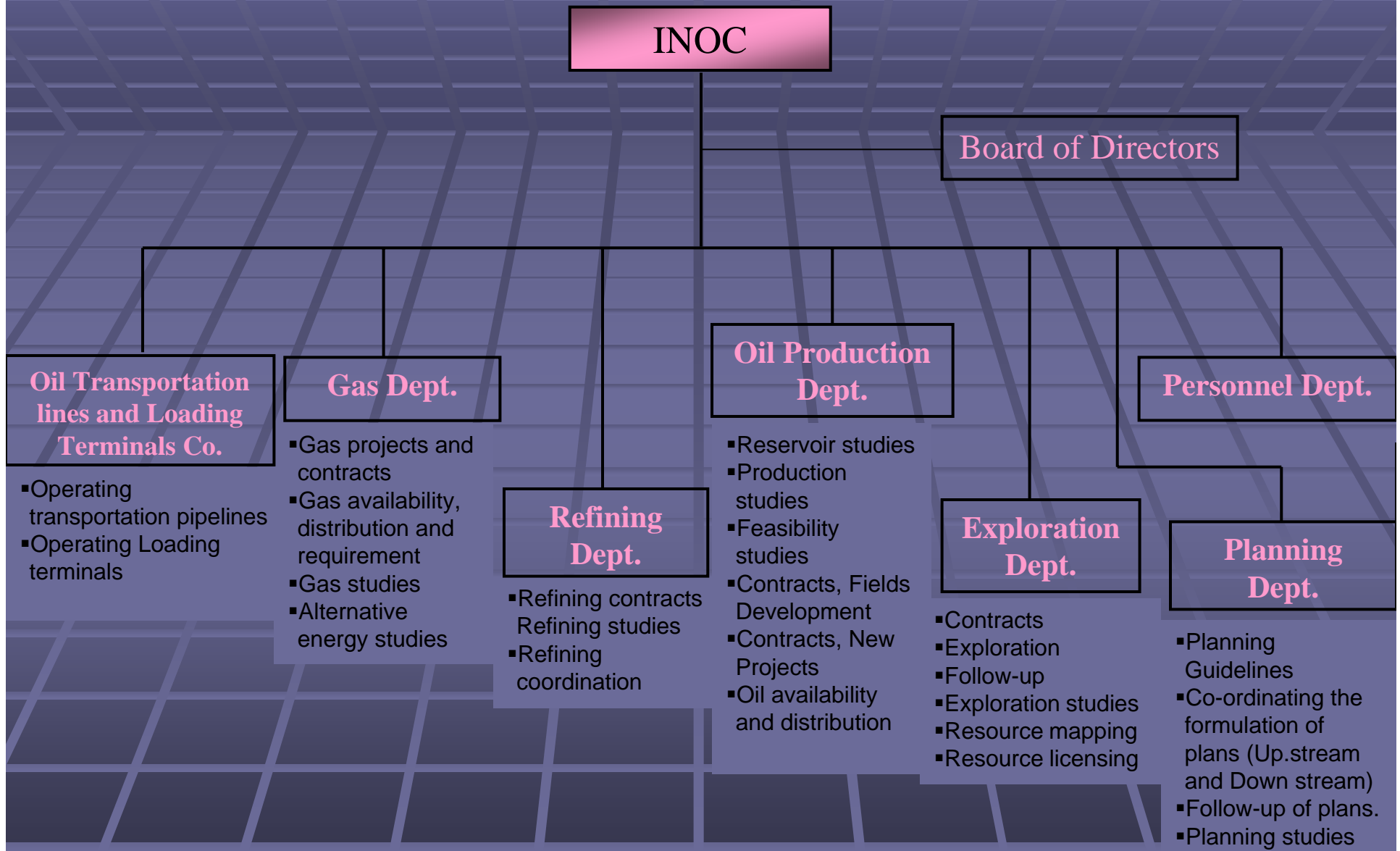
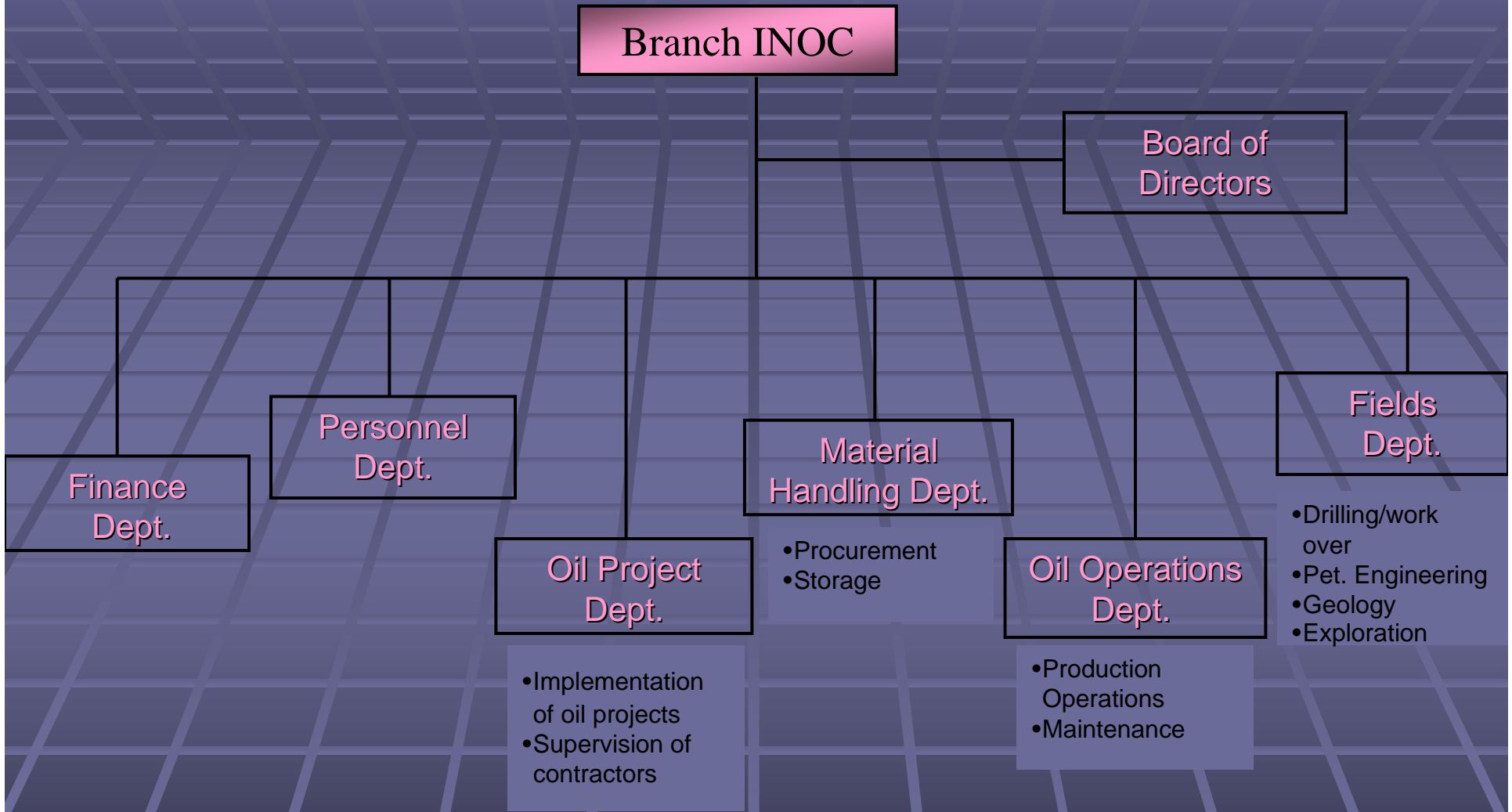
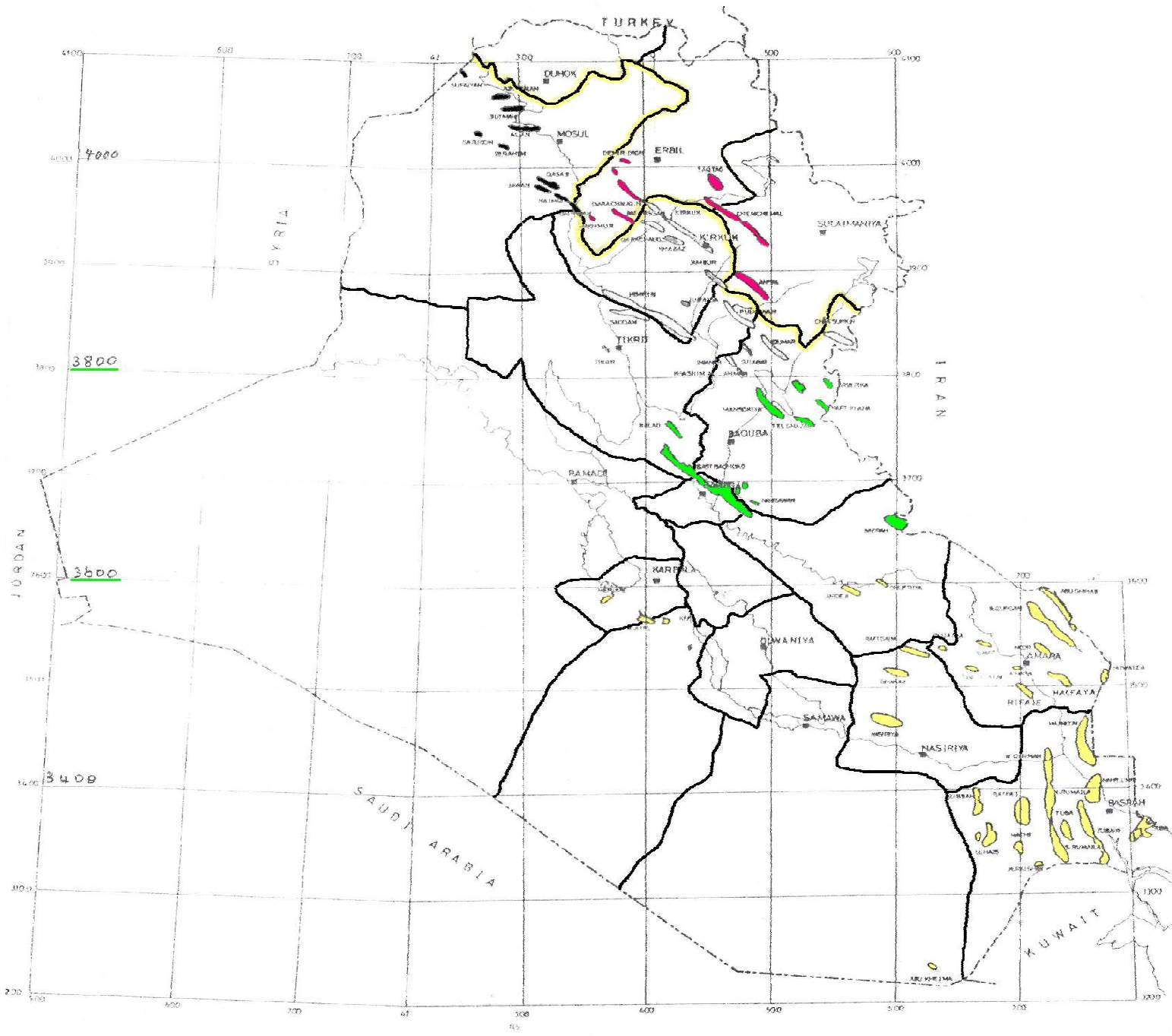


Fig. 3





Appendix 5: Presentation by Sarbaz Hawrami, George Yaku and Zaki Fattah

Management of New Natural Resources In the Kurdistan Region of Iraq

- 1) The Kurdistan Region of Iraq is a land of plenty, well endowed with natural resources. Its population is eager to live proudly and catch up with advances in world development.
- 2) Regarding oil and gas, and other natural resources, the aim is efficiency in exploration and exploitation. This will occur in accordance with the Constitution of Iraq for the benefit of all the people of the country, not just the region.
- 3) All Iraqi oil belongs to all Iraqi people. The method for distributing oil royalties and benefits will be determined in accordance with the Constitution of Iraq.
- 4) Distribution of benefits among the regions and provinces will be proportionate by population, in accordance with the Constitution. Based on this principle, details of the sharing mechanism are to be decided through discussions at the central level.
- 5) It has been demonstrated worldwide, and in every sphere of business, that decentralization is more efficient. It is, therefore, more efficient to explore and exploit our natural resources on a regional basis:
 - In addition, all types of contracts, with standard terms and conditions, are known internationally. Advantageous terms are no less attainable at the regional level than at the national level.
 - In fact, the processing, selection, control, and upgrading of technology are more effectively carried out at the regional level.
 - Excessive centralization, bureaucratic inefficiency coupled with discrimination in employment and biases in selectivity are characteristics of the central approach. This is well known in Iraq; it is our experience. And it is our experience in dealing with centralized economies of the former Soviet Union, Romania, etc.
 - There are many examples and case studies that show that regional management and organization in the exploration and exploitation of natural resources is effective. It is more effective when the media and public opinion are involved in monitoring and follow up.
 - At the regional level, information is provided at source and usually in a more detailed form on a regular basis. This makes decision making more democratic, more transparent, and more immune to corruption.
 - Advantages that centralism may claim are still open to regional management. In Iraq, we are one country and can establish a central coordination commission for building and operating associate facilities such as pipelines,

terminals, refineries, training, marketing, financing, reference pricing, bidding, regulations for conservation of natural resources and unified representation in OPEC and OAPEC. This, therefore, is not an argument that can be used against a decentralized approach.

- Regional management is necessary and essential for adapting advanced, modern management and organization known as MATRIX. This has proven to be extremely successful in Japan, USA, Canada, UK, and Norway. We hope that we, too, will benefit from applying it.
- The regional decentralized approach of management is necessary to defeat dictatorial desires. The regional approach will not allow diversion of resources on a large scale to armaments. It will more likely allow and promote diversion to development.

6) In Iraq, oil is regarded as both a blessing and a curse. It is a curse when controlled by dictators, and by economists of questionable loyalty. It's a blessing when controlled by responsible and responsive democratic governments, as is happening in Canada, England, Norway, and other countries, and we hope in our part of the world, too. Oil is also a blessing if the people, in accordance with an economic distribution model, benefit from the profits in a fair and pragmatic way.

Appendix 6: Presentation by Tariq Shafiq

A Call to Reconsider: Oil Industry Implications of Iraq's Constitutional Articles 108, 109 & 111 Governing Oil & Gas Assets

1. Constitutional Articles Governing Oil and Gas Assets

Article 108*¹² states that “oil and gas are the property of the nation (people) of all the Regions and Governorates”.

Article 109* states:

1st “The Federal government development will administer (manage) the production of oil and gas fields in cooperation (consultation) with the governments of the producing Regions or Governorates,” “provided that the revenues will be distributed in a manner compatible with the demographical distribution all over the country.”

2nd “The Federal government and the governments of the producing Regions and Governorates in cooperation (in consultation or together) will draw up the necessary strategic policies to develop oil and gas assets (wealth) to achieve the greatest benefit to the Iraqi people, based on the most modern market technology and encouraging investments.”

Articles 108 and 109 fall under the exclusive powers of the Federal Government; hence the choice of words in the translation is affected accordingly, as in the possible use of ‘consultation’ rather than ‘co-operation’ or ‘jointly’.

Article 111* states that, “All that is not written in the exclusive powers of the Federal government falls under the authority of the Regions and all that is not written in the exclusive powers of the Federal authority is in the authority of the of the Regions and Governorates. In case of disputes on matters that fall under powers common (shared) between the Federal government and the governments of the Regions and Governorates the priority will be given to the latter.”

2. Technical facts

There are in Iraq some 530 structural anomalies. Some 115 have been drilled to-date. Of these, 80 fields have today proven oil reserves of some 115 billion barrels (Bb). The 415 unexplored structural anomalies are estimated to have in excess of 215 Bb.

Present production is 2 million barrels per day (mbpd), of which the export is 1.5 mbpd. Historical production high was 3.5 mbpd in 1979 and production prior to March 2003 war was 2.8 mbpd.

Finding & development cost per barrel of oil is estimated at US \$1.0, which is equivalent to around US\$ 5,000 per 1 bpd production rate (365 barrels per year) and operating production cost is US \$1.0-1.5pb.

¹² *The above articles 108*, 109*, and 111*, have been changed to 111, 112 and 115 respectively.*

Present proven reserves can support a production rate of 10 million barrels per day (mbpd) which can be maintained for over 8 years before it starts its decline.

Building Iraq's current production rate to a peak of 10 mbpd and maintaining the plateau for 8 years would require annual depletion rate of 4% at the beginning, rising to 5.3% when it would be allowed to decline in order to maintain the sound depletion rate of 4%-5%. Theoretically, if it is allowed to decline, the oil production rate would have reached 6.4 mbpd by the end of 25th year of production when the country's reserves would have declined to around 40 Bbbl, from the present 115 Bbbl at the start of the build-up of production capacity which is still a few times of the North sea or Caspian reserves.

The 10 mbpd plateau could be raised to 12+ mbpd, with the addition of new reserves to maintain the sound depletion rate of 4%-5%. However, it would take Iraq over a decade or even two to reach a production rate of 10 mbpd.

Contrary to the generally held concept that exploration activities are required at all times at least to replenish the reserves which have been produced; Iraq's case is unfortunately and sadly unique. Iraq's production rate has never been commensurate with its proven reserves over the past decades throughout the Iraq Petroleum Company (IPC) concessionary era or the nationalised era that followed since the 70's.

The IPC parents had an obligation elsewhere in the Middle East to develop and hence limited production in each country to a low 1% annual depletion rate. And, they considered other countries safer to invest in than Iraq, which pursued radical policies since the issuing of Law 80 in 1961 which enforced unilateral relinquishment of the unexplored areas and undeveloped discoveries.

INOC, since then, adopted inherited practices including low production depletion rate. Having to rebuild production capacity from where they started repeatedly, because of the numerous Gulf wars, while oil reserves continued to accumulate, resulted in hugely disproportionate reserves to production ratio.

Iraq today has, on a global basis, the highest proven reserves or total oil resource reserves to production ratio (a measure of life expectancy) of 157 years and 452 years respectively (when adding the potential to the proven reserve). At a production rate of 5 mbpd it would still take 62 years and 180 years respectively. Couldn't Iraq then hold on unnecessary long term exploration PSA contracts for a few years or at least until stability prevails and big powers' pressure subsided?

In the mean time, the industry can concentrate its capital investment and limited human resources on production capacity growth to bring in the necessary revenue.

Major producers outside the Middle East keep reserves to production ratio at a fraction of Iraq's: UK at 6, Norway at 8, Denmark at 9, USA at 11 and Russia at 21 years, according to the statistics at the beginning of 2005. Russia's production rate was 9.4 mbpd with oil reserves of 72 Bb which corresponds to an annual depletion rate of 5%.

This does not mean, however, no exploration activities should be carried out to enhance the understanding of the geological knowledge and enrich the oil and gas prospectively. Such exploration activity would be part of the comprehensive and unified planning for exploitation and development of the whole country. But, it would be limited to a scale far smaller than the un-coordinated competing numerous exploration ventures by IOCs in the various regions and governorates which are expected under the present constitutional articles. In fact Kurdistan had already started and a few other Governorates are at the beginning of the road, following suit.

3. Planning oil fields development

Planning oil fields development for production capacity growth is carried out on a composite master plan which examines the capacities of the discovered and producing fields (including each and every producing formation within each field) from technical and economic feasibility points of view. In the mean time, it takes into consideration Iraq's economic development plans and needs. The choice of the plan for execution must ensure:

Optimal use of proven reserves which are housed in numerous and different locations throughout the rich governorates and regions

Optimal oil fields development cost plus cost of any additional or replaced major pipeline carriers and export terminal capacities

Catering for future additional potential reserves as and when needed

Securing investment capital and the managerial capability of the national effort (be it the ministry and/or INOC) and deciding on the role and number of the complimentary international oil companies (IOCs)

Such comprehensive and integrated planning could not be realised in the absence of a centralised, coordinated and unified oil policy mechanism and the whole country's data base. It is best accomplished by the central authority, Ministry of Oil (MoO) and/or a High Energy Commission working jointly with the MoO and in consultation with a think tank and qualified non-governmental organisations (NGOs) from the various regions and governorates, chosen, though, on merits.

4. Management of oil field exploration and development in the light of the present constitutional articles

Without a central unified policy there will be disharmony and competition between INOC (operating on production and marketing its export oil to provide the state's income) and the Regions & Governorates (operating on exploration for unneeded additional reserves), and among the various Regions and Governorates, with disharmony and envy between the haves and have nots. This would lead to an unhealthy oil industry, causing instability and damaging consequences contributing to the fragmentation of the country.

Instability would discourage the serious major IOCs with knowledge, capital and markets from engaging in Iraq's oil industry development. Iraq would then find itself accepting the speculators and minor independents with more promises than they can deliver.

Lack of experienced oil personnel of managerial quality at the regional level and absence of unified model contractual terms and agreements are likely to lead to inferior oil and gas agreements with the knowledgeable IOCs, which is, in itself, a failure as it does not satisfy the constitutional requirement of “ensuring highest benefits to the nation”. Worse yet is the likelihood that accountability and transparency might prove difficult to expect from the embryonic Regional governments and Governorates lacking institutions and traditions. Furthermore, contracts enacted under such conditions of unfair terms due to gross disparity between the parties would be considered nil and void under the Unidroit (International Institute for the Unification of Private Law) principles of international commercial contracts which establishes contract law principles.

Highest benefit from produced oil could only come from a national oil operation where direct investment of US \$1 per developed barrel brings in a return of over US \$55 in today’s market, which is unlikely to fall below US \$35-40 to the end of the decade and beyond. It is illogical to leave such a highly profitable business solely to the IOCs.

The interpretation of the constitutional paragraph, “latest technology of the market principles and investment promotion”, taken out of its context of “ensuring the greatest benefit to the nation”, a wholesale of Iraq’s future oil riches is expected to go to IOCs sole operations, effectively denationalising Iraq’s oil and gas assets. This would take Iraq back to the concessionary era with all its drawbacks, including serious infringement of Iraq’s sovereignty for its near total financial dependence then on IOCs.

While IOCs can achieve many positive mutual benefits, including among others fast track and sound development, unchecked production of competing IOCs leads to excessive production causing price deterioration and market instability. This is neither in Iraq’s interest as a major producer, or in compliance with Iraq’s obligation towards OPEC.

As a long term consequence of the application of Articles 109 and 111, the oil and gas rich Regions and Governorates would lead to their exclusive future control over nearly two thirds of Iraq’s oil. And, as the oil reserves from the producing fields decline, and new reserves of the Regions and the Governorates build-up, the latter would have increasingly greater economic power than the Federal government.

5. A balanced oil policy

Reinstating INOC, which has proven success in the past (it built production capacity to over 3.5 mbpd from 1.5 mbpd in a few years and added oil reserves at the rate of 6+Bb per year during the 70’s). As long as Iraq’s economy remains dependent on oil income, it is absolutely necessary to establish a national state-owned oil industry, which should be given the administrative and financial independence to command a pivotal role in the development of the country’s oil industry. It would ensure orderly exploration and developments (E&D) operations, decisions based on technical and commercial priorities, and optimum flow of income to the treasury.

Large investment capital for future oil and gas development should not give credence to substituting national operation by IOCs. To build a production capacity of one barrel per day (365 barrels per year) costs around US \$5000. The oil industry elsewhere was built by the IOCs through loans to the extent of 80%-90% of the required investment capital. A borrowed capital of US \$5,000 to build a rate of a barrel of oil per day could be paid in less than 100 days of production in today's market price. A bridge loan under such circumstances would be fairly easily obtained. And, the case would not be far different under a market of US \$35-\$40 per barrel under such price eventuality. Thus, while capital investment for fast track oil development coming from IOCs has credence, its benefit should not be exaggerated.

Partnership between the national oil industry (INOC) and IOCs is the best balanced policy option for expediting the building of Iraq's oil industry to dimensions commensurate with its huge resource base. This is preferable to the disadvantages of sole operations of IOCs, regardless of contractual form. Partnership with INOC is also the preferred route of the major oil companies. It provides transfer of technology and management, eases capital investment requirement and ensures orderly development and marketing oil export. However, there is no universal contractual form, being PSA or any other. Different situations demands suitable contractual forms under different market and competitive circumstances, be it a PSA or Buy-back, other Service type contracts or Tax & royalty contractual forms.

Today, Iraq's oil industry limitations inhibiting fast track oil field capacity development (clearly, apart from the lack of security, instability and absence of a government in full control of the country), are caused by insufficient oil experienced management personnel and the lack of up-to-date state-of-the-art technology. An active INOC working jointly with IOCs on oil field development provides a solution to technology and management limitations and a balanced approach between total State oil monopoly and a free market controlled by IOCs.

Growing dependence on IOCs, in a diminishing or absent role for INOC, deprives the State from economic independence and puts it at serious risk during circumstances when the IOCs' obligations toward its shareholders or nationality might have to override Iraq's national interest.

Upstream oil exploration and development is capital intensive. It would be wasteful to use it as a means of creating employment in the Regions and Governorates. Oil and gas are the assets of all the people. It should remain the best tool in the hands of the State for generating capital to the nation as a whole. However, many of its technical and commercial arms such as drilling, seismic/gravity/magnetic surveying, well-bore examination by various tools and testing operations could be privatised to create investment opportunities and employment for the Regions and Governorates. Likewise, many phases of the downstream operations could be privatised, such as distribution and even refining. However, proper planning along a reasonable time scale and preservation of labour rights should be upheld.

Additionally, "local content" (obligations on IOCs to carve some of the industry's functions to nationals to lessen total dependence and provide wealth and employment for the locals) ought to be adopted and enforced as obligatory contractual policy. "Local content" accounts to 51% in Iran and the Soviet Union and 70% in Norway. It

has worked to the mutual benefit of IOCs and host countries. It has been accepted elsewhere and there is no reason not to adopt it in Iraq. However, like every thing new, it should be built gradually in accordance to rules and regulations to avoid abuse.

Internal power politics exhibiting itself in appointments based on sectarian and ethnic divisions, not on merit, and the politicisation of oil policy and management are bound to obstruct the development of an efficient, transparent and accountable Iraq oil industry. A corrected course of action and the appointment of well-qualified oil technocrats are badly needed to rectify much of the wrong doings of the present trend.

The constitution, that is the articles governing oil and gas, has been dictated by the heads of the ruling political parties, and changes made to the draft prepared by the parliamentary drafting committee were made in isolation from the managerial, technical and economic realities of the oil business. A corrected course of action to modify the present constitutional articles governing management and strategic policy making is badly needed in order to create the right conditions for an efficient, growing, transparent and accountable oil industry that does justice to Iraq's present huge proven and potential reserves. In turn, this would truly create the conducive conditions to help realise the overriding article 108 that "oil and gas are the property of the nation (people) of all the Regions and Governorates".

5. Corrective measures:

The application of articles 109 and 111 as illustrated and stated above, would lead to serious damaging consequences and cannot achieve the equitable distribution of wealth and benefits among the entire nation demanded by article 108. It would not ensure the highest benefit to the nation unless corrective measures are taken which should include, among others:

Separating the two factors of (A) management of the oil industry from (B) revenue distribution, by breaking the linkage between the two provided in Article 109. The former factor, (A), ought to be re-examined and so worded in such a way as to create and optimise an Iraqi oil industry that would bring in the greatest return commensurate with its natural richness, and which could put it on par with the world leader, Saudi Arabia. Treatment of the latter factor, (B), ought to be based on equity, fairness and the needs of each of the Governorates and Regions in the context of the economic and social development of the country and the nation, rather than on ethnic or sectarian basis or on the temptation of the Regions and Governorates to control the underground mineral resources under their surface. These mineral resources are not owned by their surface proprietor. Article 108 resolves this issue. Corrective measures ought to be considered to avoid the inevitable and seriously damaging consequences. The wording should also be carefully chosen to clear up the confusion of the present imprecise text. Criteria should include:

Application of a unified oil plan and policy free from uncalled for contradictory competing plans between the Federal government and the governments of the Regions and Governorates, and among the Regions and Governorates.

Adoption of a hydrocarbon law which sets out the foundation for a national oil company as the principle operator in the country under sound health and safety rules

and technical and commercial codes of practice to explore and develop oil and gas in all the Regions and Governorates, with transparency, accountability and efficiency.

INOC working independently and jointly with IOCs on internationally accepted and balanced contractual modes with “local content” that ensure greatest benefit to the nation, encourage private enterprise and permit an assured reward to IOCs, governed by clear rules and regulations, under a secure and stable social and political environment.

A radical solution to truly satisfy the objective of article 108 and set Iraq’s oil and gas industry on a correct path, therefore, requires the inclusion in article 109 of “exploration operation” to unfold and develop Iraq’s huge oil and gas resource potential, in addition to the management of production operations.

Article 109 should then read as follows: “The Federal government shall manage the oil and gas production of the discovered and producing fields as well as the exploration and production operations necessary to unfold the potential oil and gas resource.” This implies eliminating articles 111, which allocate future exploration to the governments of the Regions and Governorates and give them the right to overrule the Federal government in case of differences or disputes.

It is neither correct nor practical for a part (any part of the nation) to rule the whole nation. Consultation and/or representation in policy making and management should provide the logical solution.

Making the national oil company (INOC) a parent company with operating oil companies in the Regions (the nucleus for this in fact already exists; the North & South Oil Companies) whose directors could become members of the board of INOC, provides an effective role for the Regions and Governorates in the whole country’s oil and gas operations jointly with the Federal government.

In order to have efficient development of the oil industry “ensuring highest benefit to the nation” it is necessary that a reference be made in the constitution to legislate a hydrocarbon law which endorses, among others, the allocation of the upstream and down operations and related commercial aspects, to a national oil company (INOC), while the Ministry of Oil and a Higher Energy Commission focus on strategic plans, policy and overall regulatory supervision.

Oil policy by the Ministry of Oil should be made in consultation with the Regions and Governorates through a consultative body from among relevant NGOs and oil technocrats having representation from the Regions and Governorates. The policy should then be reviewed for approval by the cabinet, which, after all, represents the will of the elected members of Parliament from all the regions.

Negotiated oil and gas agreements with IOCs, oil and gas related strategic projects with other countries and between the regions and governorates, in order to become valid, should have the approval of Parliament in order to ensure that their terms and conditions satisfy the hydrocarbon law, constitutional criteria of article 108, and satisfy acceptance by the representatives of all the Regions, Governorates and the nation as a whole.

Leaving the constitutional terms unchanged, the Regions and Governorates' likely course would be to go down the route of indiscriminate Pass and second rate oil companies and the damaging consequences enumerated above. This would also be regarded by critics as inviting privatisation of the nation's very livelihood through the back door; a policy known to be absolutely unacceptable by the nation.

Appendix 7: Presentation by Sabah Shabib (pending)

Appendix 8: List of Participants

Last Name	First Name	Institution Name	Position
Al-Chalabi	Isam		ex MoO
Ali	Jamal	Iraqi Alamal Association	Director
Rouhi	Dhoha	Iraqi Alamal Association	Development and Governance
Fattah	Zeki	KRG	Economic Advisor to the PM
Khadduri	Walid	Al-Hayat	Economics Editor
Al-Aaraji	Bahaa	Parliament	MP
Al-Mehaidi	Kamil	Private	
Shibeeb	Sabah	SOC	Legal Council
Shihan	Abduljabbar	South Oil Company	Director
Aziz	Rasoul	Basra Provincial Council	Investments
Faraj	Shamkhi	Ministry of Oil	DG Economics and Marketing
Ghadhban	Thamir	IG	former Minister of Oil
Humadi	Zuhair	IG	Economic Advisor to the VP
Shafiq	Tareq	IRW	former CEO INOC
Yacu	George	OGE-KRG	Deputy Director
Bell	Joseph	Hogan & Hartson	Consultant
Lissakers	Karin	RWI	Advisor
Marcell	Valerie	Chatham House	Research Fellow
McCarthy	Julie	RWI	Acting Director
Richter	Anthony	OSI	Deputy Director
Said	Yahia	IRW/LSE	Director
Welikala	Asanga	UNAMI	Constitutional Affairs