

# Breaking Iraq's oil-law stalemate

Until a legal framework is in place, signing up for exploration licences in Iraq and Kurdistan remains a huge political risk, says Keith Myers\*

RECENTLY facilitated a workshop for Iraqi parliamentarians, from all political blocs, on the country's stalled oil and gas law. The meeting was organised by Arab Region Parliamentarians Against Corruption and the Revenue Watch Institute, and brought members of the oil and gas committee together with those from the integrity and economic investment committees of the federal parliament to discuss petroleum governance and the legal and regulatory framework for Iraq.

The Iraq federal oil and gas law is, perhaps, one of the most eagerly awaited and contentious pieces of legislation in the oil industry, worldwide. Iraq holds some of the largest remaining untapped global oil resources – more than 140 billion barrels of discovered reserves, plus much more still to be found. Yet production is just 2.8 million barrels a day (b/d), although the government claims 12 million b/d is feasible, should existing fields be developed and essential export-infrastructure built.

Above ground, the politics and the rule of law remain as challenging as the geology below ground is promising. Iraq passed its constitution in 2005 and a draft oil and gas law was first circulated in 2007, with two further drafts this year. But, as yet, no law has been passed.

Meanwhile, both the federal government in Baghdad and the Kurdistan Regional Government (KRG) continue to pursue separate petroleum-licensing policies. Parliament's oil and gas committee is charged with producing the next draft of the law to be submitted to the chamber for debate. To understand why the legislation is proving so difficult, it is first necessary to understand the politics today.



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Prime minister Nouri Al-Maliki is a Shia, who leads a national coalition government that includes all the main political blocs, which, in turn, comprise a myriad of smaller parties. The coalition is in power with the support of the Kurds, who agreed to enter government on the basis of a coalition agreement – which they feel Maliki has not fulfilled.

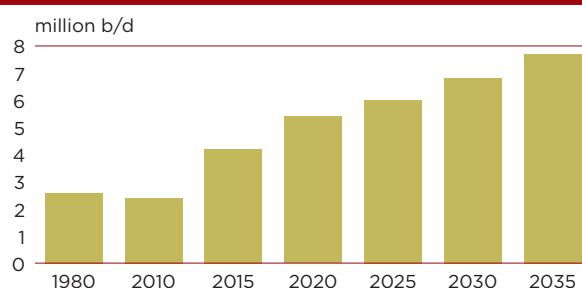
The Arab Sunni blocs mistrust both the Kurdish- and Shia-led political blocs. Meanwhile, the Kurds and the Shias fear that the mainly Sunni Ba'athists may try to regain power when US troops withdraw at the end of this year. Suspected Ba'athists have been arrested and there has been an upsurge in violence attributed mainly to Sunni groups. Corruption is rife.

The KRG has established a relatively more secure, business-friendly semi-autonomous regime, with a functioning government, albeit with widespread allegations of corruption and nepotism. Other Iraqi governates are pushing for this same regional status, having seen the advantages autonomous status has given Kurdistan – not least the 17% share of oil revenues it receives, rather than the fixed \$1 a barrel production allowance on offer for the other governates.

The fractious national coalition, together with a top-down, highly centralised decision-making style, has two consequences: there is no opposition in parliament to hold the executive to account; and parliamentarians tend to await instructions from the leaders of their particular political bloc, rather than take the initiative in consensus building.

One of the few things all Iraqis agree on is the mistrust between the political factions. And where there is mistrust, clearly defined

Figure 1: Iraqi oil-production forecast



Source: International Energy Agency

enforceable rules are crucial to facilitate decision-making. Mistrust, and the lack of rules, has led to chaotic and dysfunctional governance.

The Iraqi Constitution was agreed in 2005 and sets out how the country is to be governed. But its language is ambiguous in many crucial areas and its meaning subject to interpretation, with no apparent means of clarification. For example, Article 111 states: "Oil and gas are owned by all the people of Iraq in all the regions and governorates." This is interpreted to mean that each Iraqi owns an undivided share of any barrel produced anywhere in Iraq. But some try to read through the "all the people" language to believe Iraqis in each region or governorate own the oil and gas within their region or governorate. This principal of ownership is fundamental to the legal regime.

A second unresolved constitutional debate is over the meaning of the word "with". The first clause of the constitution's article 112 states: "The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields ... and this shall be regulated by a law."

The second clause states: "The federal government, with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth ..."

What does "with" mean in the context of policy and management decisions? How are decisions to be taken? Is the decision to issue a licence a policy to be taken by consensus, or a management decision to be made at a governorate or regional level?

## A lack of clarity

This lack of clarity is at the heart of the issue. It has hindered the translation of the Iraqi constitution into a coherent set of federal policies concerning the petroleum sector that can be enacted into federal laws and regulations.

Depletion policy, which governs the rate of exploration and extraction, is fundamental to any petroleum-rich country. For Iraq, a depletion policy must recognise oil-market demand as well the country's potential to supply – and its Opec obligations. So far, the KRG and federal oil ministry have developed and implemented separate petroleum policies; and there has been no "with" when it comes to policy and regulation. Worse still, both policies have fundamental flaws on a national level.

The International Energy Agency (IEA) forecasts demand for Iraqi crude will reach 7.7 million b/d by 2035 (see Figure 1). Under this projection, by that year, Iraq would have produced only 36% of what the government estimates to be 143 billion barrels of reserves – well below the 50% level that usually signals the onset of decline. Using the IEA projection, production from new fields discovered through exploration may not be needed before 2040 to maintain an output level of 7.7 million b/d.

Opec's quotas are decided based on the reserves held by each member country; so the group's politics will require Iraq to keep

exploring, and discovering, to defend a high output quota. (Iraq has been exempt from Opec's quota system since 1990.) But this means Iraq is asking international oil companies (IOCs) that won upstream licences to invest in exploration that may not generate a return for 25 years.

The Baghdad government has signed 10 licences for producing and undeveloped oilfields that, in theory, commit Iraq to output capacity of 12 million b/d by 2017, with seemingly little consideration of what effect this may have on world oil prices; the logistics of building crucial export infrastructure; or whether Opec and Iraq's neighbours will allow a rival producer to quadruple its output – 2.6 million b/d in October, says Opec. On top of this, the KRG predicts output of 1 million b/d by 2015.

Meanwhile, the KRG has committed to an intense IOC-led exploration programme, across some 40 licences, to discover reserves that Iraq has no need to produce for decades. The federal government also has a bidding round in progress for 12 exploration licences elsewhere in Iraq.

That Iraq is sitting on enormous oil reserves is not doubted, and this attracts IOCs like bees to honey. But petroleum policy seems not to be grounded in robust or transparent resource estimates. Last year, the government increased its estimate of proved reserves by 24%, from 115 billion to 143 billion barrels. Although there was some granularity to the estimate – it was broken down into 66 discovered fields – many in the industry remain sceptical.

Discovered oil-in-place estimates for Kurdistan have been given as at least 45 billion barrels, based by the KRG on oil company calculations. Industry analysts Richmond Energy Partners estimates about 8 billion barrels of discovered, recoverable resources in the region, based on public data; while the KRG puts the figure at 11 billion barrels.

## Reserves uncertainty

There may be confusion in some quarters over discovered oil-in-place, compared with discovered recoverable oil. The KRG's 45 billion barrels is the former, so not comparable with the 143 billion barrels of recoverable oil claimed by the central government – which included only Kurdistan's Taq Taq field in its figures.

But the confusion is significant. With 45 billion barrels reserves, the KRG would control one-quarter of Iraq's discovered oil resources. With 45 billion barrels oil in place, it would control just 7% of resources. This is politically loaded, because Kurdistan is entitled to a 17% share of Iraqi oil revenues – a figure reflecting its share of the country's population. Inflating Kurdistan's oil endowment influences perceptions as to whether the region is receiving a good deal from federal Iraq, further fuelling disagreement.

IOCs that have signed technical-service agreements (TSA) with the oil ministry are frustrated that: security in southern Iraq remains weak; by dysfunctional central government; and by demands to pay for export infrastructure, as well as field development. This extra capital requirement is eating into economic returns from contracts already regarded as meager, especially when compared with the more generous terms on offer from the KRG – which has issued over 40 production-sharing contracts under its own regional oil and gas law.

But companies operating in Kurdistan have been exploring and making discoveries that they are unable to develop fully because they cannot access export pipelines controlled by the federal government. There are reports of large scale smuggling operations exporting oil through Iran.

ExxonMobil's deal with the KRG for six blocks, including licences in disputed territory, has caused big ructions. Until now, the oil ministry blacklisted companies signing deals with the KRG – but this is the first time a company with a TSA has tested the waters.

The federal government has threatened to remove ExxonMobil from the West Qurna-1 TSA, which it shares with Shell, saying the supermajor has broken Iraqi laws. But this is disputable: given that a petroleum law has not yet been agreed, it's unclear what rules ExxonMobil has contravened.

It's in this political landscape that the oil and gas committee must scrutinise the draft petroleum law and present its recommendations to parliament. Its task is unenviable. With limited resources, it is attempting to create laws in a policy vacuum. A good law will need consensus on the meaning of the constitution concerning the

distribution of powers between federal and regional government, and the key elements of petroleum policy.

And achieving consensus through the political leadership has proved impossible so far. Parliament is the only body where all elements of Iraqi society are represented and empowered to make laws. Can it rise to the occasion and achieve consensus where the executive has failed?

In an atmosphere of mistrust, clear rules and a commitment to follow them, and a mechanism for enforcing them are needed. This is what the legal framework is meant to provide. But first, clear petroleum policies for federal Iraq are essential, without which the risk is a lowest-common-denominator law is passed, lacking clarity and detail and proving difficult to implement.

## A way forward

Unfortunately, this is the course Iraq seems to be on. An independent analysis of the 2011 draft laws highlighted 42 important points that would benefit from clarification. But there is a way forward and there are two suggestions to advance the law's finalisation:

The country could enact the oil and gas law in stages, focusing first on the policy-making function. For example, it could pass a law to create a body to formulate petroleum policy for federal Iraq. The draft oil and gas law already calls for such a body, the Federal Oil and Gas Council (FOGC), on which regions, governates and federal government are represented. But the composition of the FOGC and how its members are appointed is not yet agreed. The FOGC could then agree the policies that would guide subsequent petroleum laws and regulations.

In this regard, aspects of the federal model in Australia may be useful; where jointly agreed federal policies and laws are mirrored by laws and regulations in individual states – which have responsibility for their implementation.

Adopt a policy commitment to full petroleum-revenue transparency to build trust. Iraq has signed up to the Extractive Industries Transparency Initiative, but should go further by publishing audited, annual national petroleum accounts, reconciling all revenues, company costs and profits, to show clearly how the federal petroleum revenues are derived.

Until a policy and legal framework is in place, continuing to issue exploration licences, for oil that Iraq does not yet need to produce, will only make matters worse. Calling a moratorium on further licencing would make sense. Meanwhile, investors should beware both the political risks of deals whose legal status is unclear, and of exploring for oil that Iraq does not need to produce for decades. ● **First published online on 30 November**



Iraq is asking IOCs holding upstream licences to invest in exploration that may not generate a return for 25 years

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