



Iraqi Oil: Black Gold or Black Hole?

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This is a guest post by Nawar Alsaadi. Nawar currently lives in Canada, but lived in Iraq until 1990. He still has close ties to the country, and has been following the situation closely there.

Investors and global oil companies such as Shell Petroleum, Eni, China National Petroleum, and Exxon Mobile betting on Iraq are certain to be disappointed.

Ever since the fall of Baghdad in April 2003, we have heard about the unlimited potential for the Iraqi oil. Often news reports mention that Iraq has the third largest oil reserves in the world, and that Iraq's oil ministry has a goal of producing 6 million barrels/day of oil over the medium term.

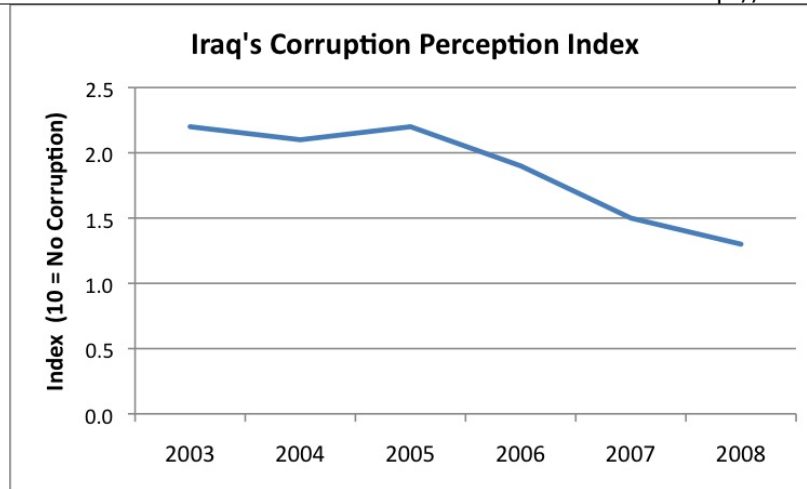
However, six years after the fall of Baghdad, the country is nowhere close to producing 6 million barrels a day. As a matter of fact, the country is still not producing at the same level it did before the war (2.2m bpd vs 2.5m bpd before the war). It is worth noting that the pre-war level was achieved despite years of war and crippling economic sanctions. Yet despite current access to capital and technology, the country could not yield better results than oil production under the Saddam regime in the midst of war and sanctions.

There are several reasons why Iraq has failed to rise to the occasion, and in this article I will attempt to address some of them:

- Endemic corruption
- Political reserves
- Bad management
- Political rivalry and foreign oil company stalemates
- Political insecurity

Endemic Corruption

As of last year, according to the [corruption ranking of Transparency International](#), Iraq ranked 2nd worst in the world. It was slightly higher than Somalia and in line with Myanmar. Actually if we were to follow the survey from 2003 to 2008, we see the following erosion in the country corruption score (10 being the highest, and 1 the lowest):



Based on [analysis of Transparency International](#)

Thus despite the Iraqi government assurances that it is doing its best to combat corruption, it seems that corruption is growing at an alarming rate, taking Iraq to the path of overtaking the failed state of Somalia in the near future.

Political Oil Reserves

It is often claimed that Iraq has the third largest oil reserves at 113 billion barrels. The source for these numbers is rarely discussed. Thus it is worth looking at the origin of those claims.

Iraq nationalized the oil industry in 1972 when it took full control of the western controlled Iraq Petroleum Oil Company (IPOC). At that time Iraq's oil reserves stood at 35.9 billion barrels according to the IPOC and were reported by Baghdad to be at 30 billion barrels as recently as 1982. However, interestingly enough, as the Iraq-Iran war raged and Iraq's need for additional revenues to finance the war grew, Iraq's oil reserves jumped to 41 billion in 1983, followed by a jump to 48 billion in 1987 and finally they topped 100 billion by the end of the war in 1988. However after the complete halt of exploration due to the 1991 gulf war, Iraq oil reserves jumped to 112.5 Billion in 1995, and this is where they stand today.

Iraq was not alone in significantly increasing its reserves, several OPEC nations did the same, one reason is that OPEC production quotes at the time were determined by the country's declared proven reserves, thus we see a race between the OPEC members to increase reserves within this period:

Selected Reported Reserves (Gb) with Suspect Increases								
Year	Abu Dhabi	Dubai	Iran	Iraq	Kuwait	Saudi Arabia*	Venezuela	Spurious Amount
1980	28.00	1.40	58.00	31.00	65.40	163.35	17.87	0
1981	29.00	1.40	57.50	30.00	65.90	165.00	17.95	0
1982	30.60	1.27	57.00	29.70	64.48	164.60	20.30	0
1983	30.51	1.44	55.31	41.00?	64.23	162.40	21.50	11.3
1984	30.40	1.44	51.00	43.00	63.90	166.00	24.85	0
1985	30.50	1.44	48.50	44.50	90.00?	169.00	25.85	26.1
1986	31.00	1.40	47.88	44.11	89.77	168.80	25.59	0
1987	31.00	1.35	48.80	47.10	91.92	166.57	25.00	0
1988	92.21?	4.00?	92.85?	100.00?	91.92	166.98	56.30?	192.11
1989	92.21	4.00	92.85	100.00	91.92	169.97	58.08	0
1990	92.00	4.00	93.00	100.00	95.00	258.00?	59.00	88.3
TOTALS: Declared Reserves for above Nations (1990) = 701.00 Gb - Spurious Claims = 317.54 Gb								

Data from Dr. Colin Campbell, in SunWorld, 1995 (Click [here](#) for references)

Furthermore none of the above nations allow for any decrease in reserves to account for the already produced oil, as of 1995 when Iraq declared an increase of its reserves to 112.5 Billion, the U.S. Geological Survey calculated that at least 22 billion barrels of Iraq oil reserves have already been produced by that date, and if we were to update those number to 2009, we can safely add an additional 10 billion barrels produced in the last 13 years.

So what is a reasonable estimation for the remaining Iraqi reserves?

According to Dr. Colin Campbell a prominent oil geologist and founder of the Association for the Peak Study of Oil and Gas (ASPO) Iraq oil reserves stand at about 60 billion barrels, or about half the official estimates.

Bad Management

Since the fall of Baghdad and the start of the “democratization” process, the country has lost thousands of technocrats under the pretext of their Baath political affiliation. This has opened the door to mainly political appointments at key Iraqi ministries including the Ministry of Oil. The lack of oil industry experience by the appointed, combined with the surging levels of corruption has conspired to limit the growth in the Iraqi oil production since 2003. This failure is amplified by the ministry’s failure to bring production back to 2002 levels six years after the regime change.

However, what is more worrisome after several years of miss-management is that Iraqi oil production is on the verge of witnessing a sharp decline in production to possibly under 2 million barrels a day, as indicated from recent news reports:

February 24th 2009

A Guardian newspaper article talked about a 250,000 barrels/day decline in Iraqi oil output, and the alarm of the oil ministry in regard to the issue:

Pressure problems at two southern oilfields are the main reason for a decline of 250,000 barrels per day. That, on top of oil's \$100 a barrel price collapse since July last year, has already forced Iraq to cut its budget twice.

Alarmed by the loss of output from its reliable southern oilfields, Baghdad sent a high-powered committee to investigate and devise a quick fix.

April 17th 2009

Creeping water cut levels, this [second article](#) from the Guardian indicates an aggressive plan by the Iraqi oil ministry to deal with wet crude through the issuance of several tenders to deal with the issue:

It has issued a blitz of tenders recently for degassing and dehydration plants, valves, control systems, pumping software, pumps, storage tanks, and equipment for treating wet crude -- oil mixed with high levels of ground water.

For those who don't know the significance of wet crude, as oil wells age, the extracted oil is often mixed with water. An increased water to oil ratio indicates an imminent production problem and can lead to a total collapse in production, if not treated adequately.

The most dire warning came on April 23th 2009, as reported in [this MEED article](#):

The sources tell MEED the country's oil output could drop by up to 10 per cent by December 2010 as production from state-run South Oil Company (SOC) falls by 220,000 barrels a day (b/d) as a result of a deterioration in the productivity of its wells at fields including South and North Rumaila, West Qurna and Missan.

SOC suffered a 100,000 b/d fall in production in 2008. The sources say the company will suffer further 100,000-b/d drops in both 2009 and 2010.

The drop in production has already forced SOC to cut supplies to local refineries to meet crude export requirements.

Furthermore:

"The reality is that there is a crisis in the making," says one executive from an international oil company that has attended meetings with SOC to address the problem.

"Everyone is used to focusing on security and infrastructure problems whenever something is not going right in Iraq, but this time it is down to physics."

Jabbar al-Luaibi, a former head of SOC who now advises the Oil Ministry on all oil projects in southern Iraq, says the collapse in production is due to Baghdad falling

behind with its drilling programme over the past six years and the declining productivity of its existing wells.

"It has got to the point where we have 300 wells not flowing in some of our biggest fields, and that means a lot of work just to get us back on track to where we were a few years ago," says Al-Luaibi.

"We know there has been a 100,000-b/d decline in 2008 and we will see the same drop from the production platform in 2009 and 2010. After that, we could be looking at even sharper falls."

Al-Luaibi says the problems in production can be attributed to a delay in the maintenance of existing wells, reservoir management problems and the amount of water leaking into the reservoirs.

As indicated from recent news reports, Iraq oil industry seems to be in a dire state, and the country is scrambling to maintain oil production at current levels. However, if the performance of the Iraqi government over the past few years is any indication, their current efforts are unlikely to solve the issue.

Political Rivalry and Foreign Oil Company Stalemates

One of the main issues blocking the development of the Iraqi oil wealth is the political rivalry and mistrust between the various political factions governing the country. The greed and the competition for power has lead to a multi-year stalemate in the passage of the key hydrocarbon law introduced in 2006 and revised four times so far. And it does not seem that a passage is near, based on this April 17th 2009 [headline](#):

Kurdish minister 'not very optimistic' oil law soon passed

This headline is of key significance, since the Kurds are considered to be the stumbling block for the approval of the law mainly due to issues related to exploitation of the rich Kirkuk oil fields. Thus, such a comment from Ashti Hawrami the Kurdish natural resources minister does not indicate a change in their stance anytime soon.

In light of the unlikely passage of the key hydrocarbons law, the oil ministry started looking for ways to invite oil companies into Iraq without the passage of the law, under what is called "technical" oil contracts. The first plan for awarding such two-year service contracts to western oil companies was undertaken in 2007, with a goal of increasing the country's oil production by 500,00 barrels/day through signing five 100,000 barrels/day contracts. However, by 2008, no such contracts were signed, and the terms where changed to one-year. But due to growing political opposition to such no-bid contracts, the whole plan was scrapped by the end of the year.

Yet the Iraq oil ministry led by Mr. Hussain al-Shahristani was determined to sign deals with foreign oil companies. It went ahead and signed a gas deal in September 2008 with Shell Petroleum to exploit Iraqi gas, which is estimated to be burned at a rate of \$7 billion per year for lack of gas processing facilities. However the \$4 billion deal has faced opposition almost from the start, and as of April 17th 2009, Mr. Jabir Khalifa Jabir, secretary of the Iraqi parliament's oil and

gas committee announced the following:

"We are going to do everything we can to revoke this deal and to push Shell out," Jabir told Reuters. "Both these deals are illegal because they didn't go through parliament".

"The companies and their lawyers knew the old Iraqi oil law very well," he added, saying that any new deals Baghdad signs in bidding rounds under way with BP and others would also be subject to revocation."

More recently, Iraq announced the opening of the Nassiriyah oil field for bidding to foreign oil companies, in an effort to produce 100k barrels/day. A decision was supposed to be made by the end of April; however, by April 23rd 2009, the deadline was pushed back to the [end of June](#):

Abdul Mahdy al-Ameedi, deputy director general at Iraq's Petroleum Contracts and Licensing Directorate, said the ministry had asked the three companies to review their previously submitted technical and commercial offers according to "new requirements" made by the ministry.

I believe one must wonder if the "new requirements" made by the ministry has anything to do with the corruption index highlighted in the start of the article!

So what does Iraq have to show for its efforts in inviting in foreign oil companies? The sole signed and progressing contracts are with an unheard of British oil firm named Mesopotamia Petroleum Company, and a \$3 billion contract with China's CNPC, a contract that was initially signed in 1997 under the Saddam regime. Like the Shell Petroleum deal, the Iraqi parliament considers this contract also illegal.

Thus as indicated from the above issues, Iraq is facing significant political problems in its efforts to invite oil companies. The Kurds and the central government are locked in a war to control Kirkuk oil; the Kurds are unlikely to allow the passage of the oil law unless they have more control on Kirkuk; while the Iraqi government is unlikely to allow any Kurdish oil to be fully developed or exported unless the Kurds submit to its wishes. Meanwhile, the oil ministry is in a constant struggle with the politically driven parliament, as all of its plans are systematically blocked for political reasons and on suspicion of corruption.

Political Instability

2008 was a year of relative calm in Iraq. However, it seems that 2009 is turning to be a year of further instability. To better understand the current instability, it is worth looking into why 2008 was relatively stable.

2008 witnessed a weakening of the insurgency, largely due to the successful American efforts of recruiting 90,000 ex-insurgents in what is called the Awakening Councils, which are nothing more than Sunni armed militia's funded by the US at a rate of \$300 per member/per month. The US introduced this program in an opportune moment as Al-Qaeda's bloody methods and thirst for control created a significant rift within the insurgency. This rift within the insurgency and the financial and armed support for the councils created a relative level of stability in the former hot

spots such as Anbar, parts of Baghdad and Diyala.

In addition to the above, the Iraqi government was profiting handsomely from the explosion of oil prices to above \$100 a barrel for most of 2008. This windfall in wealth helped the government fund an overly large security force and the creation of a massive welfare state where close to 80% of the population is dependent one way or another on the government for employment, housing or food. As a matter of fact, the government got so wealthy that Mr. Nouri al Maliki was walking down Baghdad's streets in the summer of 2008 [handing out dollars](#).

The situation is much changed in 2009. The US passed the control of the Awakening Councils to Baghdad, but the Iraqi government has refused to incorporate more than 20% of the members of the councils into the police and army, and only a handful have been recruited to the official security forces to date. Furthermore, recent reports indicate that the government is arresting members of the councils. By March 28th we had the following [news reports](#):

On March 28, clashes erupted in Baghdad's Fadhil district after Iraqi troops arrested the leader of the local Awakening Council, Adil al Mashhadani, one of many former Sunni insurgents who had allied with American forces in the fight against al Qaeda-inspired Salafi militants in Iraq. Mashhadani's men staged a two-day uprising, which was put down by Iraqis with considerable help from American troops fighting against their former allies.

A few days later on April 7th 2009, there was a wave car bombs attributed to the councils' [growing distrust of the government](#):

Seven car bombs exploded across Baghdad yesterday in a surge of violence linked to growing dissatisfaction among the Sunni militias that helped turn the tide against [al-Qaida](#) and other insurgent groups

And as [recently as April 24th](#), several bloody attacks of a sectarian nature took place on Shia pilgrims, with the most dangerous aimed at the holy Khadamiya Shrine in Baghdad killing 65 people, and bringing memories of the Golden Dome in Samarra attack in February 2006, which lead to a massive escalation in inter-ethnic violence in 2006 and 2007.

To compound the above problem, the Iraqi government is running out of money due to the collapse in both oil prices and oil production. As a result, the country's budget was revised down three times--down to \$58 billion from \$80 billion a few months earlier. It is likely to be reduced again, as the current budget is based on \$50 oil. (Iraqi oil trades at a discount to WTI.) This situation prompted Iraq to [consider an IMF loan](#).

The collapse in Iraqi revenues has significant implications with respect to the security situation. The most obvious impact is the [freezing of security forces hiring](#), which was announced on March 20th 2009. This freeze directly affecting the hiring of the ex-insurgent Awakening Council members. Furthermore, the lowered revenues are curtailing significantly much needed investment in crumbling civil infrastructure, social services and much-needed investments to boost oil services.

In the midst of the above challenges, the current US administration is marching ahead with its plans to withdraw from Iraq, a move that will likely create a vacuum that will further weaken the Iraqi government and may very well lead to a civil war between the rival factions.

There are many questions that remain unanswered in Iraq. The fate of Kirkuk remains illusive. The [recent UN report](#) on Kirkuk was received coldly in Iraq, and the Kurds consider [their parliament](#) as the only appropriate venue to solve the issue. The Sunnis remain deeply distrustful of the Shia, and today the Sunnis have well trained and well organized militia to defend their interests, while the Shia remain divided between loyalty to Iran by some and loyalty to the country by others.

The above discussion offers only a glimpse of the political, physical and operational limitations on Iraq's ability to produce any significant amount of oil in the next few years. These issues are an indication that Iraq is likely going to experience a sharp decline in production (or perhaps stagnation at best) in its production levels over the foreseeable future.

The implications of this discussion are of great significance to investors in the oil industry, as Iraq is often looked at as one of the potential bright spots for increased oil production over the medium term. It is even more important within the context of an expected oil [supply shortage starting in 2013](#), as often repeated by the IEA.

Hence, while it might be profitable to invest in oil over the next few years, it might be wise for the oil industry and oil investors to await more stability and clarity in Iraq before moving into that country.

Disclosure: The author has no positions in any of the above mentioned companies.

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