The oil and gas law – signing away Iraq's future?

Summary briefing on the Iraqi oil and gas law
By Greg Muttitt of PLATFORM.

Overview

An oil and gas law is being considered by the Iraqi Council of Representatives, which proposes a radical restructuring of the oil sector, giving the leading role in future development to multinational companies. This raises a number of serious concerns:

- Potentially higher unemployment, and erosion of Iraq's skills base
- Contracts with foreign companies lasting up to 30 years, fixing economic terms as those agreed now, in Iraq's current weak position – meaning a long-term loss of revenues, in favour of foreign profits
- Decisions on contracts signing away huge portions of Iraq's economic base to be made without parliamentary scrutiny
- Depriving future governments of the ability to make decisions regarding Iraq's natural resources in the public interest
- Undermining the ability of future governments even to pass new laws affecting the oil sector.

Such moves would make Iraq unique among the major oil-producing countries of the world, and of the Gulf region. The oil law is more like one that might be expected in a small country with no oil industry of its own. It is very surprising that it is being proposed in a country as rich in natural and human resources as Iraq.

The oil and gas law

The oil and gas law is one of the most important to be considered by the Council of Representatives. Oil currently accounts for more than 70% of Iraq's GDP, and 95% of government revenue. Decisions made now could determine the shape of the Iraq's economy and politics for at least a generation.

A draft oil and gas law was approved by the Iraqi Council of Ministers on 26 February 2007. The Council of Ministers has asked the Iraq Council of Representatives to ratify the law by 31 May.

Iraq has between 112 and 115 billion barrels of proven reserves of oil – about 10% of the world's total. Geologists believe that there is likely to be at least another 100 billion barrels yet to be discovered. Iraq also has some of the highest levels of technical education in the world, a highly skilled workforce, and excellent high-level expertise in oil sector management.

Much of the debate so far on the oil and gas law has concerned the sharing of powers between federal and regional governments. This is issue is very important – it affects the coherence and effectiveness of the Iraqi oil and gas industry, the structure of Iraq's federal system, and the level of sectarianism in Iraqi politics. What has received less attention, but at least as important, is the question of the sharing of powers and revenues between Iraqi entities and foreign companies. This briefing focuses on this latter question.

A radical restructuring of the Iraqi oil industry

The oil and gas law provides for a fundamental restructuring of the Iraqi oil industry. Like in most of Iraq's neighbours, oil production is currently controlled by public Iraqi companies. The law would instead give the primary role in oil development to multinational companies.

The law can be seen as a direct reversal of Law No. 80 of 1961. Following more than three decades of exploitation by British, French and American oil companies (working as the Iraq Petroleum Company), Law 80 left those companies in charge of existing, producing fields, while allocating rights to undeveloped fields to the Iraq National Oil Company. The existing fields were later nationalised between 1972 and 1975.

Conversely, this new proposed law would leave INOC in charge only of 27 existing, producing fields (Article 6B), allowing multinational companies to take over all other discovered and undiscovered fields. The result is that as the existing fields become depleted, foreign companies will gain an ever greater share of Iraqi oil production.

PLATFORM is a London-based charity, specialising in the impacts of oil development around the world. Since 2003, PLATFORM has monitored the development of Iraqi oil policy, and its research has been published in a number of journals, and presented to Iraqi and international civil society, policy-makers, academics and oil industry experts.
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This would have a number of consequences. Among them, foreign oil companies generally employ fewer workers than state-owned oil companies, relying more heavily on technology. They also make far more use of foreign staff, especially in senior and technical roles. The result could thus be an increase in unemployment in Iraq, and erosion of the country's skills base. The draft oil and gas law places no minimum requirement on hiring of Iraqi workers, or purchasing of Iraqi equipment and services, making only vague, general statements about these.

Long-term contracts: fixing Iraq's economic future

The law proposes that multinational companies be given exclusive rights to develop Iraq's new fields, through long-term 'development and production contracts' or 'exploration risk contracts' (Article 9, 5th), lasting for up to 30 years (comprising up to 10 years of exploration and appraisal, followed by up to 20 years of development and production, with a possible further 5 years subject to mutual agreement) (Article 13). While the meaning is not specified, it is believed that these contracts are equivalent to the controversial 'production sharing agreements'.

If – as is proposed – these contracts were signed while Iraq is racked with terrible violence, while its institutions of state are new and weak, and while large numbers of foreign troops are still present in the country, the Iraqi side would be unable to negotiate a good deal. On the other hand, companies would insist on 'risk premia' built into the economic terms.

As a result, the terms would likely be very profitable. Thus for a whole generation, until 2037, foreign companies could be benefiting from Iraqi revenues, in proportions that reflected the situation in 2007.

This problem is common to many oil-producing countries: the best terms that can be obtained at the time of signing contracts are no longer seen as fair a few years later, but cannot be changed. For example, this happened with contracts signed by Russia and Kazakhstan during those countries' rapid changes of the early 1990s – with terms that are now regretted by the countries. It was also what happened with the early concession contracts in the Middle East, including the contract with the Iraq Petroleum Company, signed in 1925 during the British Mandate period.

In short, it is not wise to enter long-term commitments from a position of weakness.

No role for parliament

The draft oil and gas law would allow the executive branch of the Iraqi government (comprising the Ministry of Oil, INOC, regional governments and the new Federal Oil and Gas Council) to sign contracts, without the chance for the Council of Representatives to review whether the terms are appropriate (Article 10).

For a country as dependent on oil income as Iraq, depriving parliament of the ability to approve or not approve such important economic decisions would have severe consequences, both for the management of the economy, and for the potential scope of democracy in Iraq.

Undermining sovereignty

By allowing multinational oil companies to develop Iraq's oil under long-term contracts, the Iraqi state could lose its ability to make decisions in the public interest – for example, in managing its economy, or complying with OPEC quotas.

Iraq could even see its ability to pass new laws compromised. International investment contracts commonly contain a 'stabilisation clause', which effectively immunises the development from any changes in laws throughout the life of the contract, or requires the state to pay the costs of complying with them. For example, a future government in 10 or 20 years' time might wish to pass a new labour law – it could be faced with a choice of either exempting much of Iraq's oil production from the law, or surrendering revenues to pay the costs. There is no restriction on such provisions in the draft oil and gas law.

In some cases, contracts even exempt investors from any existing laws not listed in the contract, or to specify that some regulatory standards are defined by the investor. The draft Iraqi oil and gas law defines "good oilfield practices" as "All those practices related to petroleum operations that are generally accepted by the international petroleum industry as good, safe, environmentally friendly, economic and efficient" (Article 4) – this could undermine the ability of Iraqi authorities even to regulate the safety or environmental impact of oil production.

The draft Iraq oil and gas law allows any disputes between future Iraqi governments and investors (for example, on the interpretation or performance of any contracts) to be decided by international arbitration tribunals, rather than in Iraq's own courts (Article 39). These tribunals, in Paris, Geneva or Washington DC,

tend to favour the commercial interests of the investor, and do not generally recognise a role for the state to uphold the public interest. For example, French company Total used international arbitration to deprive the Russian government of the right to approve budgets in its development of the Kharyaga oilfield in Siberia – the result was that the state got less tax than it thought it should.

Giving more to foreign investors than any other comparable country

Contracts of the type we have described are common in countries that have small amounts of oil, do not have their own skilled oil industries, or where oilfields are technically complex (such as offshore), or where high-risk exploration is required. None of these circumstances apply to Iraq.

Looking at the top 7 countries with the largest oil reserves in the world – between them accounting for over 70% of the total – none now uses this form of contract:

- **Saudi Arabia** (22% of known world reserves): oil production is entirely controlled by the national oil company, Saudi Aramco, and the state receives all of the revenues.
- **Iran** (11.5%): a maximum of 30% of oil reserves can be developed by multinational companies, under Buyback Contracts. These are very different from what is proposed in Iraq: they last only for 8-12 years, and specify the maximum profits that companies can receive; furthermore, once a field has been developed, the National Iranian Oil Company operates it.
- **Iraq** (9.6%)
- **Kuwait** (8.5%): oil production is entirely controlled by the national oil company, Kuwait Petroleum Company, and the state receives all of the revenues. The government has proposed bringing foreign investment just into the oilfields in the north (a minority of reserves), under contracts similar to the Iranian model – and even this has been blocked by the parliament.
- **United Arab Emirates** (8.1%): foreign companies can buy small minority shareholdings in the national oil company, which controls the major oilfields; only some smaller oilfields are developed under concession-type contracts.
- **Venezuela** (6.6%): multinational companies can only invest through joint ventures, in which the state always has a majority share. The formation of such joint ventures requires the approval of parliament. Taxation is a sovereign power, not restricted by contracts. Disputes are only arbitrated in the country, not in international tribunals.
- **Russia** (6.2%): signed three production sharing agreements in 1994-95. After this, new laws restricted the reserves able to be developed in that way to 20%, and required parliamentary approval for contracts on “strategic” fields. Those three contracts have been so controversial that no more have been signed, and the government has tried (unsuccessfully) to renegotiate them.

Even in smaller countries that do use such contracts, many do not give away as much as the Iraq oil and gas law proposes. Many require a minimum state participation in contracts. In Libya, state participation is as high as 89%. Others, such as China (like Venezuela), insist that arbitration takes places in the country. Some, including the UK, maintain a sovereign right to vary taxation. Some require parliamentary approval of contracts, including Syria, Egypt, Yemen and Azerbaijan.

The proposed Iraqi oil and gas law might be reasonable in a country with small reserves, or lacking technical capacity. In a country like Iraq, it is highly unusual to favour foreign oil companies to this extent.

A proper debate is essential

Article 110 of the Iraqi Constitution states that “Oil and gas are the ownership of all the people of Iraq in all the regions and governorates”. Yet it seems that this ownership has not been reflected in the process by which the oil and gas law has been drafted.

The first draft of the oil law was completed in July 2006. Within two weeks, it had been seen by US and UK officials, and by representatives of nine British and American multinational oil companies. Two months later, it was seen by officials of the International Monetary Fund (IMF). These groups actively influenced the content of the draft law for more than seven months before it became available to most members of the Iraqi Council of Representatives. Iraqi civil society groups have been excluded altogether.

Now, attempts are being made to rush the law through the Council of Representatives, under deadlines set by the US Government (rapid passage of the oil law is one of President Bush’s “benchmarks”) and the IMF (passing an oil law to allow foreign investment is a condition of the Standby Agreement of December 2005).

The law has been claimed by some – erroneously – as a reconciliation measure, to reduce the violence in Iraq. But whatever one’s view of its content, if a law proposing such radical and far-reaching changes passes without full debate and without an active consultation with the Iraqi people, the result is likely to be the opposite.

Recommendations

We have three general recommendations:

- That long-term contracts should not be entered into, at least until Iraq is stable, its institutions more developed, and foreign troops have left. Only then might there be a chance of obtaining terms that reflected Iraqi interests.
- That any major changes to the oil industry should be subject to a full and genuine consultation with civil society groups, and without the imposition of arbitrary deadlines.
- That any future long-term contracts should be subject to parliamentary approval.

In the mean time, there is much that can be done to rehabilitate and develop Iraq's existing oilfields within the public sector. Where external technical resources are required, multinational companies can be brought in with technical services contracts – under which they carry out defined services for the Iraq National Oil Company, for an agreed price, over a specified time, as is normal in business. (Note that technical services contracts are distinct from operating service contracts, which include some element of risk, and allow a foreign company some degree of operatorship).

Iraq also has the funds available to develop the oil itself, from public budgets. Or alternatively (if it is decided to devote public budgets to other priorities), there is still the option of obtaining loans to finance oil development.

Developing the oil within the public sector for now would still leave open the option of foreign investment at a later date; in fact, with boosted capacity and a more stable situation, the outcome from later investment would certainly be better than doing so now. On the other hand, contracts signed now cannot be reversed.

It would be a tragedy if at such a terrible time in Iraq's history, the country were to sign away the future of its natural resources, and with it the country's prospects for economic development.