Executive Summary

While the Iraqi people struggle to define their future amid political chaos and violence, the fate of their most valuable economic asset, oil, is being decided behind closed doors.

This report reveals how an oil policy with origins in the US State Department is on course to be adopted in Iraq, soon after the December elections, with no public debate and at enormous potential cost. The policy allocates the majority[1] of Iraq's oilfields – accounting for at least 64% of the country's oil reserves – for development by multinational oil companies.

Iraqi public opinion is strongly opposed to handing control over oil development to foreign companies. But with the active involvement of the US and British governments a group of powerful Iraqi politicians and technocrats is pushing for a system of long term contracts with foreign oil companies which will be beyond the reach of Iraqi courts, public scrutiny or democratic control.

COSTING IRAQ BILLIONS

Economic projections published here for the first time show that the model of oil development that is being proposed will cost Iraq hundreds of billions of dollars in lost revenue, while providing foreign companies with enormous profits.

Our key findings are:

- **At an oil price of $40 per barrel, Iraq stands to lose between $74 billion and $194 billion over the lifetime of the proposed contracts[2], from only the first 12 oilfields to be developed. These estimates, based on conservative assumptions, represent between two and seven times the current Iraqi government budget.**
- **Under the likely terms of the contracts, oil company rates of return from investing in Iraq would range from 42% to 162%, far in excess of usual industry minimum target of around 12% return on investment.**

A CONTRACTUAL RIP-OFF

The debate over oil "privatisation" in Iraq has often been misleading due to the technical nature of the term, which refers to legal ownership of oil reserves. This has allowed governments and companies to deny that "privatisation" is taking place. Meanwhile, important practical questions, of public versus private control over oil development and revenues, have not been addressed.

The development model being promoted in Iraq, and supported by key figures in the Oil Ministry, is based on contracts known as production sharing agreements (PSAs), which have existed in the oil industry since the late 1960s. Oil experts agree that their purpose is largely political: technically they keep legal ownership of oil reserves in state hands[3], while practically delivering oil companies the same results as the concession agreements they replaced.

Running to hundreds of pages of complex legal and financial language and generally subject to commercial confidentiality provisions, PSAs are effectively immune from public scrutiny and lock governments into economic terms that cannot be altered for decades.

In Iraq's case, these contracts could be signed while the government is new and weak, the security situation dire, and the country still under military occupation. As such the terms are likely to be highly unfavourable, but could persist for up to 40 years.

Furthermore, PSAs generally exempt foreign oil companies from any new laws that might affect their profits. And the contracts often stipulate that disputes are heard not in the country's own courts but in international investment tribunals, which make their decisions on commercial grounds and do not consider the national interest or other national laws. Iraq could be surrendering its democracy as soon as it achieves it.

POLICY DELIVERED FROM AMERICA TO IRAQ

Production sharing agreements have been heavily promoted by oil companies and by the US Administration.

The use of PSAs in Iraq was proposed by the *Future of Iraq* project, the US State Department's planning mechanism, prior to the 2003 invasion. These proposals were subsequently developed by the Coalition Provisional Authority, by the Iraq Interim Government and by the current Transitional Government. The Iraqi Constitution also opens the door to foreign companies, albeit in legally vague terms.

Of course, what ultimately happens will depend on the outcome of the elections, on the broader political and security situation and on negotiations with oil companies. However, the pressure for Iraq to adopt PSAs is substantial. The current government is fast-tracking the process and is already negotiating contracts with oil companies in parallel with the constitutional process, elections and passage of a Petroleum Law.

The Constitution also suggests a decentralisation of authority over oil contracts, from the national level to Iraq's regions. If implemented, the regions would have weaker bargaining power than a national government, leading to poorer terms for Iraq in any deal with oil companies.

A RADICAL DEPARTURE

In order to make their case, oil companies and their supporters argue that PSAs are standard practice in the oil industry and that Iraq has no other option to finance oil development. Neither of these assertions is true.

According to International Energy Agency figures, PSAs are only used in respect of about 12% of world oil reserves, in countries where oilfields are small (and often offshore), production costs are high, and exploration prospects are uncertain. None of these conditions applies to Iraq.

None of the top oil producers in the Middle East uses PSAs. Some governments that have signed them regret doing so. In Russia, where political upheaval was followed by rapid opening up to the private sector in the 1990s, PSAs have cost the state billions of dollars, making it unlikely that any more will be signed. The parallel with Iraq's current transition is obvious.

The advocates of PSAs also claim that obtaining investment from foreign companies through these types of contracts would save the government up to $2.5 billion a year, freeing up funds for other public spending. Although this is true, the investment by oil companies now would be massively offset by the loss of state revenues later.

Our calculations show that were the Iraqi government to use PSAs, its cost of capital would be between 75% and 119%. At this cost, the advantages referred to are simply not worth it.

Iraq has a range of less damaging and expensive options for generating investment in its oil sector. These include: financing oil development through government budgetary expenditure (as is currently the case), using future oil flows as collateral to borrow money, or using international oil companies through shorter-term, less restrictive and less lucrative contracts than PSAs[4].

IN WHOSE INTERESTS?

PSAs represent a radical redesign of Iraq's oil industry, wrenching it from public into private hands. The strategic drivers for this are the US/UK push for "energy security" in a constrained market and the multinational oil companies' need to "book" new reserves to secure future growth.

Despite their disadvantages to the Iraqi economy and democracy, they are being introduced in Iraq without public debate.

It is up to the Iraqi people to decide the terms for the development of their oil resources. We hope that this report will help explain the likely consequences of decisions being made in secret on their behalf.

NOTES

1. The Iraqi government would be left with control of only the 17 fields that are already in production, out of around 80 known fields.
2. The precise terms of proposed contracts are obviously be subject to negotiation: our projections are based on a range of terms used in the most comparable countries, including Libya, which is commonly viewed as having some of the most stringent in the world. Multinational oil companies are pushing for lucrative terms by international standards, based on Iraq's high level of political and security risk. These risks place the Iraqi government in an extremely weak negotiating position. The projections are given in undiscounted real terms (2006 prices). The contract duration is assumed to be 30 years as 25-40 years is the common length. The (2006) net present value of the loss to Iraq amounts to between $16 billion and $43 billion at 12% discount rate.
3. The terminology of PSAs labels the private companies as "contractors". This report illustrates that this label is misleading because PSAs give companies control over oil development and access to extensive profits.
4. These might include buyback contracts, risk service contracts or development and production contracts