

*The Governance of the Iraq Energy Sector and the Relevance of
Association with Energy Charter Treaty*

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Governing frameworks of the energy sector in Iraq are many and differ substantially not among the main two sectors of petroleum and power/electricity but also within each sector's sub-sectors. While the governance modalities and their related frameworks of power sector is less matured, those for petroleum sectors are more advanced. Within petroleum subsectors there exist many and diversified frameworks including long term service contracts; joint venture; revenue sharing; maximum (up to 100%) private (local or foreign) investment; build-own-operate-and transfer, among others. This contribution focuses on petroleum sector leaving power sector for another occasion.

In its first part this contribution reviews the evolution of the Iraqi governing frameworks in petroleum sector, while it deals with INES in its second part and the country's international cooperation efforts regarding energy and petroleum governance. The paper concludes by arguing for establishing formal relation between Iraq and the Energy Charter Secretariat.

Between 2004 and 2008 the Ministry of Oil-MoO concluded some 40 memorandums of cooperation-MoCs the purpose of which was to undertake joint technical studies; training and development, and technical consultancy. IOCs cover all costs related to these MoCs. At the end of this phase two strategies pertaining to upstream petroleum development were considered: a gradual strategy and big push strategy-BPS. The gradual strategy focused on the biggest brown oilfields; capture their decline; increase production by 500kbd; use national effort with foreign firms for engineering, procurement and construction-EPC and conventional service contracts if needs be. This strategy was proposed by oil technocrats spearheaded by South Oil Company- SOC. The BPS calls for maximum expansion of production capacities at a fast pace; grand opening of petroleum sector to IOCs; bidding rounds licensing using long term service contracts-LTSCs. BPS was advocated by the "new management" of the petroleum sector, thinking of making Iraq a "game changer". Evidently, BPS prevailed though in reality it comprises the basic components of the gradual strategy.

The governing frameworks of upstream petroleum development that followed MoCs phase was affected by ambiguous constitutional provisions; by dysfunctional, incoherent, ill perceived and ill-fated federal oil and gas law-FOGL that has be stalemated ever since its inception and by the emergence of two distinct petroleum regimes: LTSCs adopted by the MoO and production sharing contracts-PSCs adopted by KRG. That has led to a difficult complex situation with unclear prospect due to too much politicization, sensitivities and contrasting orientations.

The BPS was executed beginning with the conversion of Al-Ahdab oilfield old agreement into LTSC and, so far, through four bid rounds comprising six brown oilfields, seven green-field, three gas fields and four exploration blocks. The combined proven reserves of the awarded oilfields (both brown and green) total 67 billion barrels; constituting 58% of the country's proven reserves at that time. 15 IOCs from 12 countries are involved in these 14 oilfields.

The bid rounds were conducted following similar procedure and each round takes approximately one year of preparation; all bid events were held in Baghdad in an open TV covered and attended by all involved IOCs, the press among others.

Contractually, these concluded LTSCs could bring total plateau production from these oilfields to 12.3 million barrels per day-mbd, within seven/nine years and sustainable for seven years before start declining. The bidding parameters had contributed to inflate plateau targets much above what MoO had envisaged initially prior to commencement of the first bid round.

Many had questioned the feasibility, achievability and sustainability of such plateau targets; and this prompted the government to ask the World Bank to commission a study on this issue. An international consulting firm was contracted and after 18 months of work they produced the Integrated National Energy Strategy-INES. Three plateau scenarios were considered based on different production targets, year of commencement and duration of the related plateau. It appears the authorities are accepting the middle scenario of 9mbd by 2020 sustainable beyond 2030.

The reduction of plateau production targets entails re-negotiating the related LTSCs, which has been done so far for WQ2 and Zubair oilfields, and those for Rumaila, WQ1 and Majnoon are to be followed in 2014. In the beginning, the oil companies wanted to have some sweeteners like increases in the remuneration fee, but the government refused, and instead granted them a longer plateau period and from that they have been compensated rather handsomely.

Marketing Iraqi oil has shown increasing trends towards East Asia since 2008 and by end of 2012 the Asian markets share has reached 51%. For variety of reasons this trend appears to continue, as evidenced by the expansion of export terminals in north Arabian Gulf, thus giving Iraq some strategic advantages, though the country is adopting a strategy of expanding and diversifying its export outlets. In this regard Iraq is advocating new contractual modalities for cross-border oil and gas pipelines based on build-own-operate and transfer- BOOT, e.g., Iraq-Jordan pipeline.

The utilization of associated gas has been very disappointing, and with increasing oil production associated gas flaring has been on the rise as well causing further economic loss and inflicting environmental damages. Three different contracting modalities governing associated gas utilization are in operation. BGC is formulated on Joint Venture model; Remuneration Fee for processed gas (under BR2-LTSCs); and Lukoil/MIM- MoU to assess the outlooks for constructing chemical plant to utilize the associated gas from the West Qurna-2 field, which probably be based on Investment Law (of 2006). The same could also apply to the construction of a petrochemical factory- Nebras 1.2mn tons/year capacity polyethylene project- in southern Iraq petroleum hub city of Basra projected to cost \$11 billion. The project involves Anglo-Dutch major Shell, the ministries of oil (MoO) and industry (MIM); and Nebras' Head of Agreement is progressing but not yet final for signing.

Refining capacity expansion and modernization has been very slow despite incentives to foreign investors provided by the Refinery Investment Law (of 2007). Four new modern refineries aiming to add 740kbd of refining capacity have been on offer for the last few years waiting for the private investors- both national and foreign. Due the lack of “serious” private investors and increasing annual cost of imported petroleum product compelled the government to finance one of these new refineries: Karbala 140kbd refinery. Nassiriya 300kbd refinery is scheduled for special bidding in June 2014 in combination with the filed development-NIP. The NIP is based on a new type of contracts: Revenue Sharing generated from petroleum products sold domestically and through export. If NIP fails in the forthcoming bid round, it will represent a blow and the government will be compelled to do it on its own.

In an attempt to broaden vertical and horizontal economic diversification INES presents coherent vision to harmonize development efforts between petroleum sector, power sector and selected number of “linked industries”, within industrial sector, in which Iraq possess significant comparative advantages. If things go as foreseen by INES the share of non-oil/gas in GDP would increase from 57% in 2012 to 63% in 2030. For this purpose INES proposed a governance structure comprising specific “Task Force” and “Institutional Reform Committee” in each of the three ministries of oil, electricity and industry; and all these organs are linked to the Prime Minister Office. But, in Iraq reality seldom coincides with expectations.

International cooperation in the area of energy governance is important for Iraq, which has concluded many of such instruments on both bilateral and multilateral levels. Cooperation modalities with EU and EITI are highlighted here and could have significant contribution to enhance energy governance in the country. Iraq has concluded many of such modalities with the European Union-EU including the MoU on Strategic Partnership in Energy-SPE (2010); Joint Declaration-JD (2011); Partnership and Cooperation Agreement-PCA (2012); The EU Iraq Energy Centre EUIEC (2012/3-2014). EUIEC is currently in the early stage of the European Commission' bidding process with many consulting firms submitted on 16 May their Expression of Interest as the first step in the bidding process for the EUIEC, which its implementation phase could start probably by the end of this year. Once established EUIEC could have the potential to be a *regional* center.

Also Iraq has been complying rather well with Extractive Industry Transparency Initiative-EITI requirements and so far IEITI issued three annual reports, and the fourth one is in preparation which is due for release in December 2014. Good progress has been evident, though much more is needed under the EITI new Standard. A “Gap Analysis” was presented to the Ministry of Oil few days ago in an attempt to enhance the quality and coverage of the compliance as EITI requires; contributing to more and comprehensive transparency and governance of the energy sector. Nowadays more is publically known about the extractive activities in Iraq than any time in its history. As it stand today and despite their shortcomings the learning and improvement curve demonstrated by the IEITI annual reports would make Iraq *the best compliant* country in MENA region; but this should be a cause of inspiration not complacency!

The presentation ends with the following remarks:

The success of development in Iraq’s petroleum sector is vital for Iraq and for global energy balance. However, this faces serious and formidable challenges. Domestic challenges (political stability and security situation; policy coherence and sound planning; Bureaucracy and program management; infrastructure and logistics); Regional challenges (determinants of landlocked-ness & geopolitical factors); International challenges (global energy balance; OPEC politics, and oil prices).

Risk analysis based on Impacts and Likelihood would indicate the importance of domestic and regional challenges in the short-medium terms while international challenges in the medium-long terms.

Iraq experience with EITI shows that comprehensive, regular and annual reporting on petroleum governance improves governance standard and enhances transparency especially of export revenues. Also the establishment and functioning of the EUIEC would contribute to enhance the good governance of the Iraqi energy sector. Hence, effective formalised international cooperation (bilateral and multilateral) plays critical positive role in this respect.

It might be worthwhile for Iraq and the Energy Charter Secretariat- ECS to explore cooperation opportunities and possibilities. Having direct dialogue between them aiming for more formal and institutional relationship could be beneficial for both sides.

Iraq is increasingly becoming a major producer and exporter of oil with potential to be exporter of gas and petroleum products as well. But being a semi-landlocked country cross-border pipelines have strategic significance and thus play critical role in the realization of its export ambitions. Moreover, Iraq itself could also be a transit country! Thus having and utilizing international legal frameworks and modalities covering *producing-transit-consuming* countries has distinct relevance to Iraq.

Also for ECS Iraq could be *the* pivotal resource rich country in MENA region in the efforts for “Modernisation” of the Energy Charter and transforming it from Eurasian-focused into more global energy governance. A successful Iraq-ECS cooperation could prompt and promote other regional oil and gas producers- the GCC, even those having Observer status and possibly Iran- to join and thus have their effective say in the formulation of a possibly World Energy Charter. Moreover, awareness gap and acute perception problem appear to exist

since, “The Energy Charter is hardly known in MENA and the Energy Charter Secretariat hardly knows MENA”; Iraq-ECS cooperation could bridge awareness gap address perception issue and enhance the outreach efforts.

Both Iraq and ECS may consider seriously establishing a contact and ECS could act proactively and take the necessary initiative in this effort.

From my direct involvement and constant follow-up I am of the opinion that Iraq’s experience with PCA, EUIEC and EITI could very well furnish the necessary ground and encouraging premises for mutually beneficial cooperation between Iraq and the ECS; but the dialogue between the two sides has to take place first, and the sooner the better!

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