

Midyear Review of the Iraqi Upstream Petroleum Sector

Ahmed Mousa Jiyad

Iraq/ Development Consultancy & Research

NORWAY.

Email: mou-jiya@online.no

Introduction and Key Highlights

2016 has been, financially as in any other aspects, so far very difficult and the fiscal difficulties are likely to persist during the second half of the year, though at slightly lower scale.

This half-yearly brief review addresses basic issues pertaining to the upstream petroleum sector in the country. The analysis focuses on the middle and southern petroleum producing provinces and the exports from southern terminals; while exports from KRG are addressed briefly.

The covered basic issues are:

- Oil Exports Revenues and Fiscal Deficit;
- Brent/ Iraqi Oil Price Differentials;
- Associated Gas Utilization and Development of Gas Fields;
- The Progress in the Awarded Exploration Blocks;
- KRG' Oil Exports, Revenues and Fiscal Difficulties and finally,
- Petroleum Issues in the IMF-Iraq Stand-By Arrangement.

Key highlights of this review

While oil export from the middle and southern petroleum producing province, through southern terminals, exceeds their threshold in the state budget 2016, their export price was much lower than what the budget envisaged; leading to a declining monthly fiscal deficit in oil revenues. Such fiscal deficit accumulated to the tune of \$6.6 billion by end June 2016; representing 13.1% of the annual budgeted oil revenues or 26.4% of the 1st half year of the budgeted oil revenues from southern oilfields.

Hence, budget fiscal breakeven (zero fiscal deficit) of related oil export revenues requires \$32 billion in southern oil export revenues during the remaining part of 2016. Such breakeven could be attained under three different production levels at different set of oil price. But Brent price differentials over Iraq oil export price, averaged at \$8.64 a barrel during first half 2016, would seriously limits the possibility to attain that breakeven and could results in total fiscal deficit between \$7 billion to \$9 billion in this year, depending on southern oil production in the remaining part of the year.

Daily rate in flaring associated gas reduced modestly in the first five month of the year compared with the daily rates for the second half of previous year, leading to a comparative substantive improvement in gas utilization. Condensates (C5+) and LPG export in addition to increase in dry gas supply for power generation are behind the improvement in utilization of associated gas. Nevertheless, 69% of the southern associated gas was flared in the first five months of this year.

Development of Mansuriya and Akkas gas fields suffered serious setbacks due to deteriorated security conditions, while Siba gas field development is progressing.

Varying degrees of activity progress are reported in exploration Blocks 9, 10 and 12; while no activity could be reported in Block 8 among those offered under the fourth bid rounds.

As matters of transparency MNR-KRG monthly reports still suffer from many serious loopholes despite the apparent improvement and regularity of the reports. Hence, both numbers of export volume and revenues need further clarifications and careful auditing. Leaving these concerns aside, daily oil export during the 1st half of the year was short of the rate mentioned in the federal budget law; and the resulting fiscal deficit could be substantive considering the facts that MNR export price for June was \$3.94 a barrel less than SOMO's export price of the southern crudes for the same month.

In addition to the accumulated debt, prepayments, loans and unpaid entitlements to main producers, there were a court awarded claims by Dana Gas and remaining claims, by the same company, estimated at over five folds of the awarded claim.

Low oil prices and the imposed limitation on the ability of KRG in making due payments to oil producers had seriously impacted the financial positions of these companies; some scaled down their investment and operational activities and some were on the verge insolvency.

Among the latter, as example, is Gulf Keystone.

Undoubtedly, with these legal claims, the above mentioned accumulated debts and financial difficulties of small-medium oil producers the economic prospect of the KR is, alarmingly, very dim.

In a partial way-out of its financial calamity, Iraq concluded a Stand-By Agreement-SBA with the IMF. The SBA comprises, as a form of conditionality, three issues pertaining to petroleum sector: arrears to IOCs; Basra Gas Company and KRG oil exports and revenue sharing.

None of the above issues is problem-free and thus they have to be examined thoroughly by the Ministry of Oil among others to ensure compliance with the provisions of the concluded contracts relating to the first two issues and much more for the third one.

I- Oil Exports Revenues and Fiscal Deficit

Iraq's oil exports revenues during the first half of this year was confined to those exported from the southern exports terminals and produced in Basra, Missan, Wasit and Thi-Qar provinces since KRG, according to the Ministry of Oil website, did not deliver any revenues for oil from NOC.

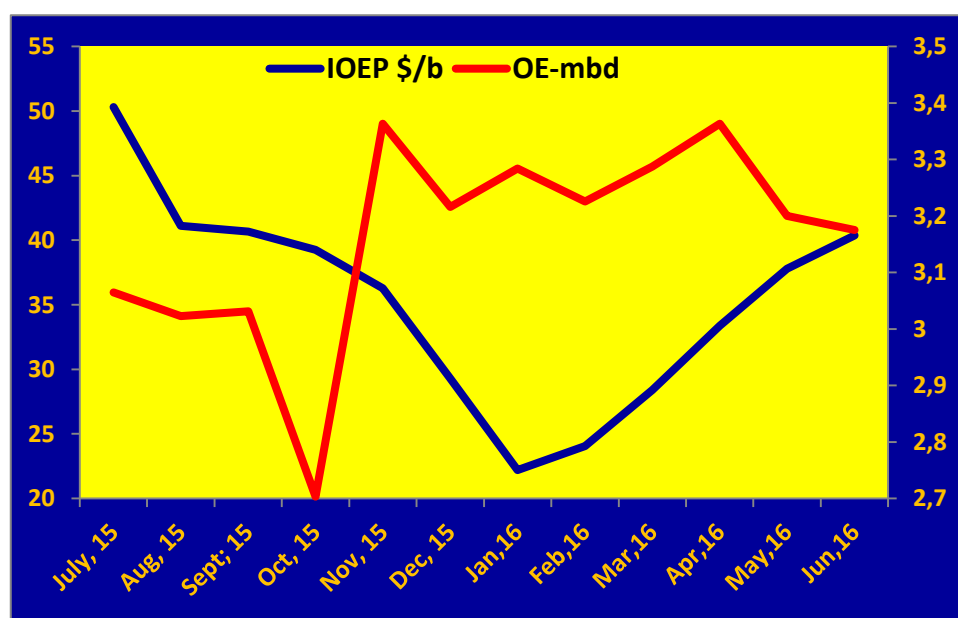
During the first half of the year Iraq exported more than 592 million barrels that generate ca. \$18.4 billion; at an average \$31 a barrel and 3.256 million barrels per day (mbd). Moving from the aggregates of the half yearly to the monthly and quarterly bases would provide further insights. While total export during the 2nd quarter declines slightly, by 0.006%, compared to the previous quarter its export revenues increased by 47.6% over those for the 1st quarter. This improvement in export revenues was, obviously, due to corresponding increases in oil prices.

Iraq oil price reached its ever (at least since July 2008) lowermost of \$22.21/b in January 2016 then began gradually its upward trend to reach \$40.367/b for June exports. The “V-shape” of oil price curve over twelve months period indicates high probability that a floor price has been reached at the beginning of the year and it is unlikely to witness similar floor, though it remains volatile.

The improvement in Iraqi oil prices could be explained by or attributed to three factors: the general improvement in global oil prices; the segregation of crudes, heavy and light Basra, away from the old blending practice and the market configuration and destination.

The following chart exhibits the profiles of actual oil prices for the exported Iraqi crudes from the southern export outlets (IOEP-\$/b): the blue curve measured on the left side and oil exports (OE-mbd) in million barrels daily: the red curve measured on the right side.

Chart 1: Oil Price (IOEP \$/b) and Oil Export (mbd): July 2015-June 2016



Source & note for chart 1: Author (AMJ/DC&R) compilation using MoO data. June data are preliminary; the final will be posted on 25th July 2016

Unlike oil prices the volumes of oil exports have been fluctuating reaching its highest level of 3.363 mbd in April (similar to those for November 2015) then declines in May, due to weather conditions, and further in June, due to increasing crude allocation for domestic power generation, as testified by Ministry of Oil sources. (At time of finalizing this paper MoO did not post on its website June data on petroleum production and domestic allocation to verify such claims by MoO. But judging by May data, oil supplied to refineries and power generation was 394kbd and considering the decline in oil export of 25kbd in June, means increasing domestic consumption to 419kbd assuming no change in June production compared with May)

In addition to its fluctuating pattern, oil export during the 1st half of 2016 grew by only 5% over the 2nd half of the previous year. This modest increase in oil exports is associated with a

modest increase of 3% in daily oil production rates from southern oilfields during the first five months of this year compared to those of the 2nd half of previous year.

Infrastructural capacity limitations (storage, pipelines and water injection among others) and financial constraints (that impacts payments to related IOCs) had contributed to such low growth in production rates since 2016 work programs and related budgets for all service contracts operating major southern oilfields were reduced significantly. Furthermore, domestic politics and internal security conditions are bound to leave their pressure and downward consequences directly or indirectly. Thus, it was anticipated that such infrastructural limitations, security conditions and fiscal constraints would impact the pace and scale of progress in the upstream petroleum activities.

On the export revenue side the two half-yearly comparison shows differences in both trend and magnitude when it declines by 17% in 1st half of 2016 as compared with the previous 2nd half of 2015. Again that was attributed partially to oil prices; the average oil price for Iraqi crudes was \$39.36/b, during the 2nd half of 2015, while it was \$31.02/b, during the 1st half of this year.

Fiscal Deficit in Export Revenues

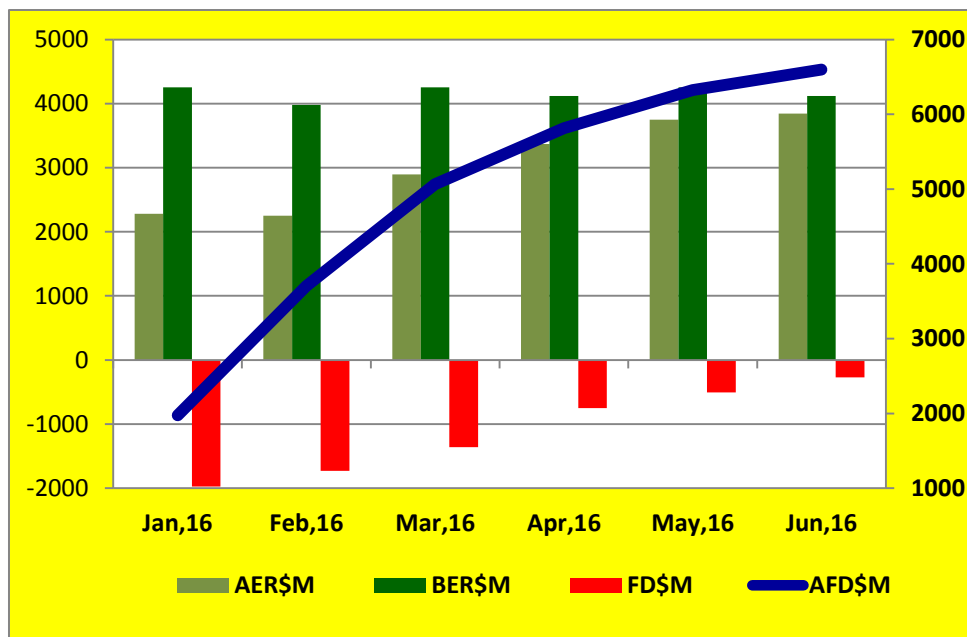
State budget for 2016 was based on oil price of \$45/b and oil export at 3.6 mbd: 0.550 mbd to be exported through Turkey and comes from KRG oil (0.250 mbd) and from North Oil Co-NOC (0.300mbd) while 3.05 mbd comes from the rest of Iraq and be exported through the south export outlets at the north Arabian Gulf.

For known reasons relating to the tenacious acrimonious relationship between KRG and the Federal Government no revenues from oil export through Turkey was delivered to the federal Government, and accordingly MoO official data shows zero export of the 0.550mbd part. Hence our calculation and analysis will be confined to those exports through the southern outlets, i.e., the 3.050mbd.

Both budget parameter, oil price per barrel and daily export rate, deviated from the norms adopted by budget law 2016. As shown above in chart 1 actual daily oil exports were higher than the budgeted threshold of 3.05mbd in every month this year so far, while oil prices have been lower than the adopted \$45/b in every month of the covered period. Such deviation is bound to reflect clearly and result in significant fiscal deficit in budgeted oil revenues.

The monthly comparison between actual export revenues (AER\$M) and the corresponding budgeted export revenues (BER\$M) are presented in the following chart 2. Accordingly, the monthly fiscal deficit in oil revenues (FD\$M) and the profile of accumulated fiscal deficit (AFD\$M) were calculated and exhibited in the chart.

Chart 2: The Fiscal Deficit in Oil Export Revenues- 1st H 2016 (\$million)



Source & Note for chart 2: Author (AMJ/DC&R) compilation using MoO data and Budget Law 2016; data for June actual export revenues are preliminary; the final will be posted on 25th July 2016

Actual export revenues (light green column) have been lower than budgeted export revenues (dark green column) in every month during the 1st half of this year, resulting into monthly fiscal deficit (red column). But the magnitude of the monthly fiscal deficit was on continuous declining trend from \$1974 million in January to \$273 million in June. The improvement in oil prices combined with above budgeted oil export explains this declining trend in monthly fiscal deficit during this half of the year. The monthly fiscal deficits led to accumulated fiscal deficit (blue curve measured on the right side of the chart) to the tune of \$6.6 billion by end June 2016; representing 13.1% of the annual budgeted oil revenues or 26.4% of the 1st half year of the budgeted oil revenues.

The budget fiscal breakeven (zero fiscal deficit) of oil export revenues requires \$32 billion in oil export revenues during the remaining part of 2016. This fiscal breakeven can be attained by different combination of oil export and oil prices.

To estimate oil revenues for the second half of the year I will use three actual rates for oil exports:

- 1- the highest monthly oil export during the 1st half of 2016 (HOE); which is 3.363mbd, April 2016;
- 2- the lowest monthly oil export during the 1st half of 2016 (LOE); which is 3.173mbd, June 2016;
- 3- the average of monthly oil export during the 1st half of 2016 (MAOE); which is 3.256mbd.

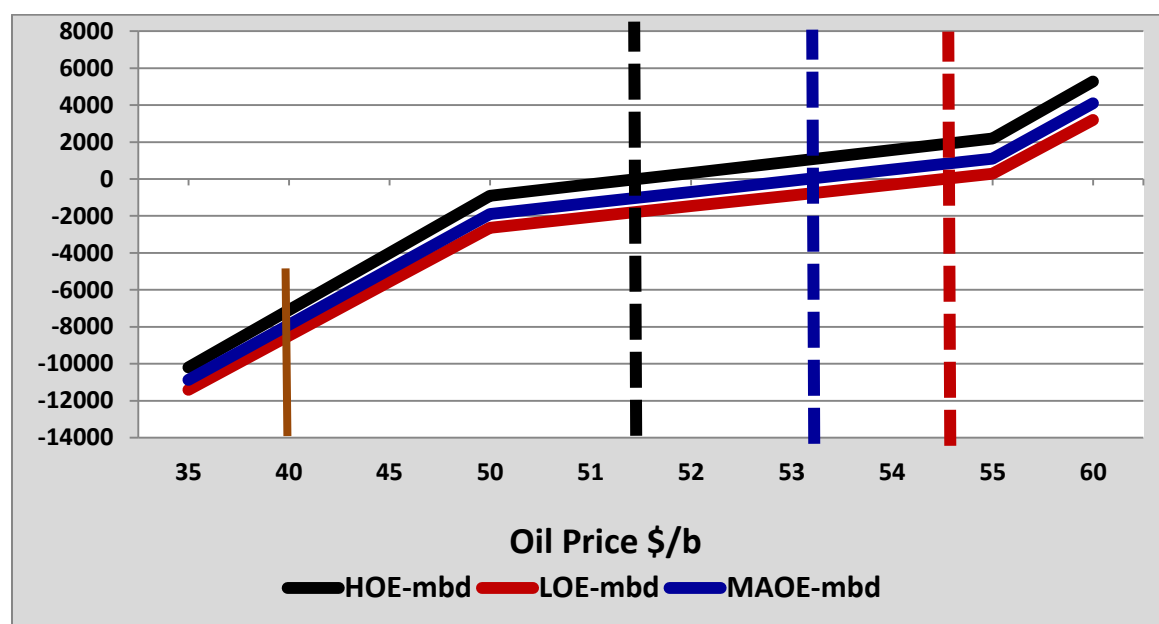
The fiscal deficit or surplus under each of the above three oil export thresholds was calculated at oil prices ranging from \$35 to \$60 a barrel as presented in the following chart three.

The calculation shows, as chart 3 exhibits, there will be a fiscal deficit in oil export revenues under all three export rates as long as oil price is under \$51 a barrel during the entire second half of the year. But the fiscal breakeven could be between the price \$51 and \$52 if oil exports are at the HOE rate of 3.363mbd. Under this case the fiscal deficit in oil revenues declines from \$10.2 billion at \$35/b to \$291 million at \$51/b, then moves to fiscal surplus when oil price is \$52/b. (This is demonstrated by the black line 'HOE-mbd' and the breakeven point is shown by the broken black vertical line on chart 3)

If oil exports remains at that LOE rate of June at 3.173mbd then fiscal deficit becomes larger and the breakeven oil price higher. In this case total fiscal deficit in oil revenues becomes \$11.4 billion at oil price \$35/b and declines until it turns into a positive territory at \$55/b. Hence, the breakeven oil price under this level of oil export lays between \$54 and \$55 a barrel. (This is demonstrated by the red line 'LOE-mbd' and the breakeven point is shown by the broken red vertical line on chart 3).

Between the above two possible situations there is another one, which is based on monthly actual oil export (MAOE) during the 1st half of this year at 3.256mbd. Under this export daily rate, fiscal deficit amounts to \$10.9 billion at \$35/b then declines gradually with increasing oil prices until \$54/b when fiscal surpluses occurs. Thus, breakeven oil price stands between \$53 and \$54 a barrel. (This is demonstrated by the blue line 'MAOE-mbd' and the breakeven point is shown by the broken blue vertical line on chart 3).

Chart 3: Budget Fiscal Profile (\$million) Breakeven at Different Levels of Oil Exports (mbd) and Iraq Export Oil Prices (\$/b)



The question now is how likely is it for Iraq to reach a breakeven? The answer depends largely on Iraq oil export price, which is strongly correlated, with significant differential, to Brent global oil price; this is discussed next.

II- Brent/ Iraqi Oil Price Differentials

Technically speaking, Iraq could, with a reasonable degree of certainty, export during the 2nd half of the year at any of the above mentioned three rates. But the situation could be different when it comes to oil prices. Most consulted price forecasts for the remaining part of the year that are done by credible international entities indicate that global oil price (for Brent), absent major geopolitical event, would remain volatile, in their trading sessions, with upwards trend towards \$60/b threshold by closing of the year.

Actual Iraqi oil export price is the average outcome of SOMO's pricing formulas that are designated for the main market destinations (Asia, Europe, Americans); these formulas comprise parameters relating to crude quality differentials, the price of marker crude, freight among others. SOMO uses at least four marker crudes in its pricing equations and Brent is one of them; Brent is the widely used crude as the global oil price reference. Hence, the relationship between movement of Brent price and Iraq export price is very helpful in estimating the near future levels of the Iraq oil export price.

The movement of Brent price and Iraq oil export price during the 1st half of the year is highly correlated (with 0.994 correlation coefficient) giving an average price differential of \$8.64/b for Brent; meaning Iraq oil export price will be less than Brent price by \$8.64/b. Hence, knowing the short-term (six month) Brent forecast would help in estimating Iraq oil export price and, accordingly, export revenues under the three export thresholds above mentioned.

In its monthly Short Term Energy Outlook, issued 12 July 2016, US Energy Information Administration-EIA forecasted Brent price average of \$44/b for 2016 and \$52/b in 2017. Based on that and since average Brent price during first half 2016 stands at \$39.67/b, I estimate that to arrive at an average of \$44/b for 2016 the average Brent price during the second half has to be \$48.33/b.

If Brent Iraq oil price differential holds at \$8.64/b then average Iraq oil price during the second half of 2016 could be \$39.69/b.

Back to Chart 3: with this average Iraq oil price during the second half of 2016 estimated at \$39.69/b there will be no breakeven at all, and the fiscal deficit in oil export revenues 2016 will be between \$7 and \$9 billion (brown solid vertical line).

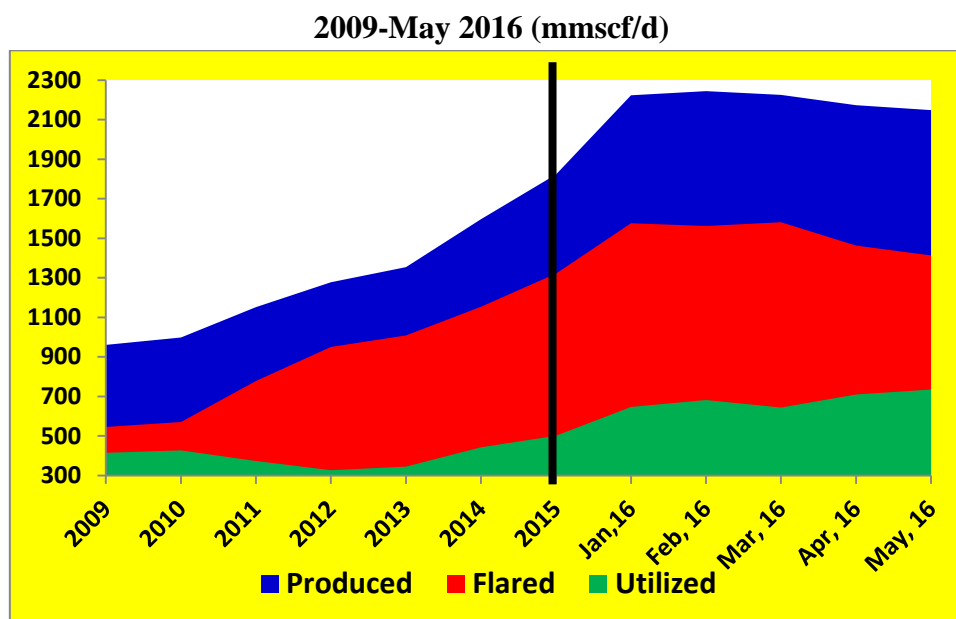
III- Associated Gas Utilization and Development of Gas Fields

Associated gas production during 1st five months 2016 was 2628 million standard cubic foot daily (mmscfd): 84% are from the southern oilfields while 16% are from NOC oilfields. Out of that 1714 mmscfd was flared representing 65% of total produced associated gas.

Expectedly, much of the flared gas (89%) was in the south, which is the focus of this paper. The following chart 4 exhibits southern associated gas production, utilization and flaring since 2009. With increasing oil production, associated gas increases as well reflecting the gas/oil ratios of the producing oilfields. For variety of reasons and complexities most of the associated gas is flared.

Southern associated gas production during the covered period stands at 2203 mmscfd, out of which (69%) was flared; this indicates to a 4% reduction in gas flaring compared with those for the 2nd half of 2015.

Chart 4: Southern Associated Gas Production, Utilization and Flaring



Source & Note for chart 2: Author (AMJ/DC&R) compilation using MoO data

This modest percentage decline in gas flaring led to significant improvement rate (of 26.5%) in gas utilization in the same period of comparison. Such increase in gas utilization is an outcome of a few positive developments in the petroleum and powers sectors.

During March-May 2016 SOMO exported first four shipment of Condensate (C5) (Condensate gas, also known “Natural Gasoline” is a mixture consisting of C5 + liquid hydrocarbons which can be further processed and sold as gasoline blend or chemical feedstock. Condensate is typically produced as part of the gas refining process) totaling 60 thousand cubic meters (kcm); 10kcm for each of the first two shipments and 20kcm for each of the last two. Also SOMO exported the first shipment, 2000 tons, of liquefied gas (LPG).

Both new exported products, Condensate and liquefied gas, are attributed to the joint venture Basra Gas Company-BGC; which has increased its gas processing from 400mmscfd to 600mmscfd between June 2013 and now.

LPG shipment was sold at \$350/ton generating \$700,000 of revenues but no official information was disclosed regarding revenues generated from the exports of Condensate; what is available indicates that these revenues were earmarked to the partners in the joint venture, Shell and Mitsubishi, as payment for their past arrears at end of 2015. (However, BGC spokesperson was reportedly said that BGC has been paid for its 2015 invoices, but the government remains behind on 2016 payments. See also BGC issue in SBA hereunder).

Deputy Oil Minister for Gas Industry, Dr. Hamid Y. Salih, affirms that gas sector became self-sufficient in liquefied gas production (LPG) with a daily production of (5000) tons and also export condensed gas quantities which can be used as feedstock in the petrochemicals

industry; this in addition to the growth in dry gas production designated for power generators in the country. As on mid-May dry gas production stands at (1100) mmscf daily, he says.

In addition to the contribution of BGC in utilising associated gas and reduce gas flaring, other positive development in the gas sector had also their marks.

Production capacity of LPG cylinders for household consumption, stands at 150,000 cylinder/daily, is much more than domestic needs of 90,000 cylinders; with a possibility to increase production even further when needed.

Some significant utilization on oilfields levels had taken place too. Alahdab oilfield, for example, produces, as on May 2016, 14kbd combined with 70 mmscf/d of gas supplying the province power stations, and liquefied gas production of more than 240 tons per day.

The first gas station in Mejnoon oilfield, under reduction of gas flaring efforts, was inaugurated in April 2016 intended to supply gas to Rumaila gas-driven power-plant. The gas station capacity to process, at its first phase, some 70mscfd that is needed to produce 300mw, increasing further upon completion of the second phase. Rumaila gas driven power plant, scheduled for completion in 2017, will generate up to 235,000KW per day at peak efficiency during winter months and a minimum of 150,000KW in the summer, when the high temperatures affect the efficiency of the gas turbines.

The Ministry inaugurated, in April 2016, a \$150 million cost liquefied gas pipeline project for transporting 3000 to 4000 tons/ day of gas from production locations in Khor Al-Zubair to the gas complex in Thi-Qar province.

The development of two of the three free gas fields, awarded under bid round three 2010, have suffered very serious setbacks due to Daesh factor and deteriorated security situation. Work on Akkas gas field (Anbar province) and Mansuriya gas field (Diyala province) was suspended until further time in the future. Hence, no progress was reported or observed regarding these two gas fields.

On a more positive note, Kuwait Energy, operator of Siba gas field (Basra province), concluded in mid-April last year EPC deal for gas processing plant, worth \$185 million, with Petrojet company (Petrojet is wholly owned by the state Egyptian General Petroleum Corporation-EGPC). The project is scheduled for completion in October 2016 leading to gas production at a rate of 110mmscf/d.

IV- The Progress in the Awarded Exploration Blocks

Four exploration blocks were awarded in the fourth bid round by the Ministry of Oil, 30 May 2012; except one, works continued in the remaining three during the first half of the year.

On Block 8 (Diyala and Wasit Provinces) there was no progress to report during the first half of the year due to the security conditions and Daesh factor that impacted activities in Diyala province.

Unlike block 8, progress in Block 9 has been remarkable. Last April an Export Oil Sales Agreement was signed between SOMO and the Consortium led by Kuwait Energy (60%

participation interest-PI; other partners are Dragon Oil Holdings Ltd, 30%PI and Egyptian General Petroleum Corporation, 10%PI). It's worth mentioning that the first exploration well, *Faihaa-1*, in this Block 9 spud in March 2014, and led to significant oil discoveries in September and December of the same year. Tests of the first exploration well flowed at between 5,000 bpd and 8,000 b/d at 35 API. Oil production commenced from the Block in October 2015.

Russian Lukoil and Japan's Inpex began drilling their first exploration well in Block 10 on 2 April 2016.

Finally, Russian Bashneft and partner UK's Premier Oil completed, in April 2016, field seismic surveys at Block 12 as part of the geological exploration program approved by the MoO and the start of exploration drilling has been scheduled for late 2016.

Bashneft International B.v. holds 70% participation interest and Premier Oil, represented by its subsidiary, Premier Oil Exploration and Production (Iraq) Ltd., holds 30%PI.

V- KRG' Oil Exports, Revenues and Fiscal Difficulties

According to MNR –KRG monthly reports, KRG has during the 1st half of 2016 exported ca 85.6 million barrels and generated ca. \$2.8 billion. However, as matters of transparency MNR monthly reports still suffer from many serious loopholes despite the apparent improvement and regularity of the reports; but this is another matter that I could address in the future.

Both numbers of export volume and revenues need further clarifications. On the export volume side, MNR of the KRG used, up to end January 2016, to disaggregate exports in two categories: export from KRG operated oilfields and those from Federal government owned NOC oilfields. Hence, from February onwards it is not known how much NOC oil was taken and exported by KRG without making their payment to the federal government.

The revenues side is not straightforward as well since monthly revenues include loans, prepayment and revenues retained by buyers against past payment; sometimes these are specified (in one month they constitute more than half of the declared export revenues) while in other months they are not. Furthermore, monthly exports include quantities sold from previous oil storage in Ceyhan, causing further complexity in calculating export price due to monthly price variations. Probably this is why MNR monthly reports do not include export price, except its brief June 2016 overview. Also export volumes and revenues were severely affected by pipeline sabotage during the first quarter of the year.

Finally, net monthly export KRG revenues are further affected by payment to main and minor oil producers, which amounted to \$398 million for the main producers and unspecified amount for the minors, as the MNR reports mention.

Leaving the above observations aside, daily oil export during the 1st half of the year was ca. 471 barrels; 79 b/d short of the 550b/d rate mentioned in the federal budget law. The resulting fiscal deficit could be substantive considering the fact that MNR export price for June was \$3.94 a barrel less than SOMO's export price of the southern crudes for the same month (0.90247% of SOMO June price). This is rather unusual considering the facts that export price of the northern crudes (Kirkuk blend) are usually higher than those of the southern

crudes. The average Kirkuk price was \$54.4/b during the period October 2014 (when export of this crude was resumed after six months interruption) and September 2015 (when KRG suspending the delivery of exported revenues and thus no quantities and values for Kirkuk blend were posted by the federal MoO) while that for Basra crude was \$45.75/b; a price differential of \$8.65/b for Kirkuk blend turns into \$3.94 /b for Basra crudes. Obviously, such reversal of price differential causes significant financial losses for KRG and Iraq and thus calls for questioning the oil marketing performance by MNR.

As mentioned above, MNR did not disclose the export price in its reports prior to June 2016. Hence, using this percentage price differential to January-May monthly exports would reduce export revenues from \$2.84 billion to \$2.42 billion; the difference of \$419 million represents the total of loans and prepayment received by KRG during the first half of the year (MNR mentions \$350 million in one report and mention but not state the amounts in another report). This also indicates to ca. \$2.1 billion fiscal deficit in the budgeted export revenues (almost equal the generated export revenues).

Prepayment arrangements concluded by MNR-KRG with some “coded” buyers, in the monthly reports, are expected to be conditional upon delivering, by KRG, specific volumes of oil and values as per such prepayments. Expectedly, such deals comprise interest rate and further rates in case of default leading to debt accumulation. The details of such prepayments are not made public. Also partial payments, according to the related PSCs, to the main oil producers lead to further accumulation of debts. KRG total debt is estimated, end May 2016, at \$26 billion.

In addition to prepayments, loans and unpaid entitlements to main producers there is \$1.98 billion claims, by Dana Gas relate to payment for production at the Khor Mor and Chemchamal gas fields, that was awarded the London Court of International Arbitration (LCIA) end November 2015 but payable before end 2015. The Company asserts, in a further statement, that its consortium’s remaining claims are estimated at over \$11 (Eleven) billion principally for wrongful interference, by KRG, with the Consortium’s long term rights over the Khor Mor and Chemchemical fields; KRG disputed LCIA judgement and the final stand on these staggering \$13 billion claims is not done yet.

Low oil prices and the imposed limitation on the ability of KRG in making due payments to oil producers had seriously impacted the financial positions of these companies; some scaled down their investment and operational activities and some were on the verge insolvency. Among the latter, as example, is Gulf Keystone; unable to service its debt the bondholders will get an 85.5% stake under a deal that will see more than \$500 million of debt converted into equity. Upon announcement of such a deal Gulf Keystone’s shares plunged as much as 47%, on 14 July 2016, to 2.5 pence in London. They were at 15 pence at the start of the year and touched a high of 3.49 pounds in 2012.

Undoubtedly, with these legal claims and the above mentioned accumulated debts the economic prospect of the KR is, alarmingly, very dim.

VI- Petroleum Issues in the IMF-Iraq Stand-By Arrangement

IMF provides, through a lengthy (100 page) Country Report and a few Press and News releases, detailed information on the Iraqi economy and recently approved Stand-By Arrangement-SBA facility.

Under the SBA facility, IMF provides a three-year \$5.34 billion loan focusing on implementing economic and financial policies to help the country cope with lower oil prices and ensure debt sustainability.

The program, under SBA, focuses on four key elements:

- Reduce budget spending and restore public finances to a healthy state and stabilize debt;
- Protect spending on the social front to ease the lives of the poorest, internally displaced people and refugees;
- Improve the quality of public spending and prevent accumulation of unpaid debt through improvements in public financial management; and
- Begin the process of restructuring state-owned banks to reduce their dominance in the banking system, thereby mitigating financial sector risks and preserving the sector's stability.

Discussing all the above components is beyond the scope of this review; instead I will highlight matters pertaining to our topic of this review- the petroleum sector.

Regarding petroleum sector, IMF' SBA comprises specific commitments that have to be met by Iraq concerning the following three issues:

1- Arrears to IOCs In Upstream Petroleum

IMF asserts, "Oil investment continued to be executed and was mainly financed by the accumulation of arrears to international oil companies". As such, Iraq accumulated \$3.556 billion of arrears to international oil companies (IOCs), relating to MoO bid rounds, at end-December 2015, rising to \$4.67 billion at end-March 2016.

Iraqi federal authorities have committed to pay all the outstanding arrears to IOCs by end-September 2016 and to not accumulate any new external arrears to ensure timely oil investment and oil revenue. Arrears outstanding to IOCs are defined as bills of IOCs validated by the MoO and due for more than three months after their invoice; and SBA comprises related specific performance criterion.

2- Basra Gas Company-BGC

The MoO paid all its 2015 arrears to the BGC amounting to \$204 million, will pay its outstanding 2016 arrears of \$140 million by end-May, will pay its estimated remaining gas purchase from BCG in 2016 amounting to \$700 million within the contractual 45 day-period after billing, and will use at least \$145 million of its investment budget in 2016 to finance the gas flaring-reduction investment project at the BGC.

3- KRG oil exports and revenue sharing

In order to facilitate implementation of the budget sharing arrangement, both parties (Federal and KR Governments) are considering netting out the KRG oil receipts, which the KRG plans to have audited by international audit companies starting on July 1st, 2016, with the budgetary transfers to which the KRG would be eligible under the budget sharing arrangement.

In my humble view none of the above issues is problem-free and thus they have to be examined thoroughly by the Ministry of Oil to ensure compliance with the provisions of the concluded contracts relating to the first two issues and much more for the third one. For example, service contracts for upstream petroleum that were conclude under the four bid rounds do not set deadlines for full payment of IOCs dues; rather, the unpaid dues for the IOCs from the quarterly “deemed revenues” will be deferred to the following quarter, interest free (except Supplementary Cost), and so on until they are fully paid. Therefore, commitments made under this SBA might violate contractual provisions under the concluded service contracts.

The same applies to the extremely complex and several hundred pages length BGC joint venture legal documents. Moreover, due to the magnitude of the accumulated fiscal deficit it is highly unlikely to allocate “\$145 million of its investment budget in 2016” unless such amount is earmarked from IMF loan under this SBA.

As for the third issue it is even much more difficult and complex; having legal and sovereignty ramifications; comprises components that could constitute subsidizing oil marketing inefficiency and lucrative conditions in KRG deals and PSCs; requires an elaborated operational modalities; needs strict transparency, auditing and verification measures, among others.

As a matter of methodology, this review is, by its very nature, a short-term analysis of 2016 focusing on actual performance during the first half of the year and exploring implications for the remaining part of the year. All used data are from my database which is compiled over the years from official sources referred to throughout the paper. Detailed referencing, citations and footnotes or endnotes are not provided in this version of the review.

Norway
Sunday, 17 July 2016