

Federal Petroleum Policy in Iraq: Feasibility and Challenges¹

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INTRODUCTION AND ABSTRACT

Oil production may continue to have vital and critical role in the Iraqi economy for many decades to come. Hence, federal petroleum policy would have the most outstanding impacts on the future of the country and the course of its development. Both federal petroleum policy and future development will be fundamentally affected, among others, by two pieces of legislations: the Constitution and the hydrocarbon law. Considering the prevailing conditions in the country and those surrounding these two essential legal frameworks, the paper argues that sound effective and operational federal petroleum policy is less likely unless serious reviews are taken place and comprehensive changes are introduced on both the Constitution and the still “proposed” Oil and Gas Law- OGL.

The paper has three parts and concluding remarks. Part one examines briefly the basic premises, which a national petroleum policy in Iraq should, in the normative, take into consideration. These basic premises include: Structural Dependency on Oil; The depleting nature of the hydrocarbon resources; The “economic rent” associated with these resources and its consequences and finally Geo-political reality and considerations. In the second part I will elaborate on the fundamentals of the federal petroleum policy by analysing the main components of such a policy within holistic development orientations in a post-conflict resource-rich country or situation. The main components of the federal petroleum policy includes the following: I- Mandatory Framework and Guiding Principles; II- Institutions, Stakeholders and Partnership; III- Macro-economy dimensions and IV- The “sector-specific” role. Part three discusses selective key issues and possible scenarios of pertinence to sound federal petroleum policy in Iraq. The paper ends with few concluding remarks.

PART ONE: BASIC PREMISES

Sound, functional and implement-able federal petroleum policy in Iraq should, in the normative, take into consideration and base upon certain basic facts and premises. These include the following:

I- Structural Dependency on Oil:

Oil has and will continue to have a pivotal and critical role in all aspects of the national economy. This can be manifested by the contribution of oil producing sector in the main macroeconomics indicators such as GDP, current budget, investment budget, balance of trade, export earnings, government revenues etc.

Though most former plans aimed at reducing the dependency on oil by developing the contribution of other productive non-oil sectors the outcome is almost very marginal. This would indicate that development efforts for nearly six decades had failed to deliver a sustainable development, (Sabri Zire Al-Saadi, 2008) and, consequently, “Iraq’s dependence on oil became irreversible.” (Abbass Alnasrawi, 2001. P.3).

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The economic degeneration, which the country had gone through up to date, would only deepen the dependency even further. A relatively recent IMF report indicates to such eventuality at least in medium terms. (IMF, 2008).

The following table provide estimate for 2008 and projection for the period 2009-2012 for three oil dependency indicators. All the three indicators show further dependency. The ratio of oil export revenues to total revenues increases from 76.4% in 2008 to 83.3% in 2012. Obviously this would mean government budget whether for current expenditures or investment requirements becomes increasingly dependent on oil export revenues. The contribution of oil export revenues in the country’s GDP increases gradually during the same period from 50.1% to 56.5%. Finally, oil production maintains the exclusive role as the main source of foreign exchange since oil export revenues, which constitutes 97.3% of total export revenues in 2008 increases to 98.3% in 2012. This also indicates to the significance of oil export revenues in both the balance of payments and trade balance, and the serious limitation or absence of meaningful internationally tradable commodities.

Macroeconomics indicators for structural dependency on crude oil export

	2008B	2009P	2010P	2011P	2012P
Oil Export Revenues/ Total Revenues (%)	76.4	84.6	84.4	84.0	83.3
Oil Export Revenues/ GDP (%)	50.1	55.2	55.8	56.3	56.5
Oil Export Revenues/ Total Exports (%)	97.3	97.8	98.2	98.3	98.3

Source: Author’s calculation based on data from IMF, 2008, (Tables 2, 3 and 7) B: Budget estimate, P: Projections.

II- The depleting nature of the hydrocarbon resources;

There is an almost consensus that Iraq has a proven oil reserves of 115 billion barrels (bnb). With additional probable/potential reserves brings Iraq’s total reserves to 380 bnb (according to Tariq Shafiq 2008). Other estimates of Iraq’s potential oil reserves vary. In April 2007, oil industry consultants IHS estimated that Iraq’s proven and probable reserves equal 116 bnb, with a potential additional 100 bnb in largely unexplored western areas. The U.S. Geological Survey’s median estimate for additional oil reserves in Iraq is approximately 45 bnb . In August 2004, Iraq’s then-Oil Minister Thamer al Ghadban² stated that Iraq had “unconfirmed or potential reserves” of 214 bnb. (See Christopher Blanchard, p. 1)

In addition to oil there is natural gas. Natural gas resources are substantial as well. Proven reserves are estimated at 3.1 trillion cubic meters- tcm, representing 2% of world reserves. Undiscovered gas resources may be even greater, according to the IEA. (IEA-2005, chapter 12-Iraq)

Oil and gas are depletable hydrocarbons. Each produced quantity of oil and gas is irreplaceable. In addition to the **orderly depletion** through sound and calculated production rates, reservoir mismanagement, sub-standard engineering and careless production practices could cause what is known as a **premature depletion**. During the sanction era and due to sanction impacts, Iraqi authorities seem to have resorted to such malpractices and that could

² He is one of the three co-authors of the proposed OGL and currently, July 2008, is advisor to the Prime Minister Nori Almaliki. The other two co-authors are Farouq Alkassim and Tariq Shafiq, who turned to be strong critic of the law.

have damaged certain reservoirs seriously, especially when the UN characterized the oil industry in a “lamentable state” as early as 1998.

Considering the importance and centrality of hydrocarbons in the Iraqi economy as mentioned above, this makes it vital that revenues generated from these finite resources should be invested in productive capacities in an optimal and cost-effective manner. Sustainable development, through human and productive assets, is the only viable replacement to these resources. Failing to deliver sustainable development compromises and endangers the interest and welfare of future generations, and contravenes to one of the “core” principles of the Constitution as shall be discussed hereunder.

III- The “Economic Rent” and its consequences.

Petroleum production is generally characterized with the existence of an economic rent, which is generated from the international oil prices. Economic rent (also called minerals or resource rent) is commonly defined as the difference between the international oil prices and FOB production cost, including normal return on investment. The higher is the price of oil the higher is the economic rent for the producing country. Rent is very significant for developing countries with vast oil reserves and comparatively low cost of production, and it is simply the main source of revenues and foreign exchange as outlined above for the case of Iraq. A fundamental feature of economic rent is that it is generated **exogenously** (from outside world) and accrued **directly** to the government, thus creating a condition of a rentier State.

Economic rent has, and could generate, substantial and deep-rooted impacts on the State and its economic, social and political performance and behavior. In economic and developmental terminologies and discourse three known concepts/theses have, over the years, been the focus of debate and analysis, these are “**Dutch disease**”, “**absorptive capacity**” and “**resource curse**”.

The term “**Dutch disease**” originated in the Netherlands during the 1960s, when revenues generated by natural gas discovery led to an appreciation of the national currency and to a sharp decline in the competitiveness of the non-booming tradable sector. The revenue windfall served to increase imports to the detriment of national production, provoking a sharp decline in economic growth. This economic paradox has since been recognized as a situation in which a large inflow of foreign currency – whether it originates from a sharp surge in natural resource prices, or from foreign assistance or foreign investment – adversely affects the performance of the non-booming sectors of an economy, and in particular, the non-booming tradable sector. (UNCTAD, WIR 2007. Footnote 40. p.98)

A recent study of the developments in the hydrocarbons sector in Bolivia raises the possibility of a case of Dutch disease. This phenomenon spreads via two main channels: the resource movement effect and the spending effect.

The ‘resource movement effect’ refers to the reallocation of factors from different sectors of the economy (e.g., manufactures or other lagging sectors) to the natural resources export boom sector. The spending effect relates to the appreciation of the real exchange rate as a result of the spending of some part of the booming sector’s extra income in non-tradables. The spending can be performed directly by the owners of the factors or indirectly by the government through tax collection.

Both effects, directly or indirectly, entail a real exchange rate appreciation with possible serious ramifications to the entire economy. (See Eugenio Cerutti and Mario Mansilla, 2008)

Economic rent during the oil price adjustments of the seventies had exposed the limitations of the “**absorptive capacity**” of OPEC members, and many were compelled to recycle significant portion of their oil revenues in the international banking system, thus might have contributing indirectly to what became known international debt crisis of the eighties.

In recent years many scholars brought to the forefront of discourse evidence which suggest that countries that are rich in exportable minerals, especially oil, have been worse off than less endowed countries in terms of various economic, social and political performance measures, and this has become to be known as the “**resource curse**”. This occurs due to weak governance, which leads to wasteful patterns of revenue generated from mineral extraction rather than invests them to promote sustainable development. To reverse “curse” into “blessing” governance systems and institutional capacity need to be strengthened, and mineral wealth should be invested in the creation of knowledge for economic innovation, and in human, social and physical capital formation, including infrastructure development.³

There are, however, some skeptic scholars who would argue that the availability of such exportable resources and the vast revenues they generate prevents any desirable change on the political landscape in countries possessing these exportable natural resources. Giacomo Luciani (1996), for example, asserts that rentier states should not be expected to democratize, at least as long as they remain rentier.⁴

VI- Geo-political considerations and implications

Iraq is a semi landlocked country (see the following map), and this geographical location has its own implications and impacts on the development efforts and policies in the country, and the economic and political relationship with the neighbouring countries.

To diversify its export outlets Iraq attempts to construct and/or utilised export terminals in the neighbouring countries and lay oil/ gas pipelines for that purpose. This by itself entails substantial investment, justified on flexibility and diversity grounds. Furthermore, development efforts in the country are highly affected by the state and condition of the infrastructure and facilities (ports, terminals, roads and bridges etc) in and with the said countries. As a consequence, the transit countries have leverage (and thus posses “location rent” vis-à-vis Iraq) and they, consequently, had and could set a claim on the economic rent associated with Iraqi exports of oil and gas.

Moreover, there is good deal of “political” vulnerability associated with these pipelines with its detrimental consequences as evident by the Syrian closure of the pipeline going through its territories in April 1982 and Saudi Arabian continued closure of IPSA- Iraqi Pipeline through Saudi Arabia.

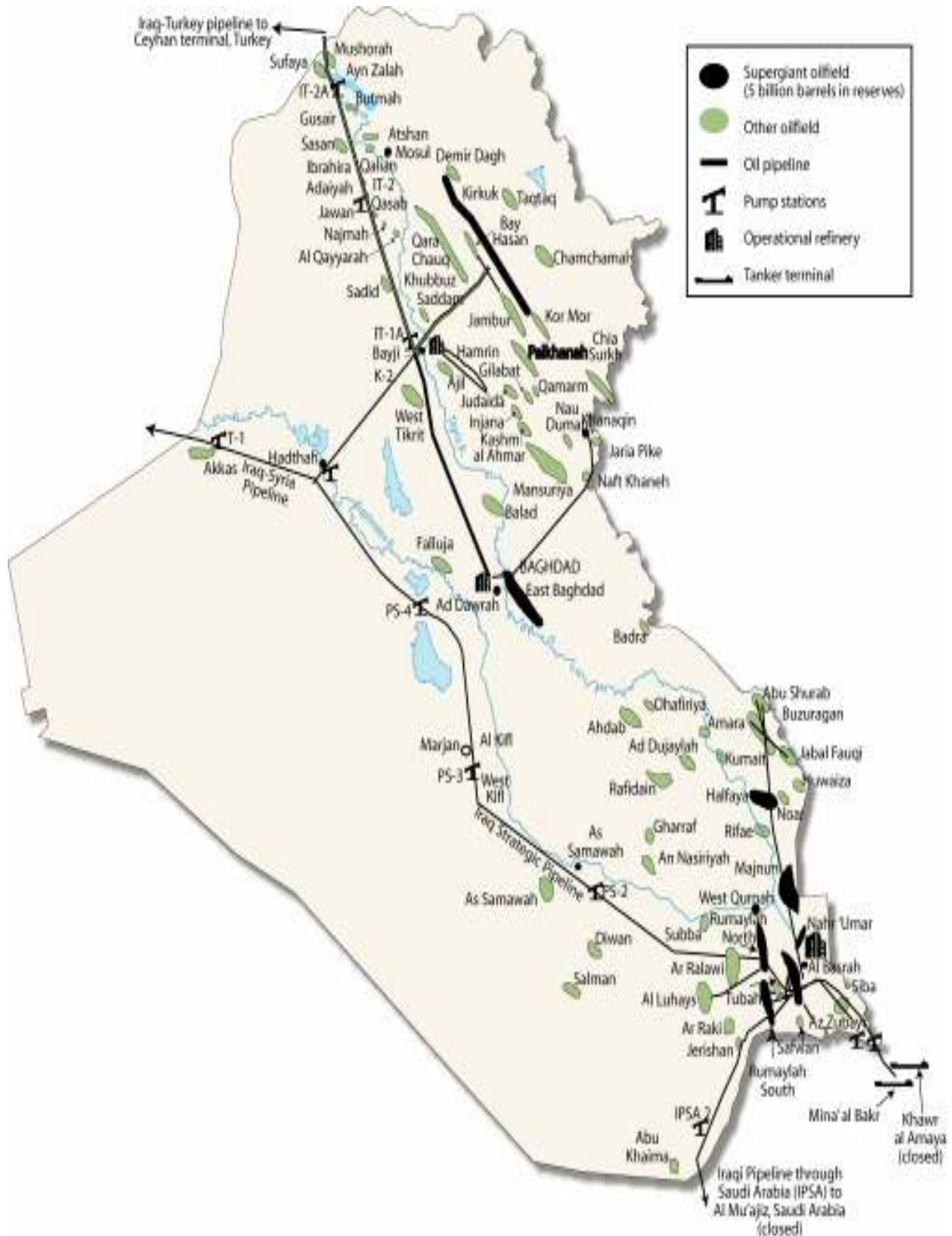
Finally, the issue of border fields, as shall be discussed in the third part of the paper, is no less important than what has been mentioned above.

Each one of the above four premises is complex by itself and the interdependency among them is even more complex and difficult. It becomes apparent therefore, that such complexity, overlapping and interdependency require well-elaborated comprehensive and operational national petroleum policy. This is dealt with in the following part of the paper.

³ For further information and different views regarding the resource curse see UNCTAD-WIR 2007, Box III.3. The “resource curse” debate. P.94

⁴ See also Nazih N. Ayubi (1995). Pp. 224-230.

Location of Iraq's Oil Fields, Reserves and Infrastructure



Source: Christopher M. Blanchard, Iraq: Oil and Gas Legislation, Revenue Sharing, and U.S. Policy. CRS Report for Congress- RL34064. USA. July 25, 2007

PART TWO- THE FEDERAL PETROLEUM POLICY-FPP

“Without appropriate policies and institutions in place, there is an increased risk that the government revenues will do little to promote sustainable development.” (UNCTAD, 2007, p.139)

For energy resource rich developing country federal/ national petroleum policy is important for sustainable development and for sound natural resource management. To serve this significant and crucial developmental role FPP has to be formulated properly and established on basic pillars that are relevant to and correspond with the expectations from such a policy. Considering the particularities of the Iraqi economy and various political, developmental and institutional conditions the following constitute essential foundations for the needed federal petroleum policy in the country.

I- Mandatory Framework and Guiding Principles

The legal and regulatory framework

The pyramid of legal and regulatory framework governing the FPP and impacting its formulation and execution composed of many levels each has distinct authority and thus includes many legal and legislative instruments. At the top/ first level of the pyramid stand the **federal** Constitution, which provides the basic principles that are relevant to FPP and constitute the heart of the mandatory framework within which the FPP functions. In addition to the Constitution, the second level includes the **sectoral** legislative instruments. These include the proposed Oil and Gas Law- OGL (still under-consideration by Council of Ministers- CoM and then by the Council of Representatives- CoR), which is a legal framework of direct relevance to petroleum sector and the federal petroleum policy especially with regards to upstream and midstream development in the sector. This level includes also the refinery investment bill- RIB. The RIB allows foreign investment in the refinery infrastructure (GoI, ICI⁵ 2008) was already approved by CoR) RIB deals with part of the downstream activities, and thus it establishes the framework for these activities of the petroleum policy.

In the third level there are or will be the **Ministerial/institutional** legal frameworks. These includes the anticipated laws for the Ministry of Oil- MoO, Iraqi National Oil Company- INOC and any other related entity that could have a role in the formulation and implementation of the FPP.

The legal instruments of the second and third levels are to be enacted by the CoR/ parliament upon proposals from CoM.

The lowest and fourth level of the pyramid includes instructions, directives, guidelines, and alike that fall within the mandate of and issued by any executing related entity, such as INOC. These instruments are directly related to execution and implementation purposes and functions.

Guiding Principles

⁵ The International Compact with Iraq- ICI, an initiative of the Government of Iraq for a new partnership with the international community, was formally endorsed on May 3, 2007. However, I proposed “Obligations-Development Sustainability Compact” with logical framework on how to operationalise it in 2004 in my paper (see Jiyad, 2004) The paper was communicated to the Central Bank of Iraq-CBI during the last quarter of that year.

Among all the mentioned above frameworks the Constitution is sovereign and supersedes all of them. The enacted laws are based upon the Constitution and they further elaborate on the “sectoral” specificities of the FPP. The following principles that are embodied in the Constitution shall provide the guiding principles for the federal petroleum policy. It is important though to make a distinction between the “**core**” and “**operational**” principles. The “core” principles are those that have a supreme nature and should be upheld all the time, by all actors and in all parts of the country. The “operational” principles deal with matters of implementation and thus should be adhered to as long as they comprehensively and effectively serve the attainment of the “core” principles.

In my views the Constitution has three core principles⁶, and they are:

- 1- Oil and gas are owned by all the people of Iraq in all the regions and governorates (provinces) (Article 111)- **Ownership principle**;
- 2- Develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people (Article 112, Second)- **Highest benefit principle**;
- 3- The co-management of the sector and formulate the relevant policies by the federal, regional and governorates governments (Article 112, First and Second, and Article 114, Second, Third and Fourth)- **Co-management principle**;

In addition to the core principles there are other “operational” principles such as:

- 1- The use of the most advanced techniques of the market principles (Article 112, Second);
- 2- Encouraging investment, (Article 112, Second), presumably private national and international-FDI;
- 3- All powers not stipulated in the exclusive powers of the federal government belong to the authorities of the regions and governorates that are not organized in a region. (Article 115)
- 4- Other powers shared between the federal government and the regional government, priority shall be given to the law of the regions and governorates not organized in a region in case of dispute. (Article 115)

The principles of the operational nature have caused serious difference of interpretation, opinions, and generate ambiguities to the extent that many observers find it necessary to resolve these ambiguities and make the required constitutional amendments.⁷

II- The Institutions, Stakeholders and Partnerships

Many actors could have roles to play and undertake responsibility in the formulation, discussion and implementation of the FPP. Some have direct and substantive regulatory role while others could play a watchdog function, and others are directly involved in the actual implementation of petroleum related projects or contracts.

Within the framework of sound FPP and for its proper functioning three vital issues need careful and proper demarcation.

The **first** deals with the specificity of the role and responsibility of each of the involved entity, stakeholder and partner as the case may be. Modalities governing the role and responsibilities are many including the Constitution, different relevant laws, bylaws, regulations, guidelines, contracts etc.;

The **second** deals with governance system over-watching the proper dispensing of such role and responsibility.

⁶ Each of these core principles has implications, which for practical reasons are beyond the scop of this paper.

⁷ Many cases of different interpretations and ambiguities were made especially by, among others, Alameer (2007), Shafeq (2008), Almehaidi (not dated).

Third, experience indicates to the critical importance of the CSOs, in addition to the media and academia, in monitoring the compliance of other actors and partners within the State-Business-Society triangle.

Furthermore, what is urgently needed is to define clearly and comprehensively the governance system that each institution, stakeholder and partner should adhere to and comply with. This governance system, as must be emphasised, should be Transparent, Accountable and Democratic- TAD.

TAD Governance system can either be **Built-in** within each institution or provided for through a **Nation-wide governance** legal framework or a combination of the two, and/or the Internationally recognised norms and standards pertinent to especially the TNCs/IOCs. The importance of TADG system lays in its role to prevent damaging corruption through three functions: **Informative** (capacity development), **Preventive** (deterrent) and **Punitive** (persecuting corrupted officials).

The following table could serve as schematic checklist for this purpose.

Institutions, Stakeholders and Partnership	Role & Responsibility	TAD Governance
National-Governmental I- Federal Level (CoR, CoM, FOGC, MoO, INOC, SOMO, etc) II- Regional Level III- Governorate Level		
National- Public (1- CSOs/ NGOs, 2- Academia 3- Media)		
International (1-Multilateral, 2-Bilateral, 3-TNCs /IOCs)		

It’s worth mentioning that Iraq has made some progress in this area by taking the followings, however, more is needed to consolidate TADG system:

- The Joint Board for Combating Administrative Corruption-JBCAC was established by Presidential Order, and is under the chairmanship of the Secretary General of the Council of Ministers. It has representatives of the Higher Judicial Council, the Board of Supreme Audit, the Integrity Commission, a representative from the Office of the Prime Minister for Monitoring Affairs and a representative of the General Inspectors. The Board aims to ensure efficiency, integrity and transparency in the implementation of the Government’s economic and social policies, and to enable coordination among the anti-corruption bodies represented on the Board. It submits periodical reports on its activities to the Prime Minister. (GoI, ICI 2008, p. 31) It remains to be seen whether JBCAC is effective enough to combat corruption and adheres to the TAD Governance principles and expectations with regards to federal petroleum policy especially various oil contracts.
- Joining the Extractive Industries Transparency Initiative (EITI). This could create a solid basis for transparency and accountability of the energy sector as it undergoes an expansion programme.⁸;

⁸ For brief information on EITI see UNCTAD (WIR 2007), Box VI.13, p180.

- Iraq also ratified the UN Conventions on Anti-Corruption.

III- Macro-economy contribution:

The FPP should be an integral component of a sustainable, holistic and rights-oriented development strategy and planning. Petroleum production level, for example, should be determined by and geared to development requirements, not the other way around since availability of “capital”, as history repeatedly tells us, is necessary but not sufficient condition for development. The fundamental question here, therefore, is not the FPP itself but what “development” is the country needs.

The development strategy, formulation and its orientation are the responsibility of the State and its government(s). Considering the depletable nature of the petroleum resources, the development efforts should aim at achieving maximum sustainable development by investing in human and productive assets.

In the pre-invasion Iraq, the economic policies had failed to deliver development and the political system was characterized by ruthless dictatorship with worst record on human rights. Post-invasion Iraq witness more of social and economic degeneration together with deteriorated security conditions that led to worsening even further the human rights and conditions for most citizens.

Under such conditions it is in our opinion that rights-based development is the most suitable paradigm for future Iraq. In short rights-based development is a holistic, multi-dimensional development that is formulated upon, aimed at and judged by substantial and progressive realization of human rights.

The developmental role of FPP includes generating revenues, through oil and gas exports, to financing development and provide inputs/linkages especially to the downstream industries: refineries, power generation, domestic and industrial sector, and petrochemicals. And this takes me to address the essential component of FPP.

VI- The “Sector -Specific” role of the FPP

The goal of Iraq’s energy policy is “To develop an energy sector (oil, gas and electricity)⁹ that meets Iraq’s energy needs and maximizes the benefits of Iraq’s hydrocarbons for all Iraqis.” (GoI, ICI- 2008, p. 49)

The sector specific role of the FPP aims at optimal development of hydrocarbon resources in a most cost-effective, prioritisation and sequencing, through elaborated time horizon, to attain a nationally required and needed production levels.

The sector specific activities include **upstream** (exploration, development and production), **midstream** (pipelines, storage and national export terminals) and sector-related **downstream** (refining, gas injection to enhance recovery factor, gas use for industrial and domestic sector and for power generation.) Accordingly this sector-specific role is the core of the FPP.

Upstream and midstream functions are the cornerstone of any national/federal petroleum policy for reasons mentioned throughout this paper regarding oil production.¹⁰

One of the basic requirements for FPP to attain the above stated objectives is to have visionary planning for both strategic and implementation purposes. The components of the planning functions are basically the following:

⁹ Since electricity generation is dependent on gas and other fuels, then in my view, oil and gas are and the petroleum policy is the backbone of the energy policy.

¹⁰ For practical considerations this paper confine its analysis to these two streams parts of the policy.

Situation Analysis: This should be comprehensive, accurate and objective assessment of the current situation in all three streams of the petroleum industry. The analysis include provide answers, among others, to what are the main features, problems and parameters of the current situation in the petroleum sector? What are the circumstances that led to the current situation and how did that happen? What are the identified weaknesses and strength of the petroleum sector? Questions related to resources availability and constraints, challenges and opportunities, etc. are dealt with here. What are the economic factors, data, indicators related to cost, investment requirements, expected returns, etc?

Goals and Targets: This function deals primarily with identification, evaluation, prioritisation, selection and sequencing of major goals and targets within defined timeframe and resource availability for the needed investment. Moving from rehabilitation through stabilisation to consolidation: what are the levels of production and investment requirements. Sub-goals, benchmarks, when, where, etc.

Implementation Process: This is the actual practice of how to move from the current situation to achieve the stated targets. Considerations of efficiency, effectiveness and timely implementation are critical and should be pursuit. This also includes the modalities that are available, partnership, necessary changes or development in the institutional set-ups, what type of road map to follow, modalities for monitoring-evaluation-revision, etc.

There are many different methodologies, approaches, techniques and analytical tools that are available and can be utilized to conduct the functions outlined above. Models differ in their sophistication, data requirements, professional expertise, time requirements and cost, among other things.

Based on the above the following table simplifies and summarises the sector-specific role of the FPP, which the officially responsible governmental entity could prepare and present in its plan.

FPP Sector-Specific Matrix

	Situation Analysis	Goals and Targets	Implementation Process
Upstream			
Midstream			
Downstream			

The Ministry of Oil (MoO), according to ICI 2007/8 report, has the prime role in preparing sectors’ development strategy. A 10-year plan, which will set out the aims, principles and strategy of the oil sector, is to be submitted to the Council of Ministers in 2008. The plan covers all the activities of the oil sector (exploration, drilling, production, refining, distribution, transport, marketing, etc.) and will provide for improved oversight and control. (GoI, ICI, 2008, p. 50)¹¹ Within the expected plan and in addition to the upstream and mid stream objectives, the ICI report envisage expanding refining capacity to reach output of 750,000 bpd by the end of December 2008. (GoI, ICI, 2008, p. 50), provides power generation with natural gas and other fuel, such as

¹¹ It is rather ambitious, and somewhat unrealistic to expect MoO to finalise such a plan when the ministry’s law as well as the INOC law have not yet been enacted by the CoR, the OGL is in stalemate and the revisions to the Constitution are not done with. Finally, only few months left in 2008 to accomplish all the above at the time when security situation is far from consolidation.

crude and heavy grade oil may be used initially as there are present difficulties in supplying the stations with natural gas. (GoI, ICI, 2008, p. 53)

It remains to be seen whether this ICI optimism is justified and the objectives be realized as foreseen or not. It is my believe that neither such objectives nor the plan itself are attainable unless the following key issues are dealt with, and clearer federal petroleum policy is properly formulated, thoroughly discussed and nationally endorsed and adopted.

PART THREE- KEY ISSUES BEFORE FPP AND POSSIBLE SCENARIOS

1- Federal, Regional and Provincial- FRP co-management: Harmony, coherence and pyramidic.

As mentioned earlier the FRP co-management is one of three core constitutional principles. However, there is good deal of confusion, overlapping and ambiguities surrounding the role, responsibility and function of each of the three levels. The mandate of each has wide gray areas that could cause conflict of authority and power. Apart from the contribution of the Constitution itself in creating such confusion, especially regarding the implications of Article 115, the proposed Oil and Gas Law- OGL makes the situation even worse.¹²

The tendency of the regional and provincial authorities to focus on and emphasise upon the “operational” on the expense of the “core” principles, and with this they eradicate the powers of the federal level, has serious ramification on the proper functioning of the FPP and, hence, it is a recipe for failure and bad management.

In the meantime the legal, technical, financial and administrative capacities of the regional and provincial authorities are at their infancy stage, at best, while the “centre” is de-capacitated. Thus serious capacity development is needed before they can undertake such functions and perform them well. In this regards, both the Constitution and the proposed OGL failed to recognise the correct correlation of power and authority with competency and professionalism, and also did not provide the needed timeframe and suitable roadmap to create such correct correlation.

Unless the role and responsibilities on the three levels of the executive branch are harmonised, coordinated and functioned in coherent and pyramidic way the possibility becomes remote to have sound, effective and functional FPP. Oil-rush, contract quick-fixing, premature depletion, provincial boarders disputes, production competition, and incompetent regional and local authorities would not be commensurate to secure the attainment of the highest benefits to the Iraqi people, as one of the core constitutional principles.¹³

These are examples of daunting challenges that must be addressed seriously and effectively. Therefore, serious revisions to the Constitution and the proposed OGL become imperative and should be done with as soon as possible. Though the government admits in its midyear ICI report that these principles will be underpinned by Constitutional amendments, which clarify ambiguities and contradictions in this regard (GoI, ICI, 2007), nothing has been done so far, and ICI Annual Report 2008 still calls for resolving these pending issues. (GoI, ICI 2008)

Human and institutional capacity development. All three levels of FRP co-management are in urgent needs for human and institutional capacity development if the objectives of FPP were to be attained. Active programmes to reintegrates Iraqi oil specialists and experts who for various reasons have fled the country is a right and good step in this respect. Partnership with

¹² For critical analysis of the proposed Oil and Gas Law see Jiyad, AM, 2008

¹³ On the issue of provincial boarders and their impacts see Kamil al-Mehaidi, (not dated).

IOCs through different forms of service and management contracts should include skills and managerial capacity development. Finally, numerous modalities and avenues are available and can be explored in this respect through various channels of inter-governmental international cooperation, such as the one concluded with Norway.¹⁴

2- Production capacity: development requirement vs. swing producer

Oil production capacity and the time horizon to develop it, is an essential pillar for and major undertaking by FPP. The debate on this issue reveals different positions: on one side of the aisle calls for linking oil production to sustainable development requirements and thus develop the production capacity accordingly. The other school advocates maximum production capacity as soon as possible since the country's proven reserves are large enough that permit and support such expansion. "optimal development" mean simply to maximize oil production in the shortest time possible (Hamid Dhiya Jafar (2007).

Obviously, maximising production within shortest time is in effect advocating for attaining the status of swing producer. The ambition among some Iraqis to reach the stage of a "swing producer" is not really recent. A former Minister of Finance, Hikmat Al-Hadithi, announced in Switzerland two decades ago that Iraq has the potential, capacity and willingness to be a "swing producer".¹⁵ A figure of 8, 10 or even 12 mb/d has been mentioned as sustainable production level. According to Shafiq Iraq's present proven reserves can create a production capacity of 10mn b/d and maintain it for a decade before decline sets in, but with proven and potential reserves of 380bn barrels, on par with Saudi Arabia, Iraq will be able to raise its production capacity to over 12mn b/d and sustain it for over a decade. (Tariq Shafiq, 2008)

But even this, in my view, cannot be enough to reach and maintain the status of a "swing producer" because, inter alia, of an existing swing producer- Saudi Arabia, which is driving for much higher production capacity than Iraq could. It has been reported that, "Saudi Aramco's strategic business plans call for an expansion of sustainable capacity to 11.5mn b/d to the end of the decade. But the US Department of Energy (DOE) projects that demand for Saudi crude will top 13.6mn b/d by 2010, rising to 19.5mn b/d by 2020." (See Sami O Ajam Meera and Bachir Boustani, 2006)

Apart from this, I would argue that it is not feasible, desirable or possible for Iraq to be a swing producer. To be a swing producer there are financial, logistical, infrastructure and political conditions that are associated with and prerequisites to be a swing producer, which Iraq do not possess or could have in the distant future.

The Glossary of energy terms by the Energy Intelligence Group (UK) defines Swing producer: "A company or country that changes its crude oil output to meet fluctuations in market demand. Saudi Arabia, as it has traditionally presided over the world's largest spare capacity, is seen as the world's major swing producer." (See http://www.energyintel.com/DocumentDetail.asp?document_id=200010 Accessed 17.07.2008) The main two features of a swing producer, according to the above definition, are first

¹⁴ According to the Norwegian "Oil for Development" programme of NORAD, a request from the Ministry of Oil in Iraq (MoO) on 6 September 2004 resulted in development assistance being authorised the same year. The Norwegian Petroleum Directorate signed an agreement with the MoO on institutional and technical assistance on 26 May 2005. The estimated budget was NOK 27.5 million over a three-year period. The programme has the following elements: Data storage and recovery, transfer of technology to increase oil recovery, training, transfer of technology in connection with the national supply industry, and policy dialogue on framework conditions in petroleum administration. The program will be completed during the first half of 2008.

http://www.norad.no/default.asp?V_ITEM_ID=10064 Accessed 24.06.2008)

¹⁵ As cited in OPEC Bulletin, (February 1989, p. 48.)

to links its production to international demand on oil, and second it should have significant (the largest) spare capacity. Obviously to meet the requirements of these two conditions entails financial, logistical and infrastructure capabilities that are not necessarily combatable with sustainable development and sound optimisation of the depletable resources. Furthermore, there is high degree of vulnerability to international pressure, which again might not be in the interest of the producing country.

Having said this, FPP should focus on linking oil production capacity to the country's development requirements, and should not entertain the idea of a swing producer status or pursue such unrealistic and undesirable objective.

3- Prioritisation and sequencing: Exploration and production

The development of the country's hydrocarbon resources requires concerted efforts on exploration, development and production activities. The state of the Iraqi oil industry makes it necessary to apply careful prioritisation and proper sequencing between and among these major activities.

Iraq has some 115bn barrels of proven reserves with 80 fields some of which are developed and semi-developed while others still undeveloped. Its production capacity had once reached a maximum of 3.9 mb/d in December 1979 (IEA, 2005, p. 386), but currently it is much lower than that. Obviously, this would lead one to suggest that priority should be given first and foremost to increase the production capacity to its previous levels through rehabilitation and consolidation efforts on the developed and semi-developed fields. Enhancement of production capacity by additional volume is attainable by gradually developing some already discovered oilfields.

Furthermore, utilizing the associated gas should receive a collateral-priority accordingly. The proposed OGL provides "indicative" preference to the issue of gas and suggests a rather diluted provision regarding gas utilisation in an effective manner commensurate with its significance as invaluable hydrocarbon (articles 26, 27 and 28). Considering the significance of gas reserves (both associated and non-associated) in the country, FPP should explore the possibility of using the suitable technology of converting gas to liquid (GTL) to claim more of the value chain in oil production.¹⁶

ICI 2007/8 review states that the most important factors in raising Iraq's standard of living are to increase oil production and raising exports to 3.5 million barrels per day. (p. 49) This objective is possible and attainable within the Iraqi capabilities with international technical service contracts, especially since Iraq has accumulated and could generate the necessary financial reserves due to increased oil prices and debt relief.

Walid Khadduri (2007) suggests prioritizing discovered fields would raise production capacity to around 5mn b/d early in the next decade, and would be of much financial benefit for the country in the near future. Also Foad Qassim Alameer (2007) asserts that Iraq can have additional 3 mb/d from 10 discovered fields, which has total proven reserves of 63 billion barrels, within five to six years of development period.¹⁷

¹⁶ GTL technology is the process of converting natural gas into processed hydrocarbon liquids. GTL is suitable for use as fuel in many kinds of vehicles and airplanes. It is a clean fuel that does not produce harmful emissions as it contains extremely low levels of nitrogen and sulphur.

¹⁷ These fields are Majnoon, Western Qurna, East Baghdad, Ibn Omar, Halfaya, Ratawi, Nasiriya, Tooba, Al-Gharraf, and Ahdab.

According to the MoO, Iraq aims to have a production capacity of 4.5 million b/d by 2013 (increasing from current 2.5 million b/d), and to 6 million b/d within 10 years. Most of the targeted increase of 2 million b/d by 2013 would come mainly from the following fields: 200,000 barrels per day for Kirkuk, 100,000 b/d for Bai Hassan, 800,000 b/d for Rumaila north and south, 250,000 b/d for Zubair, 150,000 b/d for West Qurna and 150,000 b/d for the three Missan fields of Buzurgan, Fauqa and Abu Ghirab. These fields together with two gas fields- Akkas in western Iraq and Mansouria in the east- are the subject of current round of discussions between the MoO and IOCs.¹⁸

The availability of many discovered but undeveloped fields with substantial reserves and significant production capacity potential would make any investment in exploration for new reserves economically not justifiable and time-wise should not have priority. On this line of thinking Tariq Shafiq (2008) argues that Iraq's developed production rates have always lagged behind its reserves capacity, and he concludes that further exploration for reserves equates to additional frozen investment, generating no return.

The above discussion suggest that priority should be given to develop production capacity to the range of 5 mb/d without diverting the limited national efforts on too many objectives of intensive exploration and their consequences. The modalities, timeframe, financial conditions, contracts type, cooperating partners, and all other important issues related to the working plan to achieve such production capacity objectives have to be discussed and evaluated thoroughly and selected carefully.

4- The Boarder fields:

Geological formations know no political boundaries, sovereignty, and they extend through the territories of two or more neighboring countries. Consequently one country could become a major stakeholder and the other(s) minor stakeholder(s) depending on the proportion of the field in each country. Such borders fields are more susceptible to a premature depletion, and thus permanent loss of resources when the neighboring countries lack cooperation in the development of such fields. Instead, the minor partner might pursue the "rule of capture" and maximize production without due regards to the best practices that ensure maximum recovery from the field, and benefits cost-free from any efforts and investment by the major stakeholder to enhance the recovery from the related field. Advanced drilling technologies such as the directional and multi formation deep-drilling could even penetrate across political borders causing more sucking of oil from the territory of the other country in addition to the possible migration of oil due to drilling activities. The lack of cooperation among the concerned stakeholders and the absence of well-defined international law governing such border fields could contribute to deteriorate the relationship and develop it into a stage of serious animosity.

Iraq has many of such fields on its borders with Iran (15), Kuwait (3), Syria (2), and probably with Jordan (1) or even Saudi Arabia (?).¹⁹

The border fields with Kuwait and Iran have and could remain source of concerns and even tension. After the invasion of Kuwait the UN, with Iraq reluctant acquiescence, shifted Kuwaiti borderline northward, giving Kuwait effectively more reserves from South Rumaila, Zubair and Umm Qasr fields. Accordingly, Iraq lost 11 oil wells in Rumaila, and 3 wells at dome of Safwan in Zubair. Furthermore, Kuwait drilled more than 20 wells in the Ratqah area

¹⁸ See *International Oil Daily* (July 17, 2008)

¹⁹ For more on Iraq's border fields see Thamir Uqaili, 2008.

(located in Southern part of Rumaila) and 25 wells in the area opposite the Dome of Safwan on its side. This, according to the Deputy Chairman of Oil and Gas Committee in the parliament Mohamed Hussein Al Yassin, causes “1600 barrels of oil moving from Iraq to the Kuwaiti fields daily”²⁰

There have been a series of unconfirmed reports that the Iranians have taken over 15 Iraqi wells and started producing from them. According to Thamir Uqaili the news from Misan Governorate suggests that the Iranians have prevented Iraqi oil personnel from operating Abu Gharab producing wells located 50-100km from the border. The Iranians are reported to have claimed that the border is not well identified which needs some coordination with the Iraqi authorities to fix it.

The proposed OGL (Article 25) obligates the “Council of Ministers to take necessary measures to protect the interests of the Iraqi people in the petroleum discoveries that extend beyond Iraqi borders”

As a matter of sound petroleum policy such border fields should retain special priority and attention and be developed either unilaterally or bilaterally through cooperation efforts with the neighbouring country(s). The MoO has established a Committee dealing with the issue of the boarder fields. With this regard, the Iraqi Minister of Oil was reported to have called for speedy conclusion of boarder fields unitisation agreements with the neighbouring countries- Iran, Kuwait and Syria, to insure the rightful interests of all parties, and he asserts that “joint committees” with the said countries are working to reach final agreements on the matters.²¹

How all this will be reflected in the mentioned above 5 and 10-year plans by MoO is a matter that remains to be seen once the details of the said plans became known.

5- National and international efforts:

The contributions of both national and international efforts in the FPP are of vital importance, and FPP and other federal policies should create the viable and enabling environment to this effect.

It should be clearly emphasised at the outset that the role of the national entities and efforts should not be compromised or undermined or even treated on equal footing with the IOCs. On the contrary, priority through various legal instruments and policy directives should be granted to the national entities at least until they stand solid to compete with the international counterparts.

The failure to do so, as the proposed OGL suggests, would be a grave strategic wrongdoing, which condemn the Iraqi economy into **entrenched dependency**: not only on further dependency on oil but also, and more dangerously, on “enclave” external operators. Considering what has been mentioned above there is urgent need to delineate a clear demarcation of the spaces that are open for the international efforts in the three sub-sector activities (upstream, midstream and downstream).

In my views all discovered hydrocarbon fields should be clearly and exclusively earmarked for the national efforts through, for example, INOC and any other similar federal entity that might be created in the future.

Admittedly, international oil companies-IOCs possess technology, know-how, management skills, networks, finance and political connections. Partnership with such powerful and

²⁰ <http://www.iraqdirectory.com/DisplayNews.aspx?id=6439> Accessed July 7, 2008

²¹ <http://www.alnajafnews.net/najafnews/news.php?action=fullnews&showcomments=1&id=64614> Accessed July 8, 2008

capable IOCs has its own benefits but all depends on the terms and conditions of such partnership and the regulatory modalities that govern it, as briefly dealt with in the following paragraph.

6- The international efforts:

Oil industry uses different types of contracts regulating the relationship between the IOCs and the hosting governments. In the upstream activities the common contractual arrangements fall in four major categories: 1- Modern concessions, 2-Joint-ventures, 3- Production-sharing agreements/contracts (PSA/C) and 4- Non- ownership/sharing contracts (including variety of contracts such as service/management contracts, Risk service contracts, Buyback contracts, Cost-plus contracts, and Technical service Contracts.²²

A common denominator among all the consulted comparative assessments is that discovered fields are by definition do not have “discovery risks” and they are therefore should not be subject to any form of production sharing contracts or agreements, concession or even joint-ventures. This conclusion is even more valid for sizable or major fields.

The Constitution, as mentioned earlier, calls to use market mechanisms and encourage investment (presumably private national and international) in the development of the oil industry for the maximum benefits to the Iraqi people. The correct interpretation of this, taking into consideration our previous distinction between the “core” and “operational” principles of the Constitution, is that both market mechanisms and FDI can be used if and only if they contribute to maximise benefits to all people of Iraq. In other words market mechanisms and FDI are options not obligations. This also applies to similar provisions of the proposed OGL.

Having said this I would suggest the followings regarding the contribution of the international efforts:

Simple formula. The simple formula, which I would suggest is to “legally” earmark all currently discovered oil and gas fields to INOC (and any other federal entity that might be created) and “obligate” it to develop and operate these fields through national effort and, if needs be, by select the appropriate set of “no ownership sharing contract” types that is suitable for its planning and production objectives.

Partnership Diversity. It is beneficial for INOC and Iraq to diversify partnership vertically and horizontally. The necessity and usefulness of achieving broader international participation should be sought to avoid concentration of contracts. Horizontal intensity measures the share of a given country in the aggregate value of contracts concluded during certain period of time. The vertical concentration measures the share of a given company in the overall value of contracts signed during the period.

Achieving wider international and company participation and diversity among foreign partners is important and beneficial from technical, technological, economic and strategic perspectives.

Dynamic benchmarking formula. Regarding exploration blocks where risk component could be real and significant, the PSAs could be considered. However, I suggest a new generation of such an agreement where instead of a fixed duration I propose a “dynamic benchmarking formula” which links contract duration, through an agreed-upon factor, to the recovery of the capital invested in the concerned contract. The faster is the recovery the shorter will be the duration of the “original” contract.

²² Comparative assessments of these types can be found in the works of UNCTAD/WIR 2007, BearingPoint 2003, and Greg Muttitt 2005.

Model contracts.

The proposed OGL suggest two types of contract: exploration, development and production contracts (EDPCs) and development and production contracts (DPCs). However, ICI asserts that model exploration and development contracts are being finalised and they would apply to all major private sector investments in the upstream sector. (ICI, 2008, p. 50)

The ICI states also that the MoO has concluded a short-listing round for International Operating Companies interested in developing major new oil fields. The round was concluded in March 2008 with dozens of companies short-listed. An open and transparent bidding round is expected later in 2008 pending development of model contracts. (ICI, 2008, p. 51)

While the Constitution says nothing regarding these “Model contracts” or the “contracts” themselves, the proposed OGL makes clear and assertive role to these model contracts, and ICI, as mentioned above, is also specific on them. However, none of the above three documents contains provisions requiring CoR’s approval of the model contracts or the concluded contracts themselves.

In my view, a concluded contract with any IOCs is the legal document governing the relationship between the contracting parties. It is therefore very important for the Iraqi side to prepare model contracts that are based upon, guided by and aims at maximising the benefits for the Iraqi people. And since the hydrocarbon resources are owned by all the Iraqis in all regions and governorates, then all such contracts have to be approved by CoR. In other words if these model contracts and the concluded contracts were not approved by CoR then they are unconstitutional, and their legality can be contested accordingly. In such an eventuality this could generate a good deal of uncertainty, which could deter careful foreign investor.

To avoid such an outcome and pursuant to the principles of TAD governance I would suggest:

- 1- All “model contracts” become integral parts of the proposed OGL, and the law in its entirety should be subject to approval of CoR;
- 2- All and every “contract” should be subject to the approval of the CoR, prior or post, signing, and no such contract enters into force without the approval of CoR²³;
- 3- MoO, the Oil and Energy Committee-CoM, and parliamentary Oil and Gas Committee within CoR work out the modalities and procedural matters to obtain the required CoR approval in a timely manner.

Concluding remarks

Current and future international energy and petroleum landscape is indeed very important for the Iraqi decision makers to explore, follow-up, understand and bear them in minds.

Multiplicity of structural, strategic and circumstantial factors plays their role in affecting the main trends in world energy and petroleum balances, and oil prices.

There is an almost consensus among energy specialists, analysts and observers that the era of cheap energy is over, and for good. Depending on current forecasts future oil prices could reach or even exceed \$200 a barrel. Various factors stand behind and explain such development in the oil prices. In addition to the “fundamentals” that affects demand for oil,

²³ There is good deal of contradictions and confusion among the ministers and between the executive and legislative branches regarding oil contracts. While the Minister of Planning and Development Cooperation, Ali Baban, gave categorical assurances that each and every oil contracts will be subject to the approval of CoM, CoR and will be fully transparent (Al-Arabia TV channel, 27th June 2008), the Minister of Oil, Hussein Shahrastani, thinks that the approval of CoR is not needed <http://www.oil.gov.iq/frst-lisns.pdf>, accessed June 30, 2008, to the extent that the Iraqi parliament's oil and gas committee threatened to block long-term oil contracts signed with foreign firms if the committee did not scrutinize them. <http://www.zawya.com/video/default.cfm/sidVID20080702092715> Accessed July 2, 2008.

“speculative” activities (frequently refers to as paper oil) have made their impacts on current price surge of not less than 20%.²⁴ Weakened US currency has its contribution as well in explaining price levels: the lower goes the US dollar, the higher become oil price. Continued growth and increased demand for energy in the emerging economies with India and China spearheaded them are powerful factors behind growth in global energy demand. Finally, unlike in the past the world residual petroleum production capacity is currently very slim, estimated at less than 2%. Any disruption in petroleum production whether that be due to weather conditions, scheduled and/or sudden closure, or for geo-political circumstances etc would cause serious and prompt shortages of petroleum supplies.

All the above undoubtedly indicates that future global petroleum balance would be supply-driven with strong likelihood of high oil prices.²⁵ For a country, such as Iraq, that has vast petroleum proven and probable reserves with comparatively very low production cost per barrel (of one dollar compared with \$75 in deep formations elsewhere)²⁶ this is an ideal situation and unique opportunity.

Iraq, therefore, should prepare its federal petroleum policy carefully, properly and optimally, and negotiate, from a solid stand, with all its sovereign and IOCs partners to ensure maximum benefits to all Iraqis both current and future generations.

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²⁴ An IMF report states, "The recent surge in the oil price (from \$80 to over \$100 per barrel) seems to go well beyond what would be indicated by the growth of the world economy. Producers and many analysts say it is speculative activity that is pushing up oil prices now. Producers in particular argue that fundamentals would give an oil price of about \$80 per barrel, with the rest being the result of speculative activity," See Adam Bennett and Abdelhak Senhadji (2008).

²⁵ The IMF (2008a) study concludes that, “In the oil market, the price impetus from demand forces has been amplified by a sluggish supply response, which has led to a perpetuation of very low spare capacity and tight market conditions.” (p. 7) and “Futures prices embed the widely shared expectation that only high prices will induce the capacity expansion needed for continued robust oil demand growth.”(p.8).

²⁶ The figure of one dollar is based on Tariq Shafiq (2008a, p. 21) “finding cost per barrel, remains only a fraction of a dollar”, while the figure of \$75 is based on Ramsi Salman as the cost of oil produced from “deep formations” which he mentioned during a debate on current oil prices on Aljazeera TV Channel, *Mawara alkhabar* – beyond the news. June 7, 2008.

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