Iraq's oil contracts: a smart move

In 2003 US forces, mostly allied with British ones, toppled Saddam Hussein's government. Five years later, the "surge" strategy gradually enabled an internal pacification process that has been under way ever since, allowing institutions to reasonably work again and awaken its economic apparatus. Six years later, Iraq is finalizing agreements with foreign firms to increase its oil production from 2.5 million barrels per day (bpd) to 7 million bpd. World oil production in 2008 almost reached 82 million bpd. The oil production increase from Iraq will represent an important 5.5% world oil supply shock for a dormant market. Under these new production levels, Iraq will be the third biggest oil producer after Saudi Arabia (10.8 million bpd) and Russia (9.8 million bpd).

The interesting part is how the Iraqis are working out their contracts. They are not selling their oil fields, even under a strong pressure from outside opportunists, but just hiring third parties to increase oil output under a maximum US$ 2 fee per bpd. In essence, Iraq is keeping the upside while at the same time paying just enough to have reasonable returns on oil investments undergone by third parties.

The Rumaila, Zubair and West Qurna oil fields are to have 20 year contracts that before the sixth year should reach the 4.5 million bpd output increase. Contracts do not pay for existing production and Iraq favors proponents that for fees up to US$ 2 per bpd produce the most. No wonder the process was resisted by oil producers from its beginning, for world prices will certainly reflect at some time the possibility of having much bigger quantities of it at such low marginal costs.

In other words, Iraqis are keeping most of their wealth and world oil consumers are eventually participating on a smaller degree on the success of these oil "surge" contracts that surely do not fit OPEC interests in the longer run.

Just to have a perspective on the above consequences, oil represents today 35% of world primary energy consumption, the rest being explained by coal, natural gas, nuclear and hydroelectricity by 30%, 24%, 5% and 6%, respectively**[1]**. Its average price since 1946 has been US$ 35 per barrel. If we assume a shorter term value for the next years of US$ 50 per barrel, based on an excess demand for energy out of a growing world, Iraq might reach exports – assuming it increases oil consumption to 1 million bpd from the present 600.000 bpd - , valued at US$ 110 billion annually, at a minimum production cost. Iraqi government expenditures for 2008 were US$ 50 billion, for a country of 29 million people with a 2.5% population growth rate and a 69 year life expectancy.

Had former US Treasury Secretary Paulson or any other Wall Street luminary been in charge of the oil ministry, they most probably might have sold these oil fields under fixed prices and a lot of uncertainty. Iraqis knew better: they kept for themselves the prices and the uncertainty. A good lesson for many.

There is only one remaining question: when will the Texan cowboy receive a duly owed recognition for making all this possible? Iraqis are doing a good job, but let us not forget their own Omaha beaches.

Manuel Cruzat Valdes
Santiago, Chile
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[1] BP Statistical Review of World Energy June 2009