Iraq Oil Production Could Surge

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Recent reports highlight the enormous reserves of oil in Iraq and the potential for them to be exploited in the relatively near term, potentially impacting the onset of Peak Oil. From an investment viewpoint, I focus on the period ending in 2015, largely discounting whatever might come thereafter. In that time frame, Iraqi production increases are more limited and political risks are still hard to assess.

That said, one must tentatively conclude from recent events that foreign contracts are likely to be let and production is likely to increase significantly during the next six years. These events are:

- relatively free recent elections,

- the likelihood of a continuation of the present government for the immediate future, thus suggesting that ongoing negotiations with foreign oil companies will continue and reach a conclusion, and

- the apparent willingness of the U.S. to proceed toward withdrawal of troops suggest that Iraqi is becoming capable of keeping order within its borders.

Here is a summary of two recent reports:

An *Oil & Gas Journal* (1/19/09) article, "Iraq's Oil Prospects Prospects Face Political Impediments", notes that Iraq's proved reserves are 115 billion barrels, of 80 fields only 15 have been partially developed, the 7 largest fields contain 2/3rds of total reserves proven to date, and it's potential reserves are 215 billion barrels, possible the largest of any country in the world. Finding cost is a fraction of a dollar per barrel and estimated finding and development costs are between $1.50 and $2.25 per barrel, among the lowest in the world.

Iraqi production reached 3.5 mb/d pre-invasion and is currently about 2.5 mb/d. Contrasting that with the current 12.5 mb/d potential production claimed by the Saudis and their peak 10 mb/d production gives some perspective to the Iraqi potential.

How quickly could Iraq boost production? It would seem that three conditions must be met. First, Iraq must settle on a model for obtaining the required technology and skills from foreign operators. Iraqis see the state oil company model all around them and thus may be reluctant to allow private exploitation. On the other hand, Iraq may not have the funds to pay contracting firms to do all the work without giving them an incentive. So a viable business model must be determined and negotiated.

Secondly, Iraq is a founding member of OPEC, which is currently restricting production. It seems clear that Iraq would be constrained from increasing their exports for some time to come. Such a constraint might not prevent them from starting exploitation activities, but it could depress the value of equity incentives they might need to provide to contractors, as discussed above. It may be necessary for the global economy to show signs of recovery before OPEC will lift export quotas, which could be a year or two from now.

Thirdly, Iraq must secure its territory from any substantial risk of terrorist interference with oil production. Such security seems to be emerging, but complete assurance may require a working agreement with Iran which might take some time to negotiate.

In sum, it seems likely that the start of expanded oil production in Iraq may be 2 - 4 years into the future. Iraq claims to aim for production of [1] 6 mb/d by 2013. On the other hand, the O&G piece states that it would take Iraq 15 - 20 years to reach a sustainable output of 10 mb/d. If 15 years are required and 3 years are required before the effort begins, and if the goal is an increase of 7.5 mb/d that suggests a take-up rate of about 400kb/d per year.

Taking all the above into account, and assuming that security turns out **not** to be a problem, it suggests the following median case (not best or worst) rate of increase beyond the current 2.5 mb/d of production:

2009: 0
2010: 0
2011: 0
2012: .4 mb/d
2013: .8 mb/d
2014: 1.2 mb/d
2015: 1.6 mb/d

(about half the increase that Iraq claims it wishes to achieve)

A second report on the same topic was recently [2] published by Reuters. It adds some color to the above, including an emphasis on the current security risks and shortfalls. Here it is:

Iraq oilfields ready for revival, await foreigners

Feb 1, 2009, Reuters

By Mohammed Abbas and Ahmed Rasheed

BASRA, Iraq (Reuters) - Next to a pipeline snaking across a desert in Iraq's south, villas built to house an expected influx of foreign oil workers stand empty.

Nearby, a faded plaque in Russian and Arabic commemorates the opening of a pumping station in 1972, a reminder of the foreign ties that helped Iraq develop its oil industry.

As U.S. President [3] Barack Obama confronts the legacy of a war his predecessor launched almost six years ago, Iraq has once again begun to open its vast oil reserves to foreign companies.

The country has launched a bidding round for some of its largest oil and gas fields, which it hopes will attract multibillion dollar investments. There is still some confusion over the deals, scheduled to be awarded by June.

But a lack of security, rigid bureaucracy and the absence of a legal framework is still deterring the investment Iraq needs to update its decaying oil infrastructure.

"A foreign oil workers' compound, whether Exxon, BP, Shell or whoever, would be a bull's-eye for an attack," said a senior foreign oil executive who declined to be named because he is not authorized to speak to the media.

Foreigners were prime targets in the years of bloodshed unleashed by the 2003 U.S.-led invasion of Iraq, and videos of kidnapped Westerners being beheaded shocked the world.

Iraq sits on an estimated 115 billion barrels of oil, the world's third largest reserves. But tin shacks still line the road to its oil fields, and the government is desperate to use oil income to rebuild the country.

Villas which once housed Russian workers are now in need of a refit and equipment worn down by war, sanctions and sectarian violence is hopelessly antiquated.

Deprived of foreign expertise and money, Iraqi engineers have grown adept at tinkering with old equipment and salvaging spare parts, but their maintenance is only skin deep.

"We painted the tanks, improved the checkpoint, the toilets … simple things, not fundamental things for production," said Khodair Abd, a North Rumaila supervisor.

"There were companies supposed to come here for that, but I don't know what happened … This is the same station that was installed in 1972," he added.

NO MORE EXCUSES

At the South Rumaila oilfield, which has an estimated output of 800,000 barrels of crude per day, a lack of equipment means valuable gas is burned off in huge flares, the smoke streaming like jets of ink into the blue desert sky.

The violence that almost tore Iraq apart in 2006 and 2007 has fallen sharply in the past 18 months and Iraq now believes the time has come for foreign firms to start showing up.

"The excuse of a lack of security has gone. The security situation has transformed, root and branch," said Mohammed Nasser, an engineer at the 1950s-era South Rumaila plant where antique dials, gauges and switch panels sit next to more modern pieces of electronic equipment.

Some foreign firms are taking tentative steps back in.

The Chinese National Petroleum Company (CNPC) started work this year on a $3 billion project in the al-Ahdab oil field in eastern Wasit province, the first foreign firm to begin such work since Saddam nationalized the industry decades ago.

Oil major Royal Dutch Shell Plc in 2008 signed a deal with Iraq to collect the gas by-product of crude extraction that is usually burned off in Rumaila North and South, the country's two most productive fields.

And U.S. firm Weatherford International has a deal to operate in Rumaila North and in the Zubair oil field.

But they have few if any workers on the ground in the country's oil-rich south, which accounts for about 80 percent of Iraq's oil production.

"We probably could do a reconnaissance visit now, but that is very different from sending people in to work at compounds and bases. We're not ready for that," said another oil executive who also declined to be named.

IRAQIS REMAIN CONFIDENT

In spite of such skepticism, Iraqi officials believe the country's oil sector will ultimately prove irresistible.

"International oil companies are killing themselves to sign contracts with Iraq," said Isam al-Chalabi, who was the Iraqi oil minister from 1987-1990.

One of Iraq's greatest allures is the ease with its oil can be pumped. The Oil Ministry has said it only costs around $2 a barrel to extract Iraqi crude.

With oil prices below $50 a barrel, down from a high of $147 six months ago, the low cost of production gives the country a huge advantage over producers who pump their crude out of deep sea wells, for example.

Of the 35 companies qualified for a first bidding round of oil field servicing tenders last year, 30 have paid for technical information about eight oil and gas fields.

"That implies there is a real desire to work in Iraq," Oil Minister Hussain al-Shahristani said when announcing a second round at the end of December.

He did not see any impediment in Iraq's failure to agree on a law to give foreign companies access to profit-sharing deals, clarify taxation, and define how oil resources are divided between Baghdad and the provinces.

He is not the only optimist: "I'm confident Iraq will become a rich oil state and that our grandsons will enjoy a welfare state like they currently do in the Gulf countries," said Sabah Ghani, 65, an Iraqi businessman.

"It won't happen in record time."

(Additional reporting by Simon Webb in Dubai; Writing by Mohammed Abbas; editing by Michael Christie, Nick Vinocur and Sara Ledwith)

[1] 6 mb/d by 2013: http://www.energyinvestmentstrategies.com/2009/01/03/iraq-aims-to-produce-6-mbd-by-2013/

[2] published by Reuters: http://www.reuters.com/article/GCA-Oil/idUSTRE51102W20090202?sp=true

[3] Barack Obama: http://www.reuters.com/news/globalcoverage/barackobama