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Oil in Iraq: The Heart of the Crisis

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Oil is at the heart of the crisis that leads towards a US war against Iraq. For more than a hundred years, major powers have battled to control this enormous source of wealth and strategic power. The major international oil companies, headquartered in the United States and the United Kingdom, are keen to regain control over Iraq's oil, lost with the nationalization in 1972. Few outside the industry understand just how high the stakes in Iraq really are and how much the history of the world oil industry is a history of power, national rivalry and military force.

Why Iraq's Oil is so coveted by the big companies

Oil in Iraq is especially attractive to the big international oil companies because of three factors:

(1)high quality/high value product

Iraq's oil is generally of high quality because it has attractive chemical properties, notably high carbon content, lightness and low sulfur content, that make it especially suitable for refining into the high-value products. For these reasons, Iraqi oil commands a premium on the world market.

(2)huge supplies

Iraq's oil is very plentiful. The country's proven reserves in 2002 were listed at 112.5 billion barrels, about 11% of the world total. With little exploration since the nationalization of the industry in 1972, many promising areas remain unexplored. Experts believe that Iraq has potential reserves substantially above 200 billion barrels. The Energy Information Administration of the US Department of Energy has estimated that Iraqi reserves could possibly total over 400 billion barrels. If new exploration fulfills such high-end predictions, Iraq's reserves could prove close to those of Saudi Arabia, now listed at 260 billion barrels but likely also to go considerably higher as well. The Department of Energy assessment says that:

"Iraq contains 112 billion barrels of proven oil reserves, the second largest in the world (behind Saudi Arabia) along with roughly 220 billion barrels of probable and possible resources. Iraq's true potential may be far greater than this, however, as the country is relatively unexplored due to years of war and sanctions. Deep oil-bearing formations located mainly in the vast Western Desert region, for instance, could yield large additional oil resources (possibly another 100 billion barrels), but have not been explored."
(http://www.eia.doe.gov/emeu/cabs/iraq.html)

On May 22, 2002, Iraqi Senior Deputy Oil Minister gave an interview to Platts, a leading industry information source. Discussing Iraq's estimates of its potential reserves, he told Platts that "The figure we reached and which is widely known, is that we could discover 214 billion barrels of oil in addition to the present proven reserve [of 112 billion]. We are sure of this figure as all available indications and scientific standards say. This means that we will exceed the 300 billion barrels when all Iraq's regions are explored."

Hamud indicated that more reserves were probably to be found. "We have also said on many occasions that we have indications of oil structures--these are only primary indications--estimated to be more than 560 reservoirs that could be oil fields that need digging, appraisal and which we believe have a high potential oil presence. We believe that when we prove all this, Iraq will be the number one holder of oil reserves in the world. We are highly confident of this."

According to Iraq oil expert Mohammad Al-Gallani at British-based GeoDesign Ltd, Iraq has 526 prospective drilling sites, of which only 125 have been drilled. Of those, 90 have proven potential as oil fields, but only 30 have been partially developed and just 12 are on stream. "You can imagine the huge potential that lies there for the future," Al-Gallani told Canadian Press in a story datelined December 14, 2002.

As world demand for oil increases and as oil reserves in other areas decline at a fast rate, oil in Iraq will represent a steadily-larger proportion of the world's total. If Iraq's fields meet high-end estimates in the 3-400 billon barrel range, Iraq's reserves could reach over 30% of total global reserves by mid-century or even before.

(3)exceptionally low production costs, yielding a high per barrel profit
The US Department of Energy states that "Iraq's oil production costs are amongst the lowest in the world, making it a highly attractive oil prospect." This is because Iraq's oil comes in enormous fields that can be tapped by relatively

shallow wells, producing a high "flow rate." Iraq's oil rises rapidly to the surface, because of high pressure on the oil reservoir from water and from associated natural gas deposits.

More than a third of Iraq's current reserves lie just 600 meters (1800 feet) below the earth's surface and some of Iraq's fields are among the world's largest. The fabulous Majnoun Field, not yet in production, is said to hold at least 25 billion barrels. According to Oil and Gas Journal, Western oil companies estimate that they can produce a barrel of Iraqi oil for less than $1.50 and possibly as little as $1, including all exploration, oilfield development and production costs and including a 15% return. This is similar to production costs in Saudi Arabia and lower than virtually any other country.

By way of comparison, a barrel of oil costs $5 to produce in other relatively low-cost areas like Malaysia and Oman. Production costs in Mexico and Russia might potentially be as low as $6-8 per barrel (higher under current production arrangements by local companies).

Offshore production areas like the North Sea, with expensive platforms, can run to $12-16 a barrel. In Texas and other US and Canadian fields, where deep wells and small reservoirs make production especially expensive, costs can run above $20 a barrel. When world market prices dip below $20 a barrel, the North American fields yield no profit at all, and many are capped, while production in an area like Iraq proves extremely profitable in all market conditions.

Oil companies' future profits (and share prices) depend on their control of reserves. In recent years, as older fields have begun to run out, the companies have faced rising "replacement" costs. According to a 2002 report by energy consultants John S. Herold, finding costs for new reserves rose 60% in 2001, pushing replacement costs to $5.31 a barrel. ExxonMobil, BP and Shell are facing this difficulty. Imagine the lure of the vast Iraqi fields, with little prospecting required, offering nearly free acquisition. As Fadel Gheit of Fahnstock & Co. in New York commented in an article in Dawn, Iraq "would be a logical place in the future for oil companies to replace their reserves." http://www.dawn.com/2002/12/15/ebr12.htm Another expert called Iraq an "El Dorado" for the oil industry.

Estimating Profits in Iraq

Oil prices fluctuate widely, so any discussion of financial yield must be based on a long term average price estimate. For this discussion, we will use an average prices of $25 a barrel in real (inflation-adjusted) terms. This average is higher than the average price in recent years, but as oil becomes scarcer, the price should rise steadily and might well reach a far high level than $25. (During 2002, by way of reference, the price of oil has fluctuated between $20 and $30).

We will assume the level of Iraqi reserves at 250 billion barrels (a very conservative estimate) and recovery rates at 50% (also a very conservative estimate). Under those conditions, recoverable Iraqi oil would be worth altogether about $3.125 trillion. Assuming production costs of $1.50 a barrel (a high-end figure), total costs would be $188 billion, leaving a balance of $2.937 trillion as the difference between costs and sales revenues. Assuming a 50/50 split with the government and further assuming a production period of 50 years, the company profits per year would run to $29 billion. That huge sum is two-thirds of the $44 billion total profits earned by the world's five major oil companies combined in 2001. If higher assumptions are used, annual profits might soar to as much as $50 billion per year.

Though such numbers are highly speculative, the oil companies themselves engage in similar exercises, as they develop their global strategies and plan for a flow of profits many years into the future. For instance, two Russian companies, Zarubeshneft and Rosneft, told journalists in 2002 that that they were preparing to develop Iraq's Nahr Umr field that they estimated was worth about $570 billion. This estimate appears too high, based on our assumptions, but they suggest the order of magnitude. Reliable estimates for the value of the fabulous Majnoun field go up to $400 billion and beyond.

If diminishing supplies drive future prices steadily higher or if Iraq's oil reserves prove to be much larger than 250 billion barrels, the profit yield might be considerably greater. On the other hand, a nationalist government in Baghdad that would demand a higher percentage split would reduce the profit potential, as would the development of major alternative energy sources and taxes on carbon-based fuels in response to global warming. Whatever the exact results, and assuming a U.S.-friendly government, it is clear that Iraq is a goldmine that is literally "worth fighting for" in the view of the big companies.

Iraqi Gas Reserves and Pipeline Routes

The same multinational companies that rule the oil industry are also in the natural gas business. Gas is increasingly popular because it burns with less particulate and has a lower carbon content per unit of energy output. Large gas reserves have been discovered in fields in northern Iraq and other gas fields may be found elsewhere in the country. Though Iraq's gas may not prove to be as lucrative as its oil, this resource is also coveted by the companies and could be a source of additional multi-billion dollar profits. In December, 1996, Gaz de France and ENI of Italy formed a consortium to build a pipeline from the Iraqi fields to Turkey, a project that could eventually link up with the European gas grid. But because of the UN sanctions against Iraq, this project could not proceed. In post-war Iraq, the big US-UK companies will seek gas production and transport deals along with oil deals, in hopes of snatching these lucrative prospects away from continental European competitors. Other pipeline projects, to bring gas from Qatar and other Gulf states through Iraq to the European market, are also under study and offer huge profits to whichever companies get permission to build them.

New Oil Company Strategy Aims to Regain Dominance in Production

After the nationalizations that swept the oil producing countries, beginning with Iraq's nationalization in 1972, the oil multinationals lost much of their role in production, known in the oil business as "upstream." Forced to abandon the cornucopia of profits in the Middle East (and to buy Middle East oil on the world market), they developed alternative production in such areas as the North Sea and the West Coast of Africa where production costs were higher and profits lower. They had to shift much of their profit-making to "downstream" activities such as transportation (tankers and pipelines), refining, petrochemicals and retailing. Major national oil companies (such as Kuwait and Venezuela) pursued downstream strategies as well, however, leading to overcapacity and falling rates of return.

By the mid-1990s, the companies began to revise their strategy towards a return to upstream, crude-oil production, pressing oil producing governments to offer production-related arrangements that could give the multinationals a direct share in crude reserves. Such ideas proved controversial and contrary to nationalist public sentiment in the producing countries.

By the end of the 1990s, however, oil-producing governments were mired in political crises, due to corruption, wars, and civil unrest. In Venezuela, Iraq, Algeria, Iran, and other producer countries, the US government appeared to be involved in destabilization measures, deepening existing social instability and what some scholars call "the crisis of the rentier state." Facing domestic unrest and oil production problems, the nationalized companies confront the need for large new investments to preserve production in older fields and to prospect for new reserves. But corrupt and instable governments want to take all the oil revenue stream, leaving little left over for investments. The multinationals argue that their enormous finances, greater technical competence and lower production costs could benefit producer governments, but behind these technocratic arguments lies the threat of further foreign destabilization and even direct military intervention. Clearly, the companies hope to roll the clock back to the "good old days" when they ruled the oil business and gave producer governments only a very small share.

Effects of US-Dominated Iraq on Other Oil Producer Governments

A U.S. client government in Baghdad – or a U.S. military occupation government – would doubtless hand out upstream production concessions to US-UK companies that would set an important precedent in the world oil industry, tipping the balance of power in favor of the companies and away from the producer states. In this way, the war against Iraq would have an effect on the oil industry that would go far beyond the borders of Iraq.

Oil analysts believe that a US-controlled Iraqi government would quickly make deals with the companies for privatized production. Such deals, though possibly agreed-to in advance of the war, would be justified by the new government on the basis that only the companies would be able to quickly resume post-war production, in order to resume exports and buy critical food, medicines, and other humanitarian goods. Further, Iraq's huge needs to rebuild its post-war infrastructure would lead towards high production.

Even before Iraq had reached its full production potential of 8 million barrels or more per day, the companies would gain huge leverage over the international oil system. OPEC would be weakened by the withdrawal of one of its key producers from the OPEC quota system. Indeed, OPEC might face the paradox that a US military government of occupation in Iraq would be an OPEC member! Alternatively, such a government might pull out of the producers' cartel.

This would put pressure on all major oil producers like Kuwait, Iran, Saudi Arabia and Venezuela to de-nationalize their oil companies and offer US-UK companies new concessions or production-sharing agreements that could lead to far higher company profits in these areas. Iran has already made some deals based on a 50/50 split and Saudi Arabia has returned to production sharing in its emerging gas business. US military presence in the Gulf and US clandestine operations to overthrow nationalist governments such as Chavez in Venzuela would increase the pressure. Privatization, even if incomplete, could yield additional tens of billions of profits to the oil companies and would weaken and even destabilize the major oil-producing states. Oil prices might be lowered temporarily to achieve this purpose, then raised later on when a new company-friendly order had been established.

Competition among the Multinational Oil Companies

Five companies dominate the international oil industry, four of them based in the US and the UK. The largest, US-based Exxon Mobil, was the world's most profitable company in 2001 ($15 billion in profits) and the largest industrial company in terms of revenue. The three other companies in order of size are: BP Amoco (UK), Royal Dutch Shell (UK), and Chevron Texaco (US). France's

TotalElfFina ranks in fifth place. Predecessors of these firms controlled nearly all of the Iraq Petroleum Company from the discovery of oil in the late 1920s until nationalization in 1972. The British firms held half of the company, reflecting the dominant colonial position of the UK at that time in the region.

After nationalization, the Iraqis sought to gain greater control of their oil resources. They shunned the UK and US companies, while developing working relationships with French companies and the (Soviet) Russian government.. Just before the Gulf War (1990-91), Japanese companies negotiated for production-sharing contracts in Iraq and were said to have concluded a deal for the Majnoun field, but that deal collapsed due to the US-led war and the subsequent sanctions. During the 1990s, various firms negotiated with the Iraqis in hopes of gaining access to Iraqi oil once the sanctions were lifted. Shell, and possibly other US-UK companies held secret talks that did not succeed. In 1997 TotalFinaElf, China National Oil Company, and Lukoil of Russia signed agreements with the Iraqis for deals worth hundreds of billions of dollars. Lukoil's deal concerned development of the West Qurna field, while TotalFinaElf obtained rights to Majnoun and China Nations to North Rumailah (the latter is the huge field that lies astride the border with Kuwait). A number of smaller companies, mostly Russian but also from Malaysia and other countries, got contracts at about this time.

The US-UK companies, keen to regain their former dominance in Iraq, fear that they would lose their leading role in the world oil industry if these contracts with their competitors come to fruition. France and Russia pose the biggest threat, but serious competitors from China, Germany, Italy and Japan also are players in this sweepstakes. China is especially keen to gain a stake in the region's oil reserves because its rapid economic growth is pushing up its oil consumption. Chinese economists estimate that China may have to import as much as 5.5 million barrels a day from the Gulf by 2020.

The US-UK companies strongly favored the sanctions, as a means to hold their competitors at bay (and hold down excess production on the world market), but weakening sanctions in the late 1990s threatened their future prosperity. The companies are nervous but enthusiastic about Washington's war option, for it seems to be the only means left to oust their rivals and establish a dominant presence in the fabulously profitable future of Iraq oil production.

It appears that the Washington has used its post-war control over Iraqi oil to win over opposition in the UN Security Council. Discussions over access to future oil production in Iraq have apparently been going on between Washington, London, Moscow, Paris and Beijing and also between the companies directly. Many news stories have suggested that these parleys have taken place and statements by government leaders have underscored the importance of the oil issue.

"We will review all these agreements, definitely," said Faisal Qaragholi to a Washington Post reporter in September. Quaragholi is a petroleum engineer who directs the London office of the Iraqi National Congress (INC), an umbrella organization of opposition groups that is backed by the United States. "Our oil policies should be decided by a government in Iraq elected by the people."

Ahmed Chalabi, the INC leader, went even further, saying he favored the creation of a U.S.-led consortium to develop Iraq's oil fields, which have deteriorated under more than a decade of sanctions. "American companies will have a big shot at Iraqi oil," Chalabi said. Such statements have deepened the fears of the non-US-UK companies and pressured them to go along with the US war plans in order to get a share of the post-war concessions.

Business news agency Reuters, in a story datelined December 15, 2002, put the matter bluntly when it wrote "Iraq's crude reserves, the world's second largest after Saudi Arabia, are at the center of a tug-of-war between countries hoping to grab a share of Baghdad's oil wealth once United Nations sanctions are lifted."

Free Market Forces vs. Government Intervention and Military Might

The specially high rate of profit (or "rent" as it is sometimes called by economists who study the oil sector) results from the unusual monopolistic structure of the oil industry and its unusual pricing system. From the earliest days in the 1870s, when John D. Rockeller built the Standard Oil Trust, a relatively small number of major companies have controlled world production and prices. These companies have tried to keep prices and production at a controlled level – to maximize their profits. The industry has always relied on close ties to governments. Governments have helped to maintain favorable market conditions, to promote managed pricing and to help the companies gain new sources of supply in foreign lands.

In the early decades, the Standard Oil Trust completely dominated the international oil markets, and US production represented a very large share of the world's total. During World War I, US oil supplied an estimated 80% of the Allies' needs. But by the end of the war, the British had built alternative companies – the Anglo-Persian Oil Company (later BP) and Royal Dutch Shell, which together controlled more than half of the world's oil reserves. US companies feared that the British, through exclusionary policies in their empire, were going to dominate the world's oil industry. British government purchase of the Anglo-Persian Oil Company (now BP) in 1914 confirmed these fears. And British firms' leading role in Venezuela brought the competition right into the backyard of the American companies.

Throughout the inter-war period and up to the present the US and the UK have dominated the international oil industry, always in rivalry but also in collusion. The companies in these two countries have towered above those of all other nations. Bids by Japan, Germany, Italy, Russia and France to gain a major stake in the industry have largely failed, though a single large French company remains the sole challenger today to Anglo-American domination.

The Anglo-American companies have always sought to manage global oil output, though collusive agreements. In 1928, they reached the famous "Red Line Agreement" on joint action in the Middle East and the "Achanarry Agreement" to divide up (and avoid competition in) international markets. These agreements have maintained the extraordinary "rent" of Middle East producers, while supporting continued high-cost production in the United States and Canada. If oil markets functioned "normally," production would increase in the low-cost areas like Saudi Arabia, Kuwait, Iran and Iraq, driving out of business the low-cost producers in North America, but this has not been the case.

Because of the enormous value of oil concessions and the high "rent" that results from low-cost fields, oil concessions are rarely allocated on a purely "market" basis. The companies typically win the most lucrative concessions through their host governments' political and military power.

Imperial Control and Local Opposition: Will the US Iraq Plan Succeed?

The long, bitter experience of oil producing countries with the US-UK companies has left behind an anger and militancy in local politics that hinders the companies' efforts to re-organize the "upstream" system. Such feelings run deep in Iraqi politics, going back to British seizure of Iraq after World War I and the bloody repression (including the use of poison gas) that crushed the nationalist revolt of 1920. British leaders fulminated against "Turkish misrule" in Iraq, but their own rule proved equally odious to Iraqis seeking independence and democracy.

Iraqis also remember the way the companies treated the country after it gained its independence and how the companies held Iraqi production down, to manage international supply and price levels. Iraqi's also remember the fierce company resistance to Iraqi proposals for new exploration contracts in the 1960s. Such sentiments would doubtless not change after the ouster of Saddam Hussein.

These feelings are magnified by US support for Israel and by the long, punishing US-UK-UN sanctions. The US-UK would thus find it very politically difficult to create an indigenous post-Saddam government that would agree to a sweetheart deal for the US-UK companies. For this reason, the US-UK have announced that they are planning a military government that will "purge" Iraqi politics of its

Baathist and nationalist elements and remain in power more than a year or as long as necessary. Though the US-UK official announcements speak about "human rights" and "democracy," it would appear that the main goal of the war and "regime change" is to carry out the oil deals and re-fashion Iraqi politics on a new and more conciliatory and pro-US basis. Scenarios circulating in Washington talk about rapid military seizure of the oil fields, rebuilding oil infrastructure and protecting the oil production system from the negative effects of local politics.

Oil Companies in Iraq: A Century of Rivalry and War (November 2003)
Iraq: the Struggle for Oil (August, 2002)
The Iraq Oil Bonanza: Estimating Future Profits (January 28, 2004)