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**E-mail Message**

**From:**

**To:**

**Cc:**



**Sent:** 06/09/2004 at 16:33  
**Received:** 06/09/2004 at 16:36  
**Subject:** Re: RESTR: Energy Strategy for Iraq

**Attachments:** oil policy doc.doc  
oil policy - executive summary.doc

<> <>  
Dera All,


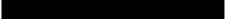
Many thanks for your comments on this.

Attached is a final version and also a one page summary covering the short-term outcomes for oil/energy we want to see before elections in Jan 2005. Very much a working document so please shout if further work is needed or new developments come to light.

I will follow specific points up with you separately as necessary.



Economic Section  
Iraq Policy Unit  
Foreign and Commonwealth Office

Tel   
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**UK ENERGY STRATEGY FOR IRAQ**

D04/594350 – Attachment 1

**OBJECTIVES**

1. Our mutually enforcing objectives are:
  - i) The development of an efficient, outward-looking and transparent oil and energy industry, capable of delivering both sustainable export revenues to meet Iraq’s development needs and meeting domestic needs for energy in an efficient, equitable and secure manner.
  - ii) Iraq’s energy sector development to be complemented by the increasing involvement of UK firms, leading to sustained investment over the next 5 to 10 years and substantial business for the UK.

**CONTEXT**

2. Iraq now has full control over its natural resources and control of oil revenues as reaffirmed in United Nations Security Council Resolution 1546 of 8 June 2004. CPA advisors have left - although some remain attached to the US-run Iraqi Reconstruction Management Office

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The IIG has taken its first step in institutionalising oil policy by establishing a Supreme Council for Oil and Gas, chaired by the Deputy Prime Minister and consisting of the Ministers of Oil, Finance, and Planning and Development Co-operation. It therefore appears that the Iraqi Ministry of Oil (MoO) will take the lead in running the daily affairs of the oil sector whilst the Supreme Council will supervise and approve medium and long-term strategy and approve major investments and their financing.

3. The successful development of Iraq’s oil sector is dependent on continued progress on the political front and an improvement in security. The Iraqi Interim Government (IIG) will remain in office until elections in January 2005 for a Transitional Government. The IIG is constrained (as determined in the Transitional Administrative Law) in its ability to make decisions affecting Iraq’s long-term destiny.

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Key strategic decisions are therefore not likely to take place until after January 2005. This however should not rule out detailed plans being drawn up and announcements being made. Full national elections are to be held for a new representative Iraq by 31 December 2005. It is not likely to be until after this date that the full complement of legal, regulatory, and fiscal reforms affecting the oil industry are finally implemented and production goals are set for the medium and longer term. This timetable is likely to lead to delay in reform and will pushback large-scale investment by the International Oil Companies (IOCs). Any slippage in the political process would result in further delay.

4. Progress will also require a sustained reduction in the number of terrorist attacks and acts of sabotage on the oil infrastructure. Such attacks come at huge cost to

the national budget, the repair and rehabilitation of the infrastructure itself, and in fostering the required climate for investment by the IOCs.

## KEY CHALLENGES



5. To meet our objectives the principal challenge for Iraq's oil industry will be to institute the necessary structural, fiscal and regulatory reform needed to attract foreign direct investment (FDI) into the sector. It has been estimated that USD 20 billion would be needed to increase oil production from present levels (2.0-2.5 million barrels per day) to 4 million barrels per day, and up to USD 50 billion were production to rise to 6 million barrels per day. In the absence of a very high oil price, Iraq would only be able to finance this investment if it achieves a very generous debt deal and is prepared to make substantial cuts in government spending in other areas. Given that it is not realistic to cut government spending, Iraq will need to engage with the IOCs to do this. Without this there will be no rapid rehabilitation or significant new development.
6. Improved energy sector governance also remains key to achieving our objectives<sup>1</sup>. Some groundwork was laid in this area by the CPA but further work needs to be done to ensure these principles are embedded in all areas of oil sector operations. Reform will need to be sensitive to the need of IOCs to manage their reputational risk when considering where and to what extent to invest. Reform should therefore be initiated inline with international best practice and in accordance with initiatives aimed at promoting transparency and ethical business practice in the extractive industries.

## KEY CONSIDERATIONS

7. Iraq is extremely important to the UK's objectives on energy security. Iraq is generally accepted to have the second or third largest proven oil reserves in the world (estimated at around 112 billion barrels) and considerable potential in unexplored areas of the country (possibly another 100 billion barrels or more). Iraq also has significant reserves of natural gas (estimated at 2 percent of world reserves) which remain largely untapped. Iraq also has a role to play in the world oil/energy market. Sustainable increases in Iraqi oil and gas production would make a large contribution to global energy security.
8. The idea that Iraq's energy development needs are best served through FDI will be politically sensitive, both in Iraq – touching on issues of sovereignty – and internationally. The Iraqis will be aware of the scale of funding needed but less convinced of the need for this from foreign capital. We will wish to push the message on FDI to the Iraqis in private, but it will require careful handling to avoid the impression that we are trying to push the Iraqis down one particular path.

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<sup>1</sup> It is likely that the future scale of investment in the hydrocarbon sector over the next 20 years may be served by non-traditional financing methods, such as project bonds or the participation of very large investment funds. In these areas knowledge of international investment norms and appetite for risk are particularly low. This heightens the need for high levels of governance and transparency of process.

9. Iraq's relationship with OPEC will also be important<sup>2</sup>. Although Iraq remains a member, its production has been independent of OPEC quotas since the first Gulf War and there has been no call yet from other OPC countries for Iraq to be reintegrated into the quota system. This could happen as early as 2005 but equally it might not happen for several years. If a decision were made to reintroduce a quota there would be implications for how much and when FDI would be needed. In this case, although continued investment would be required to maximise exploitation of existing fields, the need for large-scale international investment in the immediate term could be significantly less.
  
  10. A modernised, transparent and investment friendly energy sector in Iraq will be a strong exemplar to other Middle East oil and gas producing countries. We should encourage the strengthening of Iraq's economic and trade ties with its neighbours and other countries in the region to help promote stable economic and political systems. Iraq's main export route for oil is through terminals in the Persian Gulf and the Kirkuk-Ceyhan pipeline through Turkey. There are also oil pipelines through Syria and Saudi Arabia that are currently closed. Iraq will also look towards its neighbours as markets. Tamir Ghadban and his Syrian counterpart are reported to have set up a joint committee to examine increased co-operation in energy, in particular the export of Iraqi oil in exchange for oil products (benzene, kerosene, and liquid gas). Iraq is also reported to be looking to export more crude oil to Jordan and Lebanon. There is also potential for oil for electricity swaps (for example with Kuwait) which should be encouraged where possible.
  
  11. Oil development will also raise political questions about the control of resources within Iraq and between regions. Under Iraqi law all natural resources are property of the national government and only it has the power to conclude agreements for the development of these resources. 
- FOI: 27**
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12. Our wider energy policy objectives for Iraq need to be dovetailed with commercial goals to ensure the best overall result for the UK national interest. The two sets of goals of goals are mutually enforcing given the need for foreign investment. Iraq's energy sector will provide considerable market opportunities for UK firms and the export of UK equipment, services and best practice.
  
  13. Fiscal stability is also important. Economies that rely wholly, or to a large degree, on oil revenues to fund their national budget need mechanisms (such as a stabilisation or savings fund) for ironing out the fluctuations in oil prices and export volumes that inevitably occur. Given Iraq's high level of debt and the continuing need to finance reconstruction this is likely to be more of an issue for

<sup>2</sup> A sudden break-up of OPEC would not be in the UK's interest since it would add to oil market and geopolitical instability. Joint FCO/DTI/HM Treasury analysis in late 2002 concluded that it would be preferable that Iraq remained within OPEC, but that its future production levels are such that they put pressure on OPEC in terms of the price levels it is able to target.





highlighted in the BearingPoint report presented to the MoO in December 2003 and of work by Terry Adams and Bob Morgan.

- **Development of a transparent fiscal and regulatory structure governing the oil sector** – To attract international financing and investment Iraq will need to develop a sound fiscal and legal/regulatory framework. There is an opportunity for the UK to assist and advise on best practice and possible forms of organisation. Our objective is to see the basic principles being established now, approved by the Supreme Council.
- **Energy price reform** – To push for movement in gasoline prices and support an initial increase in the price of gasoline to 100 ID. We should advocate a small but symbolic increase in the price of diesel by 10 or 20 ID. We are not in favour of increasing the price of kerosene and LPG until there is a compensation mechanism in place. The obvious compensation mechanism would be through the establishment of a cash payment system following monetisation of the food basket. This would allow for comprehensive energy price reform over the medium term without reducing the income of the poor.
- **Improved Iraqi technical capabilities in reservoir and refinery management** – This is being addressed on the refinery side with Iraqi delegates attending a Refinery Optimisation Workshop in the UK in October. It is also important that we establish Iraqi capability in reservoir management to help their ability to exploit oil fields to maximum effect.

#### Medium-term outcomes (January – December 2005)

- **Implementation of a transparent fiscal and regulatory structure governing the oil sector**
- **Refining capacity** – An increase in refining capacity and reduction in dependency on fuel imports. There is a need to restore refineries to maximum capacity in order to reduce the import bill and ease external dependence on refined oil. We will need to reassess training needs in this area following the Refinery Optimisation workshop in October 04.
- **Energy price reform** – The implementation of a comprehensive domestic energy price reform programme, aimed at cutting subsidies and ensuring fiscal sustainability and more effective use of Iraqi resources, while protecting the living standards of the less-well off.
- **Preliminary development of Iraq's gas potential** – The MoO has said that development of natural gas is one of its highest priorities and is reported to be planning development of Iraq's first natural gas field near Kirkuk. Given Iraq's gas reserves it has considerable potential to contribute to Iraq's development and UK objectives on energy security (and Europe's need for gas). There is also the potential to use pipelines to create positive bonds with neighbouring countries.

The lead-in time for either gas pipelines or liquefaction plants to be built will be significant. We will need to consider in future options for a UK gas strategy on Iraq. We should also keep abreast of IOC plans to help the Iraqis with a gas plan. In formulating a gas strategy we would need to distinguish between three aspects:

- i) Development of Iraq's gas industry for domestic purposes. In the nearer-term we want to see substitution of gas for oil in domestic power generation.
- ii) Development of Iraq's gas infrastructure for export
- iii) Development of the regional market for gas

**Long-term actions (after January 2006)**

- **Realistic and sustainable production plan drawn up for the next 5 to 10 years**
- **Full implementation of fiscal and regulatory structure governing the oil sector**

**Ongoing and overarching priorities**

- **Increased engagement by UK companies leading to substantial and sustained investment over the next 5 to 10 years**
- **An Iraqi workforce that is effectively trained and equipped to meet the demands of running a modern, out-ward looking and transparent oil industry** – The UK to be established as a preferred centre for Iraqi higher education and effective links to be built on the oil side with the next generation of potential influence makers.
- **System of fiscal flows between MoO and Ministry of Finance in place along sensible economic lines. Continued central control over oil revenues by MoF to manage fluctuations in the oil price and ensure fair distribution of national wealth.**

**IRAQ: UK STRATEGY FOR THE OIL SECTOR**

OUTCOMES	UK PRIORITIES/ACTION	RISKS	TIMING (Assumption: Transitional Government elected January 2005, elections to a fully sovereign Iraqi government December 2005)
<p><b>Short-term outcomes (now – January 05)</b></p>			
<ul style="list-style-type: none"> <li>➤ Effective working relationship built up with Supreme Council on Oil and Gas and the MoO</li> </ul>	<ul style="list-style-type: none"> <li>➤ Supreme Council fully aware of UK work conducted by Bob Morgan and Terry Adams</li> <li>➤ UK effectively positioned to provide advice</li> </ul>	<ul style="list-style-type: none"> <li>➤ Little attention given to longer-term strategic issues by the Supreme Council and MoO</li> </ul>	<ul style="list-style-type: none"> <li>➤ Immediate</li> </ul>
<ul style="list-style-type: none"> <li>➤ Decision taken on restructuring of the oil sector                             <ul style="list-style-type: none"> <li>- Separation of powers between the Oil Ministry and National Oil Company (NOC)</li> <li>- Restructuring of oil companies into single NOC                                     <ul style="list-style-type: none"> <li>- North and South Gas</li> <li>- Companies combined into single National Gas Company</li> </ul> </li> <li>- Iraq's refineries combined into National Refining Company</li> </ul> </li> </ul>	<ul style="list-style-type: none"> <li>➤ Continue to provide advice on possible forms of organisational structure</li> <li>➤ Use of Ministerial/Senior Official visits to share information and build influence</li> <li>➤ Blueprint agreed and ready in time for the Transitional Government to consider post-elections</li> </ul>	<ul style="list-style-type: none"> <li>➤ Entrenched interests/corruption continue to make change difficult</li> <li>➤ Opposition from the regions who may want a model based on continued decentralisation</li> </ul>	<ul style="list-style-type: none"> <li>➤ Thamir Ghadban expected to make an announcement on this soon. We should push to see such an announcement by the end of 2004. Our objective should be to see implementation of the plans for restructuring in 2005 and 2006</li> </ul>
<ul style="list-style-type: none"> <li>➤ Model for future fiscal and legal/regulatory framework agreed</li> </ul>	<ul style="list-style-type: none"> <li>➤ Possible role for Philip Danie/Terry Adams and other UK consultants</li> </ul>	<ul style="list-style-type: none"> <li>➤ Model agreed but inertia/intra-Ministry politics leads to non-</li> </ul>	<ul style="list-style-type: none"> <li>➤ Should assist if asked with MoO planning immediately. Full</li> </ul>



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<p>which will give oil majors a clear idea of the basic legal and fiscal features of the new oil regime (leading to the below)</p> <ul style="list-style-type: none"> <li>➤ Reduction in attacks on Iraq's oil infrastructure</li> </ul>	<ul style="list-style-type: none"> <li>➤ Commercial terms of contract/engagement competitive with other global opportunities</li> <li>➤ Reporting on state of current oil infrastructure and nature of attacks on the infrastructure</li> <li>➤ Continue close cooperation with infrastructure security forces</li> </ul>	<ul style="list-style-type: none"> <li>➤ implementation</li> <li>➤ Too heavy focus on increasing oil production by the MoO without thought to longer planning</li> <li>➤ Large-scale terrorist/insurgent attack</li> <li>➤ Inadequate security protection</li> </ul>	<p>implementation to begin in 2005 2006</p>
<ul style="list-style-type: none"> <li>➤ Adoption of internationally accepted principles of good governance identified in the BearingPoint study and work by Terry Adams and Bob Morgan. The development of a stable, transparent and corruption free management of the oil/energy sector</li> </ul>	<ul style="list-style-type: none"> <li>➤ Iraqi endorsement of principles and actions of the Extractive Industries Transparency Initiative and other initiatives such as the G8 Anti-Corruption and Transparency Initiative</li> <li>➤ World Bank involvement</li> </ul>	<ul style="list-style-type: none"> <li>➤ Entrenched interests/corruption continues to make implementation of change difficult</li> </ul>	<ul style="list-style-type: none"> <li>➤ Good governance guidelines documents produced under CPA awaiting implementation by MoO. Objective to see the results of this during 2005 but should push to see that key principles are reflected in MoO policy statements/work plans in the short-term</li> </ul>
<ul style="list-style-type: none"> <li>➤ Installation of oil meters on all Iraq's wellheads providing for the transparent measurement of oil production to accepted international standards</li> </ul>	<ul style="list-style-type: none"> <li>➤ Lobbying by UK</li> <li>➤ Press for contracts for metering to be issued</li> </ul>	<ul style="list-style-type: none"> <li>➤ Delays in issuing contracts</li> <li>➤ Problems in securing financing/Letters of Credit</li> </ul>	<ul style="list-style-type: none"> <li>➤ Continued lack of metering leaves open possibility for smuggling and corruption. We should push to see this resolved by the end of 2005</li> </ul>

<ul style="list-style-type: none"> <li>➤ Improved Iraqi technical capabilities in reservoir and refinery management</li> </ul>	<ul style="list-style-type: none"> <li>➤ Medium-term priorities in this area addressed</li> </ul>	<ul style="list-style-type: none"> <li>➤ Training needs not adequately identified</li> </ul>	<ul style="list-style-type: none"> <li>➤ Refinery Optimisation Workshop taking place in October</li> </ul>
<ul style="list-style-type: none"> <li>➤ An increase in the price of gasoline to around 100ID</li> </ul>	<ul style="list-style-type: none"> <li>➤ Refer to the DfID advisor on energy price reform</li> </ul>	<ul style="list-style-type: none"> <li>➤ Reform difficult because of security and political concerns</li> </ul>	<ul style="list-style-type: none"> <li>➤ We want to see the IIG making a move on this immediately</li> </ul>
<p><b>Medium-term outcomes (January 2005 – December 2006)</b></p>			
<ul style="list-style-type: none"> <li>➤ First stages of implementation of fiscal and regulatory structure governing the oil sector</li> </ul>	<ul style="list-style-type: none"> <li>➤ Adherence to principles of good governance/best practice</li> </ul>	<ul style="list-style-type: none"> <li>➤ Implementation becomes bogged down due to vested interests/in-fighting</li> </ul>	<ul style="list-style-type: none"> <li>➤ Implementation to begin during 2005</li> </ul>
<ul style="list-style-type: none"> <li>➤ Improved reservoir management of Iraq's Oil fields</li> </ul>	<ul style="list-style-type: none"> <li>➤ Optimal field recovery of oil</li> </ul>	<ul style="list-style-type: none"> <li>➤ Poor management of oil fields under Saddam/the CPA</li> <li>➤ Insufficient technical capacity in Iraq</li> </ul>	<ul style="list-style-type: none"> <li>➤ Requires immediate engagement with MoO and other players to establish extent of mismanagement and necessary course of action</li> </ul>
<ul style="list-style-type: none"> <li>➤ Increased refining capacity and reduced dependency on fuel imports</li> </ul>	<ul style="list-style-type: none"> <li>➤ Budgetary cost of fuel imports reduced</li> <li>➤ Implementation of fuel price reform</li> </ul>	<ul style="list-style-type: none"> <li>➤ Problems in securing financing/Letters of Credit</li> <li>➤ Sabotage to existing refining capacity</li> </ul>	<ul style="list-style-type: none"> <li>➤ Stated priority for the MoO. MoO to make a decision shortly on whether to enact or re-tender contract for construction of new central refinery. Given the scale of development needed and the capital costs involved likely to be a medium to long-term objective</li> </ul>
<ul style="list-style-type: none"> <li>➤ Preliminary development of Iraq's gas fields and reduced wastage of associated gas from oil fields</li> </ul>	<ul style="list-style-type: none"> <li>➤ Encourage the substitution of gas for oil in domestic power generation.</li> <li>➤ Options considered for UK Gas Strategy on Iraq.</li> <li>➤ Consider options for export routes for gas, taking into account security, efficiency, and political dynamics</li> </ul>	<ul style="list-style-type: none"> <li>➤ Iraq may have to prioritise between oil and gas development, particularly without significant involvement by IOCs</li> </ul>	<ul style="list-style-type: none"> <li>➤ MoO planning to develop first natural gas field near Kirkuk – announcement due before end of the year</li> </ul>



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		2005, and 6 mbpd over a 5 year time period	
<p><b>Ongoing and overarching outcomes</b></p>			
<p>➤ System of fiscal flows between MoO and Ministry of Finance in place along sensible economic lines. Continued central control over oil revenues by MoF to manage fluctuations in the oil price and ensure fair distribution of national wealth</p>	<p>➤ MoO pushes for greater autonomy in determining expenditure ➤ MoF inflexible in considering requests for financing. Other more immediate (but not necessarily more critical) funding needs to take priority</p>	<p>➤ Financing for oil sector rehabilitation and development projects part of consolidated budget process ➤ Securitisation of oil assets discouraged ➤ IMF/World Bank involvement</p>	<p>➤ Ongoing</p>
<p>➤ An Iraqi workforce that is effectively trained and equipped to meet the demands of running a modern, outward looking and transparent oil industry</p>	<p>➤ Resource constraints ➤ Duplication of efforts with other countries/international organisations</p>	<p>➤ Needs effectively identified, including lower down the MoO ➤ Continued support to management and technical education programmes ➤ Joint IOC/Chevening initiatives ➤ Need for English language training as a precursor to technical training.</p>	<p>➤ Ongoing</p>
<p>➤ Increased engagement by UK companies leading to substantial and sustained investment in up and downstream projects over the next 10 years.</p>	<p>➤ Security situation continues to make the operating environment difficult ➤ Inability to achieve a legitimate Iraqi authority ➤ Political sensitivities of exploitation of Iraq's resources by IOCs</p>	<p>➤ Consider what help should be provided to UK companies in-country ➤ Provide guidance on the evolving political process and the security situation ➤ Organisation of trade missions, conferences ➤ Informing UK companies of potential commercial opportunities ➤ Using Ministerial/Senior Official visits to promote involvement by UK companies</p>	<p>➤ Elections successfully by end January 2005 to for a Transitional Government should give UK companies/UK oil majors a clearer horizon for investment. Full-scale engagement not likely to take place until 2006</p>



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**UK ENERGY STRATEGY FOR IRAQ**

Record: D04/594350-  
All redactions are under FOI: 40  
unless indicated otherwise

Objectives:

*i) An efficient, outward looking and transparent oil and energy industry, capable of delivering both sustainable export revenues to meet Iraq's development needs and meeting domestic needs for energy in an efficient, equitable and secure manner.*

*ii) Iraq's energy sector development to be complemented by the increasing involvement of UK firms, leading to sustained investment over the next 5 to 10 years and substantial business for the UK.*

The revitalisation and development of Iraq's oil and energy sector is extremely important to the UK's objectives on energy security. Iraq will not be able to finance this development alone. The principal will be for Iraq to institute structural, fiscal and regulatory reform needed to attract foreign direct investment. Improved energy sector governance – inline with international best practice – also remains key. The Ministry of Oil (MoO) has the lead in running the daily affairs of the oil sector. A Supreme Council for Oil and Gas has been established to approve medium and long-term strategy and approve major investments and financing. Securing our objectives will require careful handling but the UK is well placed to influence and to help with MoO planning.

To meet our objectives in the short-term (before elections for a Transitional Government in January 2005) our focus is on:

- 1. Influencing the Supreme Council on Oil and Gas and our relationship with the MoO. Areas for UK assistance to be explored*
- 2. Separation of powers – Pushing the MoO to make an announcement by the end of 2004 on establishing an National Oil Company separate from the Ministry*
- 3. Good governance – Adoption of principles highlighted in the BearingPoint report and work by UK consultants Terry Adams and Bob Morgan*
- 4. Ensuring the basis principles of a transparent fiscal and regulatory structure governing the oil sector established and approved by the Supreme Council*
- 5. Movement on fuel subsidy price reform – An initial increase in the price of gasoline to ID 100*
- 6. Improved Iraqi technical capacity in revenue and refinery management*