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INTERNATIONAL BUSINESS; Iraq Is Strategic Issue for Oil Giants, Too

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Even though Iraq has the world's second-largest oil reserves, after Saudi Arabia, oil companies do not expect to reap the benefits quickly if Saddam Hussein is ousted.

Those companies, of course, admit they are eager to develop Iraq's oil fields, but they see Iraq as one more oil-rich country that will deal with them only on the toughest terms.

''For any oil company, being in Iraq is like being a kid in F. A. O. Schwarz,'' said one senior European oil executive. ''The Iraqis need the foreign money and technology, and they will have to go to the international oil companies for that. But oil is their blood, and they won't give the shop away.''

Oil companies, industry executives and experts say, will be reluctant to invest in Iraq unless they have a wide range of guarantees. On the broadest level, foreign oil concerns question how stable Iraq would be after a war.

More to the point, executives and analysts say, oil companies worry about how the Iraqi oil industry would evolve. In what oil fields would the Iraqis want foreign involvement? What kinds of contractual terms would any new Iraqi government offer? What legal protections would companies working in Iraq have.

What is already apparent is that within the Iraqi oil bureaucracy, ''there is close to unanimity'' that ''natural resources should remain under the sovereignty of the state,'' according to a recent paper presented at an energy conference in Houston by Issam A. R. al-Chalabi, a former Iraqi oil minister and now an independent consultant based in Amman, Jordan.

''Foreign oil companies are definitely interested in Iraq, but they agree that it will take a while to get there,'' Mr. Chalabi said in a telephone interview. ''The current mood among oil companies is to wait and see. They're not in a hurry. Rather, they're waiting for the picture to become clearer. And I don't blame them.''

International oil companies already understand that getting a piece of the most promising oil fields in the world, in places like Russia and the Middle East, is as easy as trying to dig out of prison with a spoon, and oil industry executives said they expected such difficulties in Iraq.

In the Persian Gulf particularly, where oil is the primary source of income, most nations drive an exceedingly hard bargain with foreigners. For example, despite years of negotiations, deals to develop natural gas fields in Saudi Arabia and oil fields in Kuwait remain distant. Such limited access to the world's best new fields has meant that the global oil giants find it harder every year to increase their production substantially.

''The Iraqis may be caught between two tendencies: speed, which means attracting oil companies as soon as possible and that means offering favorable terms, and nationalist feeling,'' said Vera de Ladoucette, a senior director at Cambridge Energy Research Associates, a consulting group that sponsored the Houston conference. ''It requires finding a balance between attracting the oil companies and keeping as much for Iraq as possible. And that is a fine balance.''

Under the United Nations oil-for-food program, which determines how much oil Iraq can export, Baghdad negotiated production-sharing contracts in the mid-1990's with several oil companies, including Lukoil of Russia and TotalFinaElf of France, before coming back and negotiating new contracts under much tougher terms, Ms. de Ladoucette said. (Those contracts, experts say, are likely to be reviewed by any new government in Baghdad.)

Such a hard-nosed approach to foreigners, regional experts say, reflects Iraq's difficult history developing its oil industry. And it may augur how the Iraqi oil establishment, if most of it remains intact after a war, would continue to deal with outsiders.

Under a 1920 treaty between France and Britain, the British were essentially given control over Iraq's oil reserves. For decades, the ancestors of some of the world's largest oil companies, like Exxon Mobil, the Royal Dutch/Shell Group, BP and TotalFinaElf, developed Iraq's oil. At the same time, a parallel Iraqi oil industry gained expertise by sending engineers and geologists to study abroad. Gradually, Iraq wrested control from foreign companies, culminating in the nationalization of foreign holdings in the early 1970's.

But Iraq did allow foreigners to continue limited work in its fields until the Persian Gulf war, mainly as oil field service companies, said Mr. Chalabi, who was ousted as minister in 1990 but retains close contact with the Iraqi oil industry.

Since 1968, Iraq's oil potential has been nurtured by its government oil concern, the Iraq National Oil Company, considered by most in the international oil industry as among the world's more capable state-run companies. Unlike employees of other government-held oil companies, employees at Iraq National built their careers on merit, not on political affiliation, said Raad Alkadiri, a director at PFC Energy, a consulting group in Washington.

Even during the lean last decade, under United Nations sanctions, the engineers have kept fields pumping, despite the damage from the gulf war and, since then, the severely limited access to technology and spare parts.

''Foreign companies recognize that as far as Iraqi oil technocrats are concerned, the production risks are minimal, and consequently the kind of terms that will be offered on contracts are not going to be giveaways,'' Mr. Alkadiri said. ''The Iraqis will strike a hard bargain.''

But Iraq has long known that the challenges it faces are so formidable that significant foreign help is needed.

Iraq's major oil fields, like Kirkuk in the north and Rumaila in the south, form a belt along the border with Iran and have been producing for decades. Fields still to be explored are in the western desert, near Jordan. Based on data gathered before the gulf war, the country has 112 billion barrels of proven reserves. But according to Mr. Chalabi, ''there are only 15 developed fields out of 73 discovered.''

Before the gulf war, Iraq had a production capacity of 3.8 million barrels a day; that has fallen to about 2.8 million, Mr. Chalabi wrote. The fields that are working -- along with the pumping stations, pipelines, refineries and ports -- are in dire need of rehabilitation. That task, industry experts say, will probably be the industry's first priority if Mr. Hussein is ousted.

The shortage of parts and technology forced Iraqi oil workers to resort to pumping methods that kept the oil flowing but badly damaged oil reservoirs. Analysts said restoration of fields and facilities would probably be the first opportunities open to foreign concerns, mainly the oil field services companies like Schlumberger and Halliburton. In a report in October, Deutsche Bank estimated that about $1.5 billion would need to be spent at the outset to restore fields that are now producing.

Some critics and some supporters of a possible war have said that if the United States removes Mr. Hussein, Iraq will be compelled to open the taps, causing oil prices to fall sharply. But for oil facilities to be repaired, some might have to be shut first, and Iraqi production could actually decline, industry experts say. That reduction of supplies, in turn, might buoy short-term oil prices.

For global oil companies, the true prize would be working on large new fields -- and Iraq promises plenty of those. Mr. Chalabi, in his paper, wrote, ''Iraq has the potential to produce 4.7 million barrels a day more oil from discovered fields that are ready to be developed.''

With the right investments, Iraq could be producing around six million barrels a day by 2010, he estimates. Actual production might be lower if Iraq remains a member of the Organization of the Petroleum Exporting Countries and accepts tight export quotas to try to help bolster prices.

Yet any new development would require substantial investment, and few experts venture to estimate how much would be needed. And oil companies say they expect the Iraqis to look at the rest of the world to figure out what kind of contracts they should offer foreigners.

According to Mikhail Khodorkovsky, chief executive of Russia's largest oil company, Yukos, the Iraqis could opt to lease fields in blocks, as the Norwegians do. But it is more likely, he and other experts say, that Iraq would look at what its neighbors are doing in the Persian Gulf and take that as an example. If that proves to be the case, international oil companies may have to wait years for favorable terms to develop new fields in Iraq.

After the gulf war, Kuwait welcomed Western oil field service companies to rebuild wells and facilities destroyed by the Iraqi army and allied bombing. Little has happened since. In the late 1990's, Kuwait began an effort to work with Western oil companies like Exxon Mobil and BP to more than double the production of its northern fields, to about 900,000 barrels a day from about 400,000 barrels. But the effort has stalled in the Kuwaiti Parliament, and no contracts have been signed.

With the blessing of Crown Prince Abdullah, Saudi Arabia began negotiations four years years ago with three oil consortiums to develop several large natural gas fields. Many oil companies jumped at the chance, because they thought it might be the first step to winning contracts someday to work on Saudi Arabia's huge reserves. Yet despite the high-level backing, the talks have slowed to a glacial pace, largely because of the resistance of the Saudi state oil company, industry experts say.

Around the world, oil-rich countries guard their resources jealously. Mexico, for example, issues contracts to foreign companies only for oil field services, not for oil exploration and production. Foreign oil companies have been trying for more than a decade to gain a significant stake in the Russian oil sector. Yet the lack of a favorable tax structure and strong legal protections have largely kept them at bay.

On Feb. 11, BP, the world's third-largest oil company, said that it would form a new Russian oil company with local partners and would plow $6.75 billion into the project, the single largest investment in post-Soviet Russia. Still, other global oil companies have said they will wait to see how BP's investment proceeds -- and if Russia institutes certain tax and regulatory changes -- before investing substantially more there.

The world's largest oil companies complain that because of such barriers, oil production is growing at a far smaller pace than they had forecast just a year ago. Many American and British companies hold as their core assets stakes in the North Sea, Alaska and the shallow waters of the Gulf of Mexico, areas where production is declining. In the last few weeks, companies like BP, Royal Dutch/Shell and ChevronTexaco announced that they missed their production growth targets for 2002 and would no longer be providing a specific forecast for increasing output.

''The industry feels Iraq may be different'' -- that it may open up more quickly to foreigners than its neighbors have, said Roger Diwan, managing director at PFC Energy., ''But the terms are not going to be good, and people know that.''

***Correction:****Feb. 27, 2003*

*An article in Business Day on Saturday about potential investments by oil companies in Iraq referred incompletely to negotiations between the country and TotalFinaElf of France. While the company held discussions on a production-sharing contract, it never signed one.*