The Growing Role of Iraq on the Global Energy Market

17/01/2013

Author : Richard Rousseau

The recent re-launch of the Iraqi oil industry, underdeveloped since the early 1980s, can only positively contribute to the stability of the country. The war against Iran (1980-1988), the two Gulf Wars (1991, 2003), the international embargo and the difficult reconstruction have prevented the Iraqi energy sector from reaching its potential. Unexplored reserves and the growing international demand for crude oil will create great opportunities, not only for the country but also for the stability of the international market which is subject to spiralling energy consumption in emerging economies.

Iraq is already the third largest exporter of crude oil and has the fifth largest known oil reserves. In 2011, oil and gas revenues from accounted not only for almost all of the government's budget, but also for two-thirds (66%) of the country's gross domestic product (GDP) – in Saudi Arabia, for example, oil revenues account for just over half (52%) of GDP.

In June 2012, oil production stood at around three million barrels per day, of which just under two and a half were exported. Therefore, Iraq is still not able to reach the peak level of production it recorded in the late 1970s, when it produced on average three and a half million barrels per day. Currently, the bulk of exports are passing through the port terminals in the south of the country, while the rest reaches the Turkish port of Ceyhan on the Mediterranean coast through a northern pipeline route. Eighty percent of oil production still comes from the two historical fields of Kirkuk and Rumaila, respectively in the north and south of the country. The end of Saddam Hussein's regime brought an increasing number of foreign players in the country. Multinational oil companies now control more than two-thirds of crude oil production. The recent opening to foreign energy groups has led to the arrival of much-needed know-how, expertise and technology. This cooperation with foreign companies provides support to boost production and provide overall capacity to the domestic industry.

However, the lack of investment in infrastructure remains a major constraint. The range of petroleum products produced by domestic refineries is insufficient considering the Iraq's considerable needs. Gasoline represents only 15% of total annual production, while half of petroleum products is represented by heavy crude oil. Iraq is then forced to rely on imports for 30 percent of its gasoline and 17 percent of its Liquefied Petroleum Gas (LPG).

Despite a lack of appropriate investments, Iraq has acquired a growing importance in the international market. Its exports are oriented more and more towards the emerging economies, which now buy half of its crude oil, while Western countries account for one fourth (25%).

In addition to the positive presence of foreign operators in Iraq, the large quantity of discovered but unexploited reserves and easy geology of Iraqi territory (most of the oil sites are located onshore and in areas with a lower population density than those in other countries) suggest very optimistic growth scenarios. Many wells are located near port terminals in the south or the single pipeline in the north. This reduces extraction and transport costs considerably. Conservative estimates predict that by 2020 the country will be able to double its production to six million barrels per day, from the current level of three millions, with the ability to extract eight million barrels per day in 2035. Such an increase, especially in the short term, will come from the four Iraqi main oilfields, all located in the southern part of the country (Rumaila, West Qurna, Zubair and Majnoon). The development of the oil industry is concomitant to that of the gas, whose reserves are estimated at over three trillion cubic meters. If in 2010 Iraq extracted a little less than ten billion cubic meters, in 2035 gas production could reach ninety billion cubic meters.

To achieve these production levels and make up for the time lost in terms of infrastructure construction, Iraq needs $400 billion in investment over the next twenty years. Twenty billion dollars must be invested annually in infrastructure (especially in midstream operations consisting of refining and transportation) between 2015 and 2020. More than ninety percent of these investments will be financed directly by the Iraqi government, which will then obtain a substantial return from increased oil and gas royalties, as well as from other indirect benefits stemming from such investment. In particular, the modernization and construction of new refineries will allow the country to reduce the percentage of heavy crude oil it sells, as well as increase the use of diesel which is now being imported from abroad. This will in turn improve the Iraqi trade balance.

The ever increasing oil demand by Asian economies will require a greater strengthening of the Fao sea terminal in the Persian Gulf and the creation of an extensive storage capacity for the country's crude oil resources. Most likely this will be accomplished at the expense of upgrading the pipelines in the north, which are in a position to supply European markets.

Assuredly, Iraq will become a major oil producer in the world in the next two decades. The growth of its production is likely to be higher than that of Brazil during this period, and more than twice that of Saudi Arabia. While in the short term this production will predominantly be used to cover domestic energy needs – primarily for the generation of electricity in the medium term – a larger amount of gas extracted will be exported in the long term. If this prognosis materializes, within ten years Iraq will overtake Russia as the world's second largest crude oil producer. It will also have an inevitable political and geopolitical impact within the Organization of the Petroleum Exporting Countries (OPEC), of which Iraq is a member. In the past, Baghdad intentionally held its production levels well below its pumping capacity, which favoured some much less important competitors in the market. Iraq's greater volumes of oil production will soon bring about a balance of power shift within OPEC, most likely to the benefit of the international energy market.

Richard Rousseau is Associate Professor and Chairman of the Department of Political Science and International Relations at Khazar University in Baku, Azerbaijan. He teaches on Russian politics, Eurasian geopolitics, international political economy and globalization.