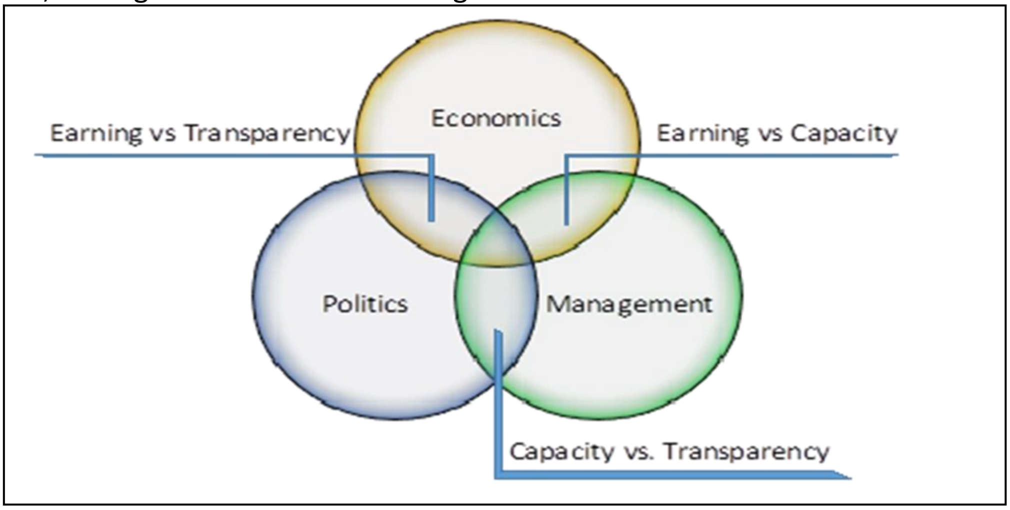
Iraqi Oil Contracts: The complementary factors of Management and Politics. By Professor Mustafa Alshawi *

Dr Ali Merza's excellent paper on the "The First Round of Licencing in Iraq: Economic Evaluation" ** has attempted me to write this short article as complementary knowledge to bring about the bigger picture to decision makers when fully evaluating the the next round of the Oil contracts.

Although economic evaluation is critical to the decision making process, it does not on its own provide the holistic picture where success or failure, of such contracts, could be attributed to. (Success or failure is measured by whether or not the contracts' targets (in mbd) are met, i.e. generating the "expected" revenue for Iraq). The past six years have clearly shown that the IOCs have partially/completely failed to meet the predicted production targets irrespective of the economic validity of the contracts. This is mainly attributed to two other critical factors; a) the capability and capacity of the Iraqi oil institutions to manage these contracts (Management factor) and b) the transparency and corruption within these institutions (Politics factor). This paper briefly explains these two factors as a complementary measure and the role they play in the success or failure of large contracts.

The first figure bellow the right shows the interrelationship between the three factors; Economics, Management and Politics along with the interface between them.



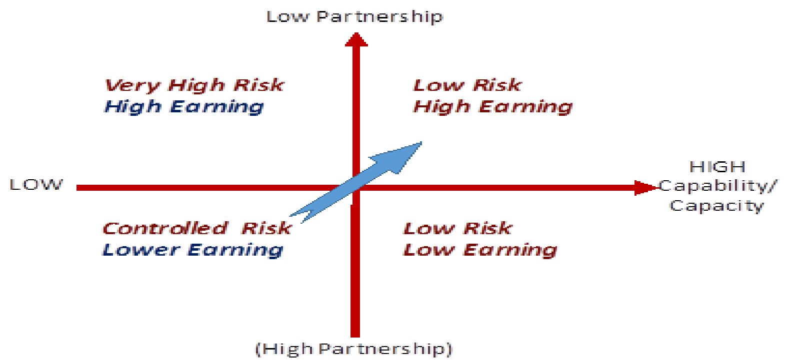
Management
This is a reflection of a) the capability (availability of skills) within the Iraqi oil institutions to manage/administrate the interface between the IOCs and the Iraqi "back-office processes" and b) the capacity (experience/practices) to provide high quality and fast service to the main contractors (IOCs). The lack of high quality Management can significantly hinder the performance of the main contractors and lead to costly delays.

Politics
This is a reflection of the level of transparency and corruption within the Iraqi oil institutions which can "make or break" a healthy work environment between them and the IOCs. The

higher the corruption level, the lower is the transparency, hence the ability to create strong client leadership to drive those contracts forward will be significantly weakened.

No country, particularly in the developing world, has reached perfection. But, in general, they have managed to arrive to balanced solutions to first ensure “maximum oil production with controlled production costs” and secondly ensure that they have the time to build up the capability and capacity of their national institutions for long-term gain (through effectively scheduled technology transfer program).

The second figure bellow shows the distribution of Risk (of not achieving the contracted production targets) versus Earning (the “expected” income from oil production). The vertical axis represents the percentage of partnership with the IOCs (assuming it is low with SC and high with PSA). The horizontal axis represents the capability and capacity of the Iraqi oil institutions, as explained earlier.



High Earning (low partnership) with High Capacity
The best scenario is the top right quartile, where organisations can generate high Earnings when they have high capability and capacity to effectively manage the performance of the main contractor. This situation is typically led by a well negotiated SC. In this context, the Risk of successfully delivering the contracts is Low and the “Expected Earning” is high.

High Earning (low partnership) with Low Capacity
The worst scenario is the top left quartile, where organisations sign a low partnership contract with the main contractor and at the same time have low capability and capacity to manage the performance of the contractor. This is to say “placing the main contractor on the driving seat and ***hoping*** that they will take the client to the agreed destination!”.

Lower Earning (higher partnership) with High Capacity
A bad scenario is the lower right quartile, where organisations have high capability and capacity to manage the contractor’s performance but sign a high partnership agreement with them. This will unnecessarily reduce revenue and most likely will create resentment within organisations.

Lower Earning (higher partnership) with Low Capacity
A good scenario to be in is the bottom left quartile, where organisations can generate “Lower Earning” while having very Low internal capability and capacity to manage the main

contractor's performance, i.e. organisations suffer from bureaucracy and lack of transparency. With higher partnership with the main contractor, the risk of achieving the contract targets will be much more controlled as any costly delays in delivering the contract will significantly harm the main contractor too. Under this scenario, organisations can sign a clearly defined long-term agreement with the main contractor to undertake a) effective technology transfer program to improve the performance of the national institutions and b) have a better influence on the main contractor's ability to contribute to the wellbeing of the local society through their Corporate Social Responsibilities (CSR). Finally, organisations in this quartile aspire to move to the top right quartile scenario after developing high capability and capacity to run future contracts.

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