

# Dip in Iraqi Oil Production Holds Ominous Harbinger

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BAGHDAD, Iraq -- Iraqi oil production fell by 8 percent last year, with a sharp decline near year's end that left average daily production at half the 3 million barrels envisioned by U.S. officials at the outset of the war in 2003.

Prospects for improvement this year are slim, according to many experts, calling into question Iraq's ability to support itself and fund reconstruction efforts as U.S. assistance is scaled back. Reasons for the shortfall include the poor state of the nation's oil fields, a creaky infrastructure, poor management and ongoing insurgent attacks, particularly to pipelines in the north-central region meant to export oil through Turkey.

"There is no instant turnaround," said Paul Horsnell, energy analyst with Barclay Capital in London. "It could take five years, six years or seven years." As of last month, Iraq was pumping a million barrels a day less than just before Saddam Hussein was toppled from power in the U.S.-led invasion of Iraq.

In helping sell the war, Bush administration officials had predicted that a strong Iraqi oil industry could help pay for the nation's postwar recovery. To prime the effort, the U.S. Congress voted on a three-year, \$20.9 billion reconstruction package, of which about \$2 billion was dedicated to restoring Iraqi oil production.

Instead of steadily increasing production, the annual output fell in 2005 to 1.83 million barrels a day, including a sharp decline over the final quarter capped by a December dip to 1.57 million barrels daily.

The latest production figures from the International Energy Agency compare with the 2.5 million barrels per day the Iraqi industry was pumping just before the war, a level it nearly equaled in March and April of 2004. Officials said December's figures were influenced by bad weather and a scarcity of tug boats at Persian Gulf marine terminals, in addition to the continuing violence, and poor facilities and management.

Oil revenues contribute 94 percent of the fledgling government's budget and a drop in oil global prices from current high levels could wreak havoc if output remains depressed. Financial stress was evident last week when Turkey suspended shipments of gasoline and other fuels to Iraq saying its refiners were owed \$1 billion. Although Iraqi officials said the non-payment was due to a short-term budget shortfall, it serves as an example of how stretched this country's finances are.

The most serious and pressing problem is the lack of adequate security, according to Gal Luft, executive director of the Institute for the Analysis of Global Security in Washington.

Insurgent attacks on pipelines -- more than 300 since the March 2003 invasion -- have not only cost the country billions of dollars in lost export sales but also diverted U.S. funds and manpower to repair the damage that instead

would have gone to oil field recovery and expansion.

As a result of pipeline attacks, exports to the Turkey port Ceyhan via the country's northern pipeline averaged only 40,000 barrels a day in 2005, compared to an 800,000 barrels a day average that the nation hit during some months before the war.

In July , Iraq officials said attacks had cost it \$11 billion in lost revenues. Kidnappings and killings of oil officials -- the country's oil minister barely escaped an assassination attempt in October -- and of oil field company workers has cooled the pace of repairs. Two German engineers were reported kidnapped Tuesday from the Beiji refining complex 155 miles north of Baghdad.

"We don't see any foreseeable improvement in security this year," said Neil Partrick, senior analyst at Economist Intelligence Unit in London.

At the same time, authorities acknowledge, the security situation has been calm around Iraq's southern oil fields around Basra, which generally accounts for more than two-thirds of Iraq's oil output.

"Even though the southern oil fields are benign, the overall security affects the perception of the government and institutions," said a U.S. official. "If the capitol is under siege, as this one appears to be, then it's difficult because you have to come here and talk to people to make those investments."

Compounding the problems, experts say, is years of neglect and damage to Iraq's oil infrastructure, some dating back more than two decades. The weaknesses range from a lack of crude oil storage facilities that were destroyed in the Iran-Iraq war in the 1980s and never rebuilt to refineries that decayed during a decade-long period of economic sanctions against Iraq. The former forces Iraq to pump oil back into the ground when pipelines are blown up or tankers are delayed, damaging the long-term viability of the reservoir. The latter means Iraq must import nearly half its gasoline and kerosene from Turkey, Iran and Kuwait.

Efforts to get the crucial Qarmat Ali water injection system in Iraq's southern oil fields back on line have lagged, after more than \$225 million of U.S. funds have been spent. Injecting water into wells to fill the void created by the extraction of gas and oil is critical to maintaining an oil reservoir's life. Improvements in performance of Iraq's three oil refineries have been outstripped by continued attacks on oil pipelines that feed them, as well as on the pipelines and truck convoys that deliver their refined fuels to the consumer, said a U.S. official who asked not to be identified.

By the end of this year, the United States will have spent \$2 billion in its 3-year effort to get the Iraqi oil industry back on its feet. Navy Captain Michael Sherbak, who is attached to the Iraq Project and Contracting Office, the agency leading the oil sector reconstruction effort, said the 3 million barrel a day goal was to leave Iraq at "a self-sustaining level that is adequate to help them invest in equipment and help them make their oil production more efficient." But reaching that level will require much more money and several more years, experts agree. The World Bank estimated it would take \$8 billion in public and/or private to restore Iraq to 3 million barrels a day of oil production, which Iraq last exceeded in 1979, and as much as \$35 billion to reach 5 million barrels of output.

Those goals seem out of reach now not just because of security issues but because of an unsettled political and legal landscape.

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