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Date 7 January 2004

Mr George Fergusson  
Cabinet Office  
Whitehall  
London SW1

Dear George

#### IRAQ OIL INDUSTRY GOVERNANCE

I raised this topic at Nigel Sheinwald's meeting yesterday. He asked that time should be found to discuss it with Jeremy Greenstock during his visit to London later this week, including DFID and HMT who are also interested. Nigel also asked me to write, briefly, to set out the issue.

2 As you know, a comprehensive study by consultants Bearing Point on the "Options For Developing A Long Term Sustainable Iraqi Oil Industry" has now been completed and submitted to the Iraqi Oil Ministry. Terry Adams has had a leading role in this process. Generally speaking it will be for the Iraqis to decide how they want to run their own oil industry, including any relations with western oil companies.

3 However there are some fundamental issues of Good Governance on which Ministers may feel they ought to seek to influence the Iraqi authorities so as to establish a sound footing for the future of the Iraqi oil sector.

4 Oil represents a huge part of the tradeable sector of the Iraqi economy and the way that it is handled will have major implications for the prosperity and stability of Iraq. The mis-handling of the governance of natural resources has played a major part in the failure of a number of oil rich developing states. HMG has launched a major

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international initiative - EITI, led by DFID - to achieve transparency of natural resource accounting in the developing world. Securing US support for this initiative is seen as a major objective being pursued, inter alia, in the US/UK energy dialogue. The principle of transparency of accounting is also enshrined in Article 1483 of the UN Resolution.

5 The key principles that need to be established are

- (a) a separation of powers between the government as the ultimate owner and regulator of the energy resource and an operating company (most probably, at least initially, nationally owned) that manages the development of the resource, and
- (b) the principle of full transparency of oil accounts, payments and budgets through published accounts.

6 We understand that the Iraqi Oil Minister, Al Uloom may be planning to present his views, in the light of the Bearing Point study, to the Governing Council later this month. We do not know what line he plans to take but early indications are that he is interested in the example of ARAMCO, the Saudi oil company, or the Kuwait Petroleum Company. In both these models there is limited separation between the government and operating company and no proper published accounts.

7 Al Uloom is the son of a member of the Governing Council and he has already acted to side-line a senior executive who the CPA believed to be the most effective technocrat in the Iraq National Oil Company.

8 We are not privy to all the exchanges between Rob McKee and Al Uloom. It is unclear as to what extent the Americans will be willing to exert their influence to achieve good governance, particularly in the light of their lukewarm response to HMG's transparency initiative.

9 The question, which is now becoming urgent, is to what extent HMG should be willing to try to exert influence in this area and - assuming that this is indeed a high priority - what avenues we can best employ both with the Americans and directly with the Iraqis.

10 It must, of course, be possible that other influential Iraqis - who are not expecting to have responsibilities for oil - will be most responsive to the merits of good governance. It is also arguable that, given the importance of natural resources in the Iraqi economy, the most fundamental principles of separation of powers and transparency should be incorporated in The Transitional Administrative Law.

Yours sincerely

*Neil Hirst*

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Copied to: Jim Drummond, DFID;  
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