

Iraq  
Oil Ministry  
Office of the Inspector General

## Smuggling Crude Oil and Oil Products

### *Second Transparency Report*

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**Introduction:**

In order to continue the implementation of the principle of transparency in the oil sector as a means of developing awareness and control, and following the positive reactions witnessed after the publication of the First Transparency Report in July 2005, we are publishing our Second Transparency Report regarding "Smuggling Crude Oil and Oil Products." This is a grave phenomenon that leads to a great loss of money and resources. It also reflects flaws, weaknesses and shortcomings at various important levels not only within the oil sector but also outside that sector. This in turn helps exacerbate wrongdoing, fraud, theft and smuggling incidents.

The Report describes in detail the smuggling phenomenon as well as the reasons, boosting factors, methods and smuggling outlets, in addition to the resulting impacts. The Report ends by offering suggestions and recommendations for treating this phenomenon.

While we are presenting this Report in order to inform our citizens about their main sources of wealth and how these sources are being squandered, we are pleading for a strong government position that would stem those practices. Such practices deplete the state budget of its available funds and undermine the country's capacity for development and growth as well as for improving living conditions. The solution resides in taking urgent measures that help us exercise control over our land and sea outlets, and in bolstering legal, judiciary and supervisory measures. These measures should run parallel to the urgent step that must be taken by oil sector management, including setting up a measurement, computational and compatibility system, reestablishing the distribution sector infrastructure according to the current situation and intervening changes, and speeding up the execution of important projects which should minimize and limit the import of oil byproducts through the development of Iraqi refineries and the building of new ones. These measures should take place while the oil facilities and pipelines are protected in an effective way. If we do not provide these measures, Iraq would suffer enormous losses, which can be estimated in billions of dollars.

The suggestions and recommendations that the Report contains should permit to contain fraud, theft and smuggling incidents. We call for the formation of a committee that would include representatives from the higher authorities and the Ministry in order to study them and implement them.

**The Inspector General of the Oil Ministry**

## **1. Description of the Smuggling Phenomenon:**

We may define the features of the smuggling phenomenon as follows:

- Sending out a portion of the imported oil byproducts to neighboring countries through the southern ports and by illegal means; according to estimates, this represents 10% to 20% of the total imports value, which amounts to \$4.2 billion in 2005.
- Theft of crude oil and of local black oil from the transport pipelines or the warehouses, and smuggling them to neighboring countries or through the southern ports.
- Diverting oil products to be delivered to public or private units or for other purposes, such as fishing boats, generators, factories, farms, and bakeries, and selling them to smuggling networks.
- Letting in a fraction of the products imported and offsetting the missing products with local products, or conniving to register the imports in full, or not delivering them to the warehouses in collusion with the inspection or receipt employees, or taking advantage of the small fines assessed against freighters in case some merchandise is missing.
- Loading additional quantities of black oil exports in the Iraqi ports, by taking advantage of weak control and the measurement methods used.

The gravity of the smuggling phenomenon resides in the fact that the smuggled goods are either stolen (without any payment), or are obtained at the official rate (which does not represent 5% of the real cost, as a result of subsidies). Hence, the losses are sustained directly by the public treasury, unlike other countries where smuggling represents for the most part a loss of taxes and duties only with respect to smuggled goods and products.

We should mention in this regard two things:

First: In addition to the smuggling activities directed overseas, there is widespread fraudulent activities that aim to get hold of large quantities of goods and sell them in the local black market (outside regular marketplace outlets). Statistics indicate that what is being sold in these markets is estimated at one billion dollars. This is based on recent data provided by the Central Agency for Statistics and Information Technology. The percentages are as follows: 41% for gas, 51% for white oil, 69% for gas oil, and 55% for liquid gas. The real cost pertaining to that is less than 20%. This means that those who are benefiting from the black market are realizing about \$800 million dollars.

Second: There are no accurate information and reports on the values and quantities of smuggled crude oil and oil products given that the ministry lacks a central database, and given that there is no precise measurement, computational and compatibility system.

<b>Government Subsidies for Fuel Prices</b>	
1. Gross Domestic Product for 2005	\$24.2 billion
2. Direct Subsidy of Fuel Prices	8.8% of Gross Domestic Product
3. Indirect Subsidy of Fuel Prices	19.53% of Gross Domestic Product
<b>Value of Overall Subsidies</b>	<b>28.41%</b>

### **Examples of Smuggling Activities Published in Local Newspapers**

<p style="text-align: center;"><b>Seizure of a Yemeni Boat Carrying Smuggled Fuel</b></p> <p>Basra – Saad Al Sammak</p> <p>The fourth region's customs patrol seized a boat bearing the Yemeni flag, which was transporting fuel in order to smuggle it outside Iraq, and arrested seven of its crew members. The director of the fourth region's customs unit, Hakim Nae, told Al Sabah that seizing the boat was part of the measures executed by the fourth region's customs directorate in Basra in order to combat fuel smuggling. Once information about the boat was in, he stated that the squad was put in place by the southern region's police. The aim was keep monitoring the situation. The boat was seized while it was anchored south of the Abu Floos harbor. It was carrying large quantities of fuel. He added that the boat crew, which comprises two Iraqis and five Indians, was also seized.</p>	<p style="text-align: center;"><b>Border Patrols Waging Battles in Shatt Al Arab</b></p> <p style="text-align: center;"><b>24 Outlets Were Closed and 166 Boats and Ships Were Seized in the Largest Sting Operation Against Fuel Smuggling</b></p>
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## **2. Main Causes and Factors Leading to Smuggling:**

**2.1 Large discrepancy in oil product prices between Iraq and neighboring countries.**

**2.2 Inadequate Control and Supervision of the Movement and Trading of Oil Products. The reasons are as follows:**

- Weakness of the measurement, computational and compatibility system.
- Weak control over the borders and over land and sea outlets.
- Existing flaws in the distribution sector infrastructure and management.
- Lack of planning, of distribution and organizational policies.

**2.3 Lax Legal and Judiciary Measures against Offenders and Lawbreakers.**

**2.4 Greater Reliance on Imported Oil Products for the Following Reasons:**

- Insufficient production by Iraqi refineries for meeting local needs because of bottlenecks as well as technical and security reasons.
- Failure to realize the investment plan for the expansion of filtering, refining and transport capacities.
- Increase in local consumption.

**2.5 Continuing Acts of Vandalism Targeting Oil Sites and Oil Pipelines Network.**

**Following the outline on the next page, we will provide a comprehensive explanation, backed by examples, of the above causes and factors.**

**Outline: Causes and Factors Leading to Smuggling**

Nonexistent or Inadequate Rules: Measurement (Counters), Control (Control of Products Movements), Compatibility (Between the Shipping and Receiving Sites)	+	Lower product prices compared to neighboring countries	+	System’s Shortcomings: Product supply and distribution to consumers and ineffectual control
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Leads to:

Leads to:

Volume fraud	Nominal concordances	Theft of products from pipelines and warehouses	Non-entry of imported products (documents only)	Internal diversions (non-delivery of volumes transported between the governorates)	More supplies than actually needed	Supplies for bogus or discontinued activities and bogus areas	Illegal sale outside the receiving parties (stations, public squares)	Scarcity of product put on sale and expanding black market
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Supporting Factors:	Vandalizing pipelines and shipments by truck undermine control	Supporting Factors	Flawed geographic distribution of gas stations and warehouses
	Defects in the distribution sector infrastructure: Overlapping, broad, corruption		Corruption in the agencies, departments and sectors that use fuel
	Import: New activity that is not backed by experience and lacks control mechanisms		Insecurity in addition to the lack of control over some sites and stations

Absence of tough laws, legislations and judiciary procedures

Land and Sea Smuggling Outlets					
Lack of cooperation from neighboring countries	Inadequate border patrols and coast guard	Corrupt outlet organizations	Non-enforcement of laws at ports and land outlets	Participation of social and government authorities in facilitating smuggling	Absence of patrols at exit routes in order to examine documents and cargoes

**2.1 Large Discrepancy in Oil Product Prices between Iraq and Neighboring Countries:**

- The largest price discrepancies exist between Iraq, Turkey, Syria and Jordan, as these can reach more than 50-fold, as is indicated in the next page.
- The rate of government subsidies for imported products is equal to 80% (following the recent increase); it is expected that the value of government subsidies will reach more than \$5 billion in 2006 (versus \$4.2 billion in 2005).
- The broad discrepancy and great profit margin that profiteers and smugglers realize foster the corruption of many oil sector department subdivision and units from without.
- The low prices have led many parties, individuals and business people to obtain the largest volumes possible and to pay their official prices, then sell them in the local black market or smuggle them abroad.
- Pursuant to the Cabinet's letter referenced 15176, dated November 14, 2005, addressed to the International Monetary Fund, oil product prices will be as follows:

<b>Date</b>	<b>Regular Gasoline</b>	<b>Premium Gasoline</b>	<b>Oil</b>	<b>Gas Oil</b>
12/18/2005	100	250	25	90
3/31/2006	130	300	50	110
6/30/2006	155	350	75	125
9/30/2006	175	400	90	155

Despite the increases that are supposed to be applied, the difference in prices remains at a rate that is enticing to smugglers.



**Comparative Product Prices between Iraq and Neighboring Countries  
(Dollar per Liter)**

Product	Iraqi Prices Before the Increase	Iraqi Prices After the Increase	Syria	Jordan	Iran	Turkey	Kuwait	Saudi Arabia
Premium Gasoline	0.03	0.17	0.55	0.60	0.13	1.40	0.24	0.24
Regular Gasoline	0.01	0.11	0.50	0.38	0.10	0.78	0.21	0.08
Gas Oil	0.007	0.07	0.18	0.16	0.20	0.87	0.18	0.10
White Oil	0.007	0.02	0.19	0.16	0.20	---	0.18	0.12
Liquid Gas Cylinder	0.14	0.42	3.00	3.80	0.68	---	2.50	0.18

Example: Selling gas oil products through seaports and profits realized by smugglers

Gas Oil	Official Price 10 dinars	Black Market Price
		\$240 per ton at Shatt el-Arab
		\$260 per ton at Abi al-Khasib
		\$300 per ton at Fao

- The driver of the smuggled truckload receives \$800 in order to transport the merchandise to the smuggling outlets.
- He pays \$500 for each truckload to police patrols.
- After the disbursement of all expenses the smuggler's profit for each truck stands at \$8,400.

## **2.2 Inadequate Control and Supervision of the Movement and Trading of Oil Products:**

Determining and controlling the volumes of imported or locally produced products and their conformance with the receiving warehouses and stations as well as with the distribution and supply outlets, is considered an important element in identifying discrepancies, and thus for determining the quantities stolen or smuggled based on the shortfalls at arrival. A shortfall in this regard will bolster all types of abuses. Actually, this is what is happening in the oil sector, and it is due to the following reasons:

### **2.2.1 Weakness of the Measurement, Computational and Compatibility System; this is reflected as follows:**

- Shortage of counters, measurement tools and standards at many sites, including the loading and distribution sites, and across many product shipment stages. Moreover, old and obsolete counters, which give inaccurate readings, are still being used. This is an inherited problem which has been exacerbated because of the war and exposure to vandalism.
- The import of oil product is considered an exceptional activity. The oil sector has not prepared for this eventuality by implementing plans, mechanisms, rules and regulations in order to exercise control over it.
- There are no authorities that examine volumes at some border points as a result of the security situation.
- There is no central compatibility unit or department which will have central control over the movement of products and that would distribute them among the various parties that are not coordinated or integrated.
- Modern technological methods (automated information) are not used.
- There are delays in providing a computational and measurement system for the oil sector, at least at the necessary and critical levels; the issue was addressed in recent months and a ministerial authorization was obtained in order to designate 3 important international companies that would implement progressively such a system.
- Inadequate coordination and lack of mechanisms as well as an effective system for volume concordance between oil companies (marketing, distribution, pipelines, gas loading, refineries).
- Vandalism and instances of tampering which impede distribution activities and the transportation of oil products, and thus thwart accurate and prompt volume conformance.
- Products shipped in containers are not examined at some delivery sites given that there are no verification tools or laboratories; this enables the shippers to divert and sell the smuggled products or to deliver non-conforming products.

Among the manifestations and outcomes of such shortcomings, we find the significant discrepancies that exist among the parties that ship and receive the oil products. These have not been adjusted despite the fact that a long period has passed. Audit activities indicate that these differences and shortfalls are the result of oil products diversions and smuggling. The cases that were unearthed have been referred to the courts.

**Examples of Discrepancies between the Distribution Sector Companies  
Belonging to the Ministry**

**Gas Oil**

<b>Period</b>	<b>Shipping Entity</b>	<b>Receiving Entity</b>	<b>Shipped Volume (Liter)</b>	<b>Received Volume (Liter)</b>	<b>Discrepancies (Liter)</b>
January 2004 – March 2005	Pipelines Company	Distribution Company	18,802,234	24,670,000	+5,867,766
January 2004 – March 2005	Southern Gas Company	Distribution Company	111,999,300	109,672,607	-2,326,693
January 2004 – March 2005	Southern Gas Company	Pipelines Company	32,197,000	30,251,971	-1,945,029
January 2004 – March 2005	Imports (Ship Cargo)	Supplied Volume (Southern Gas Company – Pipelines Company)	181,116,655	181,566,581	+389,926

\* Please note that payment is made on the basis of quantities supplied.

**Examples of Discrepancies between the Distribution Company  
Warehouses and its Branches**

<b>Month</b>	<b>Warehouse</b>	<b>Product</b>	<b>Volume according to Warehouse (Liter)</b>	<b>Volume according to Branch (Liter)</b>	<b>Discrepancy (Liter)</b>
January 2005	Babel	Gasoline	---	1,330,000	+1,330,000
August 2005	Babel	Gasoline	19,269,093	13,048,220	-6,220,873
March 2005	Karbala	Gasoline	5,196,260	5,945,982	+749,722
August 2005	Karbala	Gasoline	11,480,126	9,379,497	-2,100,629
August 2005	Karbala	Gas Oil	1,201,004	2,330,380	+1,129,376

Remark: The role of the asset compatibility units is in most cases a complementary role that aims to find the reasons, justifications and solutions for the discrepancies in order to complete the conformance after a long period of time (even if it is in appearance).

**2.2.2 Inadequate Control over the Borders and over Land and Sea Outlets:**

**Oil products are smuggled in the main from the southern ports and from the western and northern borders, given the lack of control over these points; this is due to the following reasons:**

- Ineffectual border patrol and coast guard capacities relative to the volume of transactions and that of import and smuggling activities.
- Incompetence and corruption of customs institutions and other authorities.
- The existence of illegal ports and anchorage areas operated by the smugglers.
- Inefficient legal and judiciary procedures against the offenders and those who are captured.
- Antiquated systems as well as archaic operational and control methods in Iraqi ports.
- The institutions of some neighboring countries show laxity and collusion with the smugglers.
- There are no efficient control and supervisory units operated by Customs or the Interior Ministry at the borders and outlets.

**Examples of Notices about Smuggling Cases in the Northern Outlet according to the Distribution Company Branch in the Northern Region**

<p>In the name of God, most Gracious, most Compassionate  Oil Ministry Reference: 624  Oil Products Distribution Company Date: April 12, 2005  Northern Region's Branch</p> <p align="center"><b>Oil Ministry</b>  <b>Fax</b></p> <p><b>To: Oil Products Distribution Company; Care of the Deputy Chairman</b>  <b>Subject: Oil Products Smuggling</b></p> <p>Pursuant to the notes you have written on the margin of the Oil Marketing Company's letter No. 5138 of April 5, 2005, there will be greater efforts made in order to track such cases; this will be done in coordination with the competent authorities at the Rabi'a border point.</p> <p>Please be advised in this regard that we have previously recommended the closing of the duties office of Rabi'a at the border point, following the course taken presently at the Ibrahim Al-Khalil border customs with regard to vehicles departing to Turkey. Correspondences have taken place regarding the topic, the latest being our letter referenced 7179 of 12/27/2004, a copy of which is enclosed. However, we did not receive any response with respect to the disapproval notified to us in the letter No. 16360, dated 11/24/2004, of the Oil Ministry, and its enclosure, letter No. 4704, dated 11/8/004, of the Interior Ministry (Office of the Ministry Commissioner for the Auxiliary Armed Forces).</p> <p>We would also like to inform you that the customs administration of Rabi'a should have taken the legal measures against the offenders pursuant to Resolution No. 72, dated 1999, of the abolished Revolutionary Command Council. The aforementioned Resolution incorporated deterrent penalties against wrongdoers, and considers their crimes to be ones that aim to destroy the economy. The penalty for such crimes could reach a jail term of no more than 10 years, in addition to the confiscation of the vehicle.</p>	<p><b>Ministry of Oil</b>  <b>Oil Products Distribution Company</b>  <b>Northern Region's Branch</b></p> <p align="center"><b>Oil Ministry</b></p> <p><b>To: The Director of the Ibrahim Al-Khalil Customs Checkpoint</b>  <b>Subject: Product Smuggling</b></p> <p>Dear Sir:</p> <p>Please take notice that four cars have entered through the Ibrahim Al-Khalil customs checkpoint. They were delivered at the distribution square in Zakho. The passports were sent to Al-Tahaddi (Mosul). However, it looks that the drivers agreed with anti-smuggling unit members to appear as agents conducting the work of the agents in order to stamp the documents at Al-Tahaddi warehouse and to withdraw the passports. The documents were indeed stamped at Al-Tahaddi warehouse and the vehicles were seized. The whole shipment was disposed of, although the stamps on the documents were only for cover-up purposes, and nothing went into the warehouse. Given the gravity of that phenomenon which has been widespread among the drivers, I am aware that a number of our employees and other parties took part in that operation. Thus, I would like to impose the most severe penalties against the drivers whose names are listed, in conformity with the deterrent laws, given that such activities are akin to ruining the national economy.</p> <p>Best regards...</p>
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**2.2.3 Shortcomings in the Distribution Sector's Infrastructure and Administration:**

The distribution sector within the Oil Ministry comprises the Oil Products Distribution Company, the Oil Pipelines Company, and the Gas Filling Company. Moreover, the Oil Marketing Company has joined the others, given that it is the organization that is responsible, besides its main activities (crude oil marketing), for importing oil products. There are also 3 additional refining companies in the central, northern and southern regions. The developments and changes that occurred following the post-war situation, as well as the increasing imports, did not affect the organization and administration of the distribution sector. This in turn has impacted management, control and supervisory activities with respect to product movements. This is reflected in the following examples:

- Ineffectual control among these companies' headquarters, branches, offices and units throughout Iraq. In fact, some of them lie outside any control and supervision because of the security situation. This has led to the loss of control over the supply, pricing and compatibility processes.
- There are no mechanisms and procedures for exercising coordination and compatibility measures among these companies with regard to products that are moved amongst them; this leads to great discrepancies.
- The pipelines are stretched over vast expanses that reach 7,000 km. These transport the oil production and are chronically exposed to tampering activities by thieves who want to steal oil products or for purposes of vandalism.
- The responsibility for distribution is given to units that are managerially and technically ineffectual while a number of governorates are linked to these units; furthermore, central decision-making processes have deteriorated so much that they have become impotent.
- The administrative, technical and supervisory methods, procedures, rules and regulations have become obsolete; they are thus not adapted to the new circumstances and changes; this has created many loopholes and breaches in the system.
- There is no accountability mechanism in place for the failures and violations that occur.
- Coordination is inadequate among the distribution sector companies, and sometimes their activities overlap.
- The necessary measures are not taken by those companies against their employees, the shippers, the gas station owners and others who breach the law.

Among the examples of deficiencies in the organization and management of the distribution sector, we have the following:

1. The participation of several oil organizations in the control of warehouses (Oil Products Distribution Company, Oil Pipelines Company, Gas Filling Company), in addition to overlapping responsibilities among these organizations. This is especially the case because these warehouses are distributed across the various Iraqi governorates, leading thus to the loss of administrative and technical control over those warehouses. For instance, the domestic gas stations in the governorate of Missan receive large quantities of gas oil that are neither controlled by the Shaaybe warehouse, which belongs to the Pipelines Company in Basra, nor by the Missan's warehouse which is located in the governorate of Missan. To a large extent this leads to smuggling activities in the southern regions.
2. The technical conditions of the warehouses have deteriorated inasmuch as they lack the machines and testing tools for quality verification and control; they also lack the product carrier scales, fire engines and other security mechanisms.
3. The broad and disorganized geographic distribution of gas stations and filling sites that belong to the Oil Products Distribution Company, especially in regions where their number is not compatible with the size of the population there. This is the case in the border regions that lead to the tips of Shatt el-Arab, as there are few people living in these areas.
4. This broad distribution of distribution outlets (fuel and gas stations and filling sties) is accompanied by negligence and corruption within the inspection institutions of the distribution sector, the deficient technical capacities and inadequate experience of these institutions, and the ineffectual training of their cadres.
5. The technical capacities of the distribution sector units are obsolete, since most of the counters used in the fuel stations, the gas factories and the warehouses are either damaged or provide inaccurate reading given their obsolescence. This is also the case for the pumps and the oil pipeline networks.

**2.2.4 Lack of Distribution and Supply Plans and Policies, and Inadequate Control:**

The substantial government subsidies for oil products requires that distribution activities to Iraqi regions should occur according to technical estimates and statistical data regarding the actual need and forecasted consumption concerning these products. In addition, a blueprint plan and policy for the distribution and supply outlets, including the gas stations, filling sites and end-users, whether government or private organizations, must be set up in order to avoid fraud and monopolization activities with regard to oil products, and in order to prevent the diversion of these products from their original destinations. The absence of such policies and plans has led to the following:

- The existence of large quantities of supplies that are not used for the actual purposes for which they were provided; this is the case for supplies pertaining to fishing boats, generators, factories, and various departments, whereby 70% of these supplies are sold in the black market or smuggled.
- There is a serious flaw in the fuel stations' distribution map, since the number of these stations increases in the regions that are close to the borders and they are used as sources for setting up smuggling activities.
- There are flaws and a lack of organization when it comes to the volume of supplies with regard to the different Iraqi regions, and an imbalance between the actual need and the supply volume.
- The local administration in the governorates intervenes in the distribution and supply transactions; this weakens the control, supervisory and distribution procedures and makes them incompatible with sound principles and standards.



<p><b>Attention: The Honorable Oil Minister</b></p> <p style="text-align: center;"><b><u>Subject: Complaint</u></b></p> <p>Pursuant to your note dated 9/23/2005 regarding the letter of the State Minister for National Society's Affairs (Office of the Minister), No. 420, dated 9/20/2005, concerning the complaint of a citizen who is a member of the Fishermen's Association, please be advised of the following:</p> <ol style="list-style-type: none"> <li>1. The number of large fishing boats is (716) seven hundred sixteen, and the volume that they carry every month is equal to (12,554,000) twelve million five hundred fifty four thousand liters. There are small fishing boats which number (884) eight hundred eighty four which every month carry (3,240,000) three million two hundred forty thousand liters. Thus, the total number of boats is (1,600) one thousand six hundred, including the large and small ones, and not (705) seven hundred five. And the total volume transported per month is (15,794,000) fifteen million seven hundred ninety four thousand liters, or a daily average of (526,000) five hundred twenty six thousand, and not (72,000), seventy two thousand, as transpired in the citizen's complaint.</li> <li>2. If these boats were in fact operated for fishing, the market would have drowned under sea fish.</li> <li>3. Most of these boats were manufactured in order to receive gas oil for sea smuggling activities, given the ease of their operation, although we should note that each month the number of boats increases by 50 or 60 new ones, given their uninterrupted manufacture in Basra.</li> <li>4. During our visit to the governorate of Basra we have looked into that problem. A report was sent to you in order to implement new control measures that would stem this phenomenon. As a result, a committee was set up for tackling this issue. Please find per attachment the minutes of the committee's meeting and its recommendations. Please advise us at your earliest convenience with your instructions so we can implement the necessary measures.</li> </ol> <p>Sincerely,</p> <p>Encl.: Minutes of the committee's meetings and the committee's recommendations</p>	<p style="text-align: center;"><b>Fishing Boats Outfitted for Smuggling Oil</b></p>
<b>Volumes of Gas Oil Supplied for Baghdad Domestic Generators</b>	
Number of generators	10,353
Volume of Gas Supplied	25 million liters per month

Fact-finding memorandum by the Distribution Company submitted to the Minister with respect to the complaint of a member of the Fishermen's Association, explaining the situation concerning the outfitting of the fishing boats.

### **2.3 Negligence in the Legal and Judiciary Procedures Taken against Offenders and Lawbreakers:**

The reality and size of the violations and transgressions that lead to smuggling huge volumes of products require the existence of deterrent measures which are appropriate for these actions. However, the measures implemented have not been at the proper level to be able to reduce and deter these violations. As a result, these fraudulent, diversion and smuggling activities have continued unabated. In addition, products were not delivered by domestic carriers and were disposed of, making light of the expected measures. This inadequacy in addressing the problem can be explained as follows:

- The hesitation of the oil companies concerned to resort to deterrent legal measures; they try in this way to avoid any negative repercussions or threats.
- The existence of important loopholes in the contracts ratified between the product carriers and the oil companies; these loopholes were exploited by the carriers in order to divert and smuggle oil products.
- Legal procedures are not implemented on time given the inexistence of quick and accurate concordance measures that would determine shortfalls and responsibilities; this has led to difficulties in prosecuting the carriers.
- The corruption that characterizes some of the judiciary institutions or the delays in their proceedings, which makes it harder to prosecute wrongdoers.
- The carriers and the suppliers who do not deliver products or who cheat are given fines that are equal to the official prices times 2 or 4, which do not amount to 10% of the import cost (fines were adjusted recently in accordance with the directives of our Office so that they are equal to the import cost).

**Measures Taken**

=> The number of trucks sent to the central and southern governorates from the Basra warehouses for the period between September 1, 2004 and February 15, 2005, and which their drivers did not take to their final destination, numbered 1,551 trucks. Those were the ones that were spotted. Those trucks carried 56 million liters of oil products (gasoline, gas oil, imported white oil), and the import cost of these products stood at \$28 million.

=> The fines that were assessed against the carriers for the aforementioned volumes that did not reach their destination were \$4 million; this amount represents only 16% of the value of these products, which means that the loss is equal to \$24 million.

=> The misappropriations of these products was dealt with as being cases representing shortfalls in shipped volumes, while in fact they represented theft and smuggling activities, which cause great harm to the public treasury; in addition, these cases create crises whose costs are borne by citizens.

=> The shipping companies that were fined did not pay these fines even though they represented a small amount relative to the huge profits that these companies garnered as a result of these stolen products; the issue was referred to the courts, and it has not yet been adjudicated despite the fact that 6 months have already passed.

#### **2.4 Greater Reliance on Imported Oil Products:**

The oil products import activities began after the last war as a result of a 40% decrease in net production and continuing increase in domestic consumption, which reached 60% relative to what pre-war consumption. Imports continued to rise dramatically until they reached nearly \$500 million per month at the present time. The security situation that Iraq is experiencing and the widespread insecurity existing in many regions, in particular those that are remote or close to the borders, in addition to the absence of any control procedures with regard to oil products' movements, as was indicated earlier, have bolstered grave violations and various practices that aim to smuggle those oil products. The pattern of increasing import volumes is due to the following reasons:

1. Insufficient production by the Iraqi refineries in order to meet local needs; the reasons are as follows:

- Acts of vandalism leading to the interruption of crude oil supplies that would replenish the refineries or leading to the interruption of the flow of products from these refineries.
- Shortfalls in backup materials or in the various machineries and supplies that the refineries need for managerial and financial reasons; there are, furthermore, complications pertaining to the opening documentary credits, to imports, and to the existence of the necessary expertise.
- Delays in maintenance operations and in the improvement of the capacities of gas facilities in order to exploit gas; this gas is otherwise squandered because huge volumes of it get burned.
- Inability to market and export black oil, which is the byproduct of transformation and refining operations; this leads to huge bottlenecks in the refineries, interrupting or limiting thus their operations.
- Power outages leading to the stoppage of the refineries' operations.
- Non-realization of the reconstruction plans that the American authorities have promised.
- No urgent measures were taken in order to build large refineries that would meet local consumption needs, despite the fact that this would achieve great savings, given that what is spent on imports over the course of one year could be sufficient to build two gigantic refineries that would satisfy Iraq's needs.

2. The non-realization of the investment plan for 2004 and 2005; such realization might have led to increases in the patterns of production.

3. The great number of imported vehicles (more than one million vehicles) and the use of generators because of power outages and the overall increase of economic activities.

## Production, Consumption and Imports of Oil Products

No.	Section	Gasoline (billions of liters)			White Oil (billions of liters)			Gas Oil (billions of liters)			Liquid Gas (Thousand Tons)		
		2002	2004	2005	2002	2004	2005	2002	2004	2005	2002	2004	2005
1	Annual Production	5.8	3.7	3.2	3.0	2.2	1.6	7.6	4.5	4.0	1874	751	614
2	Annual Consumption	5.6	7.0	7.7	2.8	3.0	2.5	6.0	6.5	6.6	1720	1537	1702
3	Annual Surplus or Deficit	1.2	(3.3)	(4.5)	0.2	(0.8)	(0.9)	1.6	(2.0)	(2.2)	154	(786)	(1088)
4	Annual Import Volume in order to Offset the Annual Production Deficit	---	3.3	4.5	---	1.1	0.9	---	2.0	2.2	---	716	1088

## Examples of Negative Divergence in the Execution of Development Projects for Refining, Filtering and Shipment Activities

Company	Project	Allocations	Aggregate Implementation	
Southern Refineries	- Water Feeding Unit	\$12 million	6% in 2004	0% in 2005
	- Gasoline Improvement Unit	\$5 million	1% in 2004	0% in 2005
	- Repairing Damages to Third Line (Al Dahoun Refinery)	\$7 million	15.1% in 2004	1.2% in 2005
Southern Gas	- Propane Cooling System Installation	\$20 million	7%	
	- Gas Turbine Overhaul	\$11 million	15% in 2004	7% in 2005
	- Improvement and Upgrading of Production Units Performance	\$30 million	12%	
Pipelines Company	- Delivering Fuel to Industrial and Electric Projects	\$42 million	38% in 2004	1% in 2005
	- Expanding Product Storing Capacities	\$15 million	51% in 2004	8% in 2005
	- Installation of Shaayba-Kurkh Pipeline	\$30 million	50% in 2004	10% in 2005
	- Setting up a National Control Center for Product Movements	\$25 million	57%	

**2.5 Continuing Acts of Vandalism Targeting Oil Sites and Oil Pipelines Network:**

The continuing tampering and incidents of vandalism targeting oil sites and pipelines have resulted in greater reliance on imports and increasing fraud and smuggling activities. These acts of vandalism have led to the following:

- Shutting off the supplies of crude oil to refineries, leading thus to a decrease or stoppage in the production of oil byproducts and increasing need for imports.
- Using containers to transport oil products instead of pipelines; the use of containers is beset with fraud and smuggling given the ineffectual supervision of their movements, in addition to the exorbitant cost of container shipments.
- There are instances of oil leakages from the vandalized pipelines in addition to theft and smuggling of oil products.
- Containers coming from neighboring countries are often stopped or delayed because they are the targets of attacks; this impacts the volume of oil that is available in the market and thus increases cases of cheating. This also applies to oil transport containers within Iraq.
- The tampering activities affect the execution of projects related to the increase of production and refinery capacities, and this fact undermines the efforts to reduce the reliance on imports.

We should note at this point that the question of protecting oil facilities and pipelines should be reexamined by taking into consideration all related issues. We ought, furthermore, to eliminate the situation pertaining to the distribution and dispersal of authority that is presently occurring, given that several agencies within the ministries of defense, of the interior, of tribal affairs, of oil and others are taking responsibility for protection measures; as they stand, these measures have been inefficient.

[Graph to the right]:

**Aggregate total of vandalism incidents targeting pipelines for 2003, 2004 and 2005**

[Below right graph]:

2003  
March, April, May, June, July, August, September, December, January, February

2004  
March, April, May, June, July, August, September, December, January, February

2005  
March, April, May, June, July, August, September, December, January, February

Aggregate Total to Date

[Left Map]:

**Geographic distribution of vandalism incidents targeting pipelines**

April 2003 – December 2005

Remark: The rate of vandalism incidents targeting pipelines relative to the total acts of vandalism in the oil sector is equal to 55%.

### **3. Smuggling Methods:**

#### **3.1 Delivering the Shipments after Some is Stolen:**

- The driver of the product transport containers takes some of the products and delivers the shipment with missing volumes ranging between 200 and 2,000 liters.
- The quantities taken are sold in the black market to bands that collect them and sell them to smugglers or to profiteers who benefit from crises in order to sell them illegally.
- A portion of these missing quantities is spotted and the greater part of these is handled through collusive agreement with warehouse or gas station employees.
- Even when the driver or carrier is fined the amount that corresponds to the shortfall, this fine does not represent more than a tiny percentage of the actual product's cost, and the profit margin remains high for the crooks.
- On the basis of the examples given in the next page, it becomes clear that these theft activities are executed in a deliberate manner with the intention to break the law; the reason is that they do not represent exceptional cases of shortfalls or a small number of shipping trucks.
- The phenomenon, for the most part, concerns container trucks coming from Turkey.



**Samples of Notifications concerning Truck Shipment Shortfalls in  
the North and Dawra**

**Attention: The Company's Chief Executive**

**Subject: Shipment Shortfall**

Please be advised that during the unloading of the Turkish shipments in our company's warehouses for the period from 8/1/2005 until 8/15/2005, the volumes were as follows:

1. The number of trucks at the Al-Tahaddi warehouse that had shipment shortfalls was 453; the volume of gas oil that these trucks were carrying reflected a shortfall of 302,935 liters.
2. The number of trucks at the Al-Thaer warehouse that had shipment shortfalls was 188; the volume of gas that these trucks were carrying reflected a shortfall of 102,093 liters.
3. We would like to mention that the use of the customs scale started on 8/14/2005.

**Examples of Fraud by Containers' Owners**

The Turkish containers, which were confirmed to be driven after they had been converted to the hydraulic system, were referred to the courts.

No.	Plate Number of the Container or Vehicle	Inspection Date 2005	Inspection Site	Type of Violation
1	34 S 8856/47 AH 219 TURKOIL	11/30	Al-Hadba gas station	1. Axis engine. 2. The hydraulic set is raised from the container, indicating prior alteration.
2	47 KR 209/33 E 5568 TURKOIL	12/4	Al-Abatin gas station	1. Axis engine. 2. Axial hydraulic set.
3	27 NU 609/34 AB 8773 AYGAS – OMEROGLU	12/4	Al-Hadba gas station	The hydraulic set is raised above the container, indicating prior alteration.
4	47 KR 962/31 TF 746 TIFEROM	11/30	Al-Hadba gas station	- Axis engine. 2. The hydraulic set is raised above the container, indicating prior alteration.
5	TR 31 KT 112/3 187 TIFEROM	11/30	Al-Hadba gas station	- Axis engine. 2. The hydraulic set is raised above the container, indicating prior alteration.

### **3.2 Direct Theft Targeting Crude Oil Pipelines and Oil Products:**

**Direct theft occurs as follows:**

- Breaking the transport pipelines or loosening the bolts, creating thus oil pools that are loaded and delivered to smuggling outlets; this is illustrated on the following page.
- Through some connections made into the pipeline and then siphoning off the oil special containers which are transported to the smuggling outlets.
- By connecting a plastic tube with the vent opening of non-operating wells, given that the gas pressure in these is small.

The facilities and pipelines belonging to the Southern Oil Company cover a vast geographic area which spans Al-Fao in the south, Al-Amara, Nasiriya, Haditha, Al-Habbaniya and K3 to the west, and then Kirkuk to the north. This area comprises a great number of wells and thousands of kilometers of pipelines. Those pipelines that pass through farms and remote areas, which are not adequately protected or under control, are constantly subject to criminal activities.

The stolen oil products are collected in special warehouses or tanks, and then they are shipped in containers abroad or in motorboats at Shatt el-Arab.

**Samples of Pictures and Notices of Oil Theft from Pipelines**

[Comments to pictures, from right to left]:

1. Stealing oil from oil pools after smashing the pipeline.
2. Stealing oil by connecting a plastic tube with the vent opening of non-operating wells, given that the gas pressure in these wells is small.
3. Collecting the stolen gas in special warehouses, and then smuggling it.

<p><b>Attention: The Center of Infrastructure Protection Activities – Ministry of Defense</b></p> <p><b>Subject: <u>Acts of Vandalism and Theft</u></b></p> <p>Following our letter No. 2704 of 11/22/2005, we are enclosing letter No. 314 of 12/28/2005, of the Oil Pipelines Company, regarding the existence of vandalism and theft activities targeting oil products at various sites where the oil pipeline passes (Biji – Mushahada). We would appreciate your examining the situation and providing the security forces for the aforementioned pipeline, as well as concentrating the security efforts in that area....</p>	<p><b>Attention: The Office of the Honorable Oil Minister</b></p> <p><b>Subject: Violations</b></p> <p>In the course of our security guards' regular patrol in the region of Al Mahdoura (Diesel), up to the Sabiha region, behind the former Persian Gulf's base of the Navy, and towards the tenth point that reaches Khour Al Zabir's harbor, they witnessed criminal activities targeting the oil pump pipe in the region comprised between the first point, that of the valves, next to Al Shaabiya refinery, until the sixth point, which is next to the base, and is under the responsibility of the border armed forces command. The violation encompassed boring a hole in order to steal the oil that was locked. The commander of the armed forces in that region, Colonel Karim, was notified about the situation, given that the region is under his responsibility. He replied that they are aware of what is going on and they know the band of thieves who are operating there, yet no measures were taken to deter these thieves, even though their crime was taking place at a distance of 150 meters from one of the border patrol checkpoints.</p> <p>We would appreciate your examining the situation.</p> <p>Sincerely...</p>
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**3.3 Bogus Entry of Imported Volumes (Documents Only):**

- Some imported volumes enter as documents only without the actual delivery of these volumes; this occurs in order to take advantage of the prevailing anarchy and the absence of supervision and control, and because some of the staff that works at the distribution units which receive the products in the warehouses is corrupt.
- The export companies' agents and the transport contractors play an essential role in incidents of fraud.
- This phenomenon occurs in the two northern outlets (products imported from Turkey), and in the southern land outlet (products imported from Kuwait).
- Some of the data that were received recently (they are being investigated) indicate that the volumes imported from the Gulf countries and that ought to be shipped by transport vessels through the Gulf do not reach the Iraqi ports; moreover, the receipt of the related documents are confirmed in the southern region without the actual shipment of these imported volumes.

<p style="text-align: center;"><b>Subject: Loading Document</b></p> <p>Please be advised that once more loading documents pertaining to non-existent container vehicles were submitted at the Al-Dabouniya warehouse for products imported from Kuwait. These were shown by means of the Company's agents (Al Rahal), along with a set of original documents for confirmation purposes. Enclosed you will find one of those documents in which the type of product was not confirmed. We would appreciate it if you would take the necessary measures against the carrier company.</p> <p>Sincerely...</p>	<p style="text-align: center;"><b>Subject: Number of Containers Entering from Kuwait according to Documents and which did not Enter Iraq</b></p> <p>Please find per attachment the lists containing the numbers of containers coming from Kuwait which did not enter Iraq during the period from 8/1 to 8/31/2005. We have received these from the southern region branch of the Oil Products Distribution Company. We would appreciate it if you will examine these and take the necessary measures, as well as advising us in this regard.</p> <p><u>Grand Total:</u> Gasoline = 114 trucks \\ Gas Oil = 29 trucks → 150 trucks White Oil = 7 trucks /</p> <p>Sincerely...</p>
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**3.4 Sale of Imported Oil Products within Exporting Countries and Offsetting them Locally:**

- The most serious smuggling activities are the ones that occur by truck drivers who sell imported oil products or some of these in Turkey, Syria and Jordan, and who enter Iraq with missing merchandise. Those drivers may also load their vehicles with water, and coordinate their activities with border checkpoint agents at Ibrahim, Al-Khalil and Rabi'a. In addition, some purchase oil products inside Iraq and deliver them to the warehouses as if they were imported.
- Some truck drivers convert their containers so that they seem to be carrying the full shipment; partitions are made inside the transport container's tank, and its center (the point leading to the inspection opening) would be filled with the oil product while the two sides of the tank would be empty or filled with water.
- Large-scale diversion of oil products takes place between the governorates of Baghdad, Salaheddin and Al-Anbar on one hand, and other governorates; they are then sent to northern governorates (especially to Zakho) in order to sell the oil products to Turkish trucks.
- These practices have been boosted by the inexistence of any controlling authorities between the governorates which would prevent the crossing of transported oil products without official documentation.

**Samples of Reports regarding Smuggling Incidents from the Northern Branch (Distribution)**

<p>Attention: Oil Products Distribution Company (Supply Department)</p> <p style="text-align: center;">Subject: Unloading Volumes</p> <p>In reference to the letters Nos. 10954 and 10951 of 6/29/2005, from the Oil Marketing Company, and the statements enclosed, please find below the numbers of Turkish trucks belonging to the companies mentioned next to each, and which are not entering through the Ibrahim Al-Khalil point. It is indicated that these trucks did not leave Iraq but remain inside Iraq and are supplied with documents and loaded with volumes purchased from within Iraq. We would appreciate your examining the issue and your contacting the competent authorities in order to cancel these volumes, given that they are undelivered as a result of being smuggled within Iraq.</p>	<p>Attention: Oil Marketing Company (Shipping Department)</p> <p style="text-align: center;">Subject: Unloading Volumes</p> <p>Please find enclosed a copy of letter No. 3580, dated 7/5/2005, from our northern region's branch, in reference to your letters referenced 10954 and 10951 of 6/29/2005, as well as the attached lists pertaining to the numbers of Turkish trucks that belong to the companies mentioned next to them and that do not enter through the Ibrahim Al-Khalil's checkpoint.</p> <p>We would appreciate your reviewing the issue and contacting the competent authorities in order to cancel these volumes, given that they are considered not have been received as they were smuggled from within Iraq.</p>
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<p style="text-align: center;">Subject: Violations</p> <p>Dear Sirs:</p> <p>Recently we have received information stating that some Turkish companies are selling their liquid gas shipments inside Turkey and filling their containers with water under pressures that are equal to those of gas. Thus, Major Nejm el-Din Hussein Sadek, the commander of the anti-smuggling unit that targets oil products, was appointed to monitor the issue. More than 14 trucks were in fact seized, after Turkish drivers and some Iraqis were enlisted in order to get accurate information about the drivers who commit these infractions before entering Iraq. These trucks were seized carrying water, according to the attached procedural report submitted by Major Nejm el-Din Hussein Sadek. Moreover, these trucks were videotaped. We would appreciate your appointing a task force from your company in order to investigate the topic. We will also assign employees from our company in this regard. Please take notice that the trucks are impounded at the Tahaddi depot, and they are not allowed to leave until the conclusion of the investigation.</p> <p>Enclosures: Lists of Seized Trucks</p>	<p>Dear Sir:</p> <p>Please find per attachment our letter No. 332 of 5/24/2005 regarding the issue of smuggling oil products by Turkish trucks and through a number of other methods, including the sale of large quantities of oil products in Turkey. When these trucks enter Iraq, the shortfall is replenished and the trucks reach the warehouses without the shortfall. We were not aware of these new methods. And two months earlier, we received pertinent information from our sources, which are posted among the Turkish drivers and their bureaus, with regard to that. That is the reason Major Nejm was appointed.</p>
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**3.5 Non-Arrival of Containers Moving Shipments among Warehouses within Iraq and Disposing of the Products:**

- The container drivers dispose illegally of the product and do not deliver it to the relevant destination, such as the warehouses, as is indicated in the examples on the next page.
- The driver sells the product directly to the local market or smuggles it across sea outlets after loading it.
- Even if the undelivered shipments, whose monetary value can be quite large, are uncovered, the driver does not pay for the missing volumes and the case is referred to the courts, while the legal proceedings take a long time to be resolved (the great majority of these cases are not legally adjudicated even when a long period of time has elapsed).
- For some of the cases that were spotted, the distribution sector companies were unable to prosecute the drivers given that they vanish after they steal the merchandise.

The photograph shows examiners from the Inspector General Office as they are seizing one of the trucks that carry liquid gas and that are selling gas cylinders through outside channels to one of the ambulant vendors instead of delivering the goods to the warehouses. Some of the drivers set up a special gear for filling the cylinders directly from the container.



Example: The quantities that are not delivered to the warehouses in 2004 and that are sent from the southern region's warehouses to the central and southern governorates are as follows:

Month	Quantities/Liter
January	164,000
March	72,000
April	432,000
May	741,000
October	5,856,000
November	5,491,000
December	15,596,000
Number of trucks sent to the southern warehouses and to the southern and central governorates which did not reach their destination	<ul style="list-style-type: none"> <li>- 1,556 trucks did not arrive</li> <li>- Their cargoes are equal to 55.5 million liters of oil products (gasoline, white oil, gas oil)</li> <li>- Their import cost is \$27.7 million</li> <li>- The fining values reached \$4.2 million</li> </ul>

Samples of violations perpetrated by domestic carriers and which consist in not delivering the products and disposing of them:

Quantities not received but shipped from the Al-Shaabiya warehouse to Al-Diwaniya and Babel and to the warehouses of Al-Mushahadat and Al-Rasafat						
Month	Gas Oil			White Oil		
December 2004	5 million liters			149 thousand liters		
November 2004	7 million liters			2.2 million liters		
December	8 million liters			2.2 million liters		
Quantities not received but shipped from the southern region to the central and southern governorates						
Period	Product			Quantities not Received		
9/2004 – 2/2005	Gas Oil			44 million liters		
	White Oil			20 million liters		
	Gasoline			143 thousand liters		
Quantities shipped from Al-Shaabiya and Al-Muftiya warehouses but not received in the southern governorates during the period between 9/17/2004 and 2/16/2005 (Liters)						
	Al Samawa	Al Diwaniya	Babel	Al Najaf	Karbala	Total
White Oil	1,980,000	2,948,000	7,795,000	180,000	137,000	12,950,000
Gas Oil	1,238,000	2,217,000	6,632,000	288,000	36,000	10,411,000

**3.6 Products Received by the End Users and Diverted to the Smugglers:**

- Given the absence of the necessary control and supervision with respect to the end users of oil products, including factories, farms, bakeries, generators, trucks, government outfits and power generating units, among others, the large quantities that are supplied are disposed of for other purposes than the ones they are intended for; furthermore, they are loaded and smuggled to other profiteers.
- The audit and inspection operations that we have undertaken have revealed that about 70% of these supplies are not used for the purposes they are earmarked for, and fraud takes place through their sale to other profiteers and smugglers.
- The audit and inspection operations reveal also that there are factors and units that are not operating or that do not exist to begin with and which are supplied with oil products.
- Small-scale profiteers divert oil products to the black market by filling their tank-converted cars with fuel from the gas stations; such vehicles can carry much larger amounts of fuel than the unaltered tanks, and the fuel is delivered to the smugglers' tanks and warehouses, as can be seen from the cases that were spotted in Baghdad.
- A few gas stations play an important role in diverting their products to the smugglers; this is especially the case for stations that are located in remote or border regions, or in areas where government control is absent.
- There are corrupt practices taking place in government departments which authorize requests for the purchase of oil products, as these departments approve the requests in return for bribes. To illustrate this, we will indicate below the parties that authorize the aforementioned requests.

<b>The Party Requesting the Product</b>	<b>The Party that Approves the Request</b>
Farmers	Directorate of Agriculture + the Governorate
Fishing boats	Ports Company + Customs Directorate + the Governorate + the Fishermen's Association
Electric generators	Electric Power Department + the Governorate
Tabouk and Hoss factories along with other local factories	Industrial Development Department
Bakeries	Trade Ministry + the Governorate
Citizens	The Governorate + Oil Ministry
Fuel stations and the owners of domestic generators	Oil Ministry

<p>Example of one of the seizure campaigns targeting the hoarding of fuel in Baghdad for smuggling purposes</p>	<p>Example of fraud by owners of cars that are supplied with gas oil in the governorate of Ninwa</p>
<p>Attention: The Office of the Honorable Oil Minister Subject: Al Kadimiya Operation</p> <p>We would like to inform your honor about a raid conducted in the Kadimiya region.</p> <p>1. After gathering and verifying all pertinent information, in collaboration with the Oil Ministry’s operational unit, and after putting the troops on alert and setting up the sting operation, we have fulfilled our duties and raided on August 3, 5 and 6, a gang that hoards and sells oil products, and that trades them in the black market. These include huge quantities gas, gasoline, and white oil. We have fulfilled our duty with great efficiency, and were totally successful. The operation was executed under the command of the Deputy Security Director and a few members of the security forces, in addition to the emergency forces belonging to our Directorate and the emergency forces from the central region’s branch.</p> <p>2. The products seized, including cars, containers and fuel tanks; some of which were fixed and others mobile, were taken to the Dawra refinery in accordance with a delivery/receipt report.</p> <p>3. Please find enclosed the details of the operation for August 3, 5, and 6, 2005, accompanied by the delivery and receipt report and the names of those who took part in the operation.</p> <p>We would appreciate your examining the case and taking the measures you deem necessary.</p>	<p>Subject: Registration of the gas oil share for cars</p> <p>We have received information indicating an increase in the number of cars registered with gas stations in order to be supplied with a share of gas oil. This number has reached 20,063 cars for March 2005. Following that information, we have formed a committee whose task is to reregister the cars and to implement the necessary control measures to prevent forging the annual numbers. In addition, the committee will direct the car owners to come personally to the registration committee and to request the original civil and annual status card, in addition to a letter indicating the validity of the annual document granted by the governorates and agencies. This should indicate that the car was bought from the original owner. Furthermore, in March 2005, the vehicles were reregistered. The number of registered ones in April 2005 was 9,414, with a difference of 10,649. By multiplying the result by the car’s share, which is 25 liters, we will have a product saving for the branch that is equal to: <math>10,649 \times 25 = 266,225</math> liters per day, or the equivalent of 7,986,750 liters for one month.</p>

**Attention: Salaheddin’s Police Command**  
**Subject: Sale of Oil Products**

This is in reference to letter No. 91, dated 11/14/2005, from the Oil Ministry (Technical Department), and in reference to our previous instructions with respect to increasing incidents of oil product sales in the black market next to the loading sites of the Salaheddin warehouse. It seems that most of these products belongs the governorates of Baghdad and Al-Anbar.

We would appreciate it if you set up joint teams and committees comprising your unit and the Oil Product Distribution Company in order to contain this phenomenon, arrest the offenders, and take legal measures against them. We would appreciate it also if you let us know of the measures taken at your earliest convenience.

**Example of Fraud with regard to the Shares Resolved for the Governorates of Baghdad and Al-Anbar**

#### **4. Smuggling Outlets:**

##### **4.1 Southern Region:**

- Samples of illegal anchorages in Shatt el-Arab that are used for smuggling purposes:
  - Mahoulat Al Zohair anchorage.
  - Mhayjran anchorage.
  - Al Ghanem anchorage.
  - Rmayla anchorage.
  - Babel anchorage.
  - Al Shara'a anchorage.
  - Al Tahaddi anchorage.
  - Jazirat Hijam anchorage.
  
- Samples of smuggling areas in the southern region:
  - **Al Hafr area:** It is located at a distance of 2 km from Al Shaabiya refineries; it is outfitted to store gas and black oil received from boat and ship manufacturing owners; the black oil and gas are collected and then smuggled through illegal anchorage points.
  - **The industrial area:** It is used for ship manufacturing and repair; it is occupied illegally by citizens, as government boats and other boats belonging to water shipping companies are stolen and kept, then disassembled and reassembled in the form of boats and motorboats that are used for smuggling.
  - **Al Zahd:** The Zahd Company has given false ownership records to the Ministry of Trade and controls the region that is close to the anchorages. It divides the region into lots and rents them out to business people who are specialized in the construction of ships. They carry out forgeries and alter the features of government ships, or send some parts of these to new ships. They take some of the equipment belonging to the Water Transportation Company and alter it illegally in order to use it for smuggling purposes.

**Remark:** The aforementioned illegal sites are also polluting the Shatt el-Arab waters because oil products are seeping from them; in addition there are no control measures or restrictions on their activities, and there are no environmental supervision authorities that would contain the environmental pollution.

**Office of the Oil Ministry's Inspector General**

**Second Transparency Report**

A Motorboat Outfitted for Smuggling in Shatt el-Arab

Pollution Caused by Oil Tanks and Barges

#### **4.2 Northern Outlet:**

- The northern region is experiencing unique political and regional conditions given that a large swath of its territory is under the control of the Kurdistan's government, and the other part is under the control of the governors and the government.
- The weak central government control has led, to a large extent, to widespread instances of smuggling, especially given the deteriorating security circumstances in some of the governorates, such as Mosul, Salaheddin and Kirkuk.
- The number of Turkish trucks entering Iraq through the northern point is estimated at about 200 thousand trucks in 2005. This number is quite large and exceeds the supervisory and control capacities available, given that this represents a new activity and that the ministry did not use to resort to imports before. Furthermore, it does not have the necessary experience to understand the fraudulent methods and ways that are used and that are spotted from time to time. These are practices that the units in charge of supervision were not aware of. Moreover, the security situation, the condition of the alarms, and the collusion between some of the carriers and some employees of the Oil Ministry, of customs and of the Interior Ministry, all of that has bolstered fraud and smuggling according to the methods which we have indicated in this report.

#### **4.3 Jordanian Outlet:**

Smuggling of black oil occurs in the main through the Jordanian outlet as follows:

- The smuggling parties collect and buy black oil from factory owners and others at profitable prices (\$50 per ton), while the ministry sells it for 10,000 dinars, or about \$7.
- The tankers that carry black oil travel in the direction of the Jordanian border and cross into Jordan unofficially, with the permission and collaboration of the checkpoint agents in Traybil.
- The tankers return to Iraq after they are given a Jordan gasoline voucher which confirms that the driver is carrying the oil product as part of fuel imports from neighboring countries, even though the tanker is empty. The gasoline is bought from inside the territory and emptied in Iraqi warehouses as an import (one of the import contracts was canceled after our office requested it in order to confirm fraud). Moreover, black oil activities are continuing.

**4.4 Local Black Market (Selling Outside the Regular Outlets):**

→ A large proportion of oil products are diverted from warehouses, fuel stations, gas factories and other oil and gas selling outlets, to individuals or agents and distributors; they are then sold outside those regular outlets in the local market at higher prices.

→ The volume of these oil products that are sold in breach of the supply, distribution and pricing instructions, is greater than one billion dollars, \$800 million of which are realized by those who trade these products and receive them from the official distribution outlets, or from the quantities that are diverted or stolen.

→ Diversion activities lead to the scarcity of oil products offered through the supply and distribution outlets; this impedes the supply lines to citizens and legitimate business people, and cause long waiting lines or lead to the purchase of these products at much higher prices than the official ones.

→ The scarcity of the oil products offered by the official outlets leads also to offsetting the shortage with greater imports; and in case the oil products are available at the official price, the merchants set out to divert them to the smugglers.

We can see here the overall averages of monthly family consumption for the four basic oil products during the post-war period until September 2005. It should be noted that these statements are derived from the reports pertaining to the quick survey of the Iraqi family budget for 2005, which was issued by the Ministry of Planning (Central Statistics Agency). On that basis, we notice the size of the local black market, although we should point out that the prices mentioned in the following tables are old prices approved in 2005 before the publication of the price increase resolution.

**Car Fuel (only):**

<b>Gasoline</b>	<b>Gas Station Buyer</b>	<b>%</b>	<b>Black Market Buyer</b>	<b>%</b>	<b>Total</b>	<b>%</b>
Monthly family consumption average (liters)	107.4	77.3	31.5	22.7	138.9	100
Monthly family expenditure average (dinars)	4,762.1	39.2	7,377	60.8	12,139.1	100
Average gasoline price for car fuel (dinar/liter)	44.3		234.5		47.4	
Official price (dinar/liter)	50					
<b>Car Fuel (only):</b>						
<b>Gas Oil</b>	<b>Gas Station Buyer</b>	<b>%</b>	<b>Black Market Buyer</b>	<b>%</b>	<b>Total</b>	<b>%</b>
Monthly family consumption average (liters)	7.4	63.2	4.3	36.8	11.7	100
Monthly family expenditure average (dinars)	166.1	33.6	327.8	66.4	493.9	100
Average gas oil price for car fuel (dinars/liter)	22.4		76.2		42.2	
Official price (dinars/liter)	10					
<b>(Home Fuel):</b>						
<b>White Oil</b>	<b>Gas Station Buyer</b>	<b>%</b>	<b>Black Market Buyer</b>	<b>%</b>	<b>Total</b>	<b>%</b>
Monthly family consumption average (liter)	13.1	51.0	12.6	49.0	25.8	100
Monthly family expenditure average (dinars)	339.0	15.9	1,788.2	84.1	2,127.2	100
Average white oil price (dinars/liter)	5		141.7		82.6	

<b>Liquid Gas</b>	<b>Gas Station Buyer</b>	<b>%</b>	<b>Black Market Buyer</b>	<b>%</b>	<b>Total</b>	<b>%</b>
Monthly family consumption average (cylinder)	0.4	14.9	2.2	85.1	2.6	100
Monthly family expenditure average (dinars)	336.1	10.4	2,889.7	89.6	3,225.9	100
Average price of liquid gas cylinder (dinars/cylinder)	858.9		1,297.0		1,231.5	
Official price (dinars/cylinder)	200					
<b>Product</b>	<b>Annual Consumption Volume</b>	<b>Percentage of Sales in Black Market</b>	<b>Average Sale Price in Black Market</b>	<b>Total Value of Sales in Black Market</b>		
Gasoline	7.6 billion liters	41%	234 dinars (15 years)	\$510 million		
Gas Oil	6.2 billion liters	69%	76 dinars (5 years)	\$140 million		
White Oil	2.4 billion liters	51%	141 dinars (9 years)	\$181 million		
Liquid Gas	1,662 thousand tons	85%	1,297 dinars (86 years)	\$114 million		



## **5. Impacts of Smuggling:**

### **Legal Impacts:**

- Smuggling is considered an instance of administrative corruption on one hand and of theft and public money squandering on the other. Thus, it leads to undermining the authority and the rule of law through the misuse of public assets (crude oil and oil products) in order to realize benefits for a handful of smugglers through various means (bribery, squandering of public money, influence peddling, abuse of power, theft). This leads to illegitimate profits and unwarranted gains, which result in legal obligations pursuant to the Iraqi civil code (emergence of money laundering activities that are disguised as legal and the concealment of the illegitimate and illegal sources of funds).
- The rule of law is undermined through the violation of the provisions of laws and regulations, making them thus irrelevant.

### **Economic Impacts:**

- Smuggling activities result in the creation of classes of profiteers that comprise influential criminals (smuggling mafia) who will have a negative impact on the social, economic and even political fabric of the country. Those who are involved in smuggling activities reap huge benefits from these activities and set out to launder the money earned in order to recycle it in the economy. This is done without giving much attention to the economic benefit ensuing from the investment of these funds, which are intended to be recycled without consideration for basic economic rules and laws. These practices will take place to the detriment of society's economic system, as they benefits categories of people that are at odds with the law.
- The exacerbation of the smuggling phenomenon leads to negative consequences with regard to the credibility of economic policies, and undermines the trust that economic and financial organizations might have for the country's economy. Hence, the attempts for economic reform will remain inefficient given the weakness of the national economy and the reluctance of international economic and financial organization to offer adequate assistance to the country.

- Smuggling leads to an increase in inflationary rates compared to the current situation, given that the rates of demand increase. This results in a hike in the prices of oil products and of all consumer goods (basket of goods). In addition, transport and communications services will be harmed because of price speculations concerning gasoline and gas oil outside the official distribution outlets for oil products. Thus prices will gyrate and the purchasing power of the monetary unit will plunge despite the attempts made by the authorities in order to implement a stable monetary policy and reduce inflationary rates. This contributes overall to the creation of an economic environment that is distorted and that discourages foreign investments, while at the same time undercutting reform efforts.
- The surge in smuggling activities following the 2003 war events resulted in the transformation of Iraq into a country that imports basic oil byproducts, while it used to be an exporter. This led to the depletion of funds that ensued from the export of Iraqi crude oil and their disbursements instead for importing oil products in the continuing efforts by the government to provide these products to citizens at a symbolic rate. Thus the annual budget sustains subsidy disbursements of approximately \$6 billion. At the same time large quantities of oil products are smuggled by land or sea to the neighboring countries (those countries from which imports originate). Hence, Iraq has become a speculative market with regard to the prices of these byproducts. This leads to twin losses reflected in the shares of citizens and in public money. It is best that this money be used for the renovation and upgrade of the current oil facilities and in the construction of new oil installations, in particular refineries in various regions of Iraq, insofar as this would reduce the import size of oil byproducts.

### **5.3 Political Impacts:**

One of the gravest dangers that smuggling leads to, given that it is one aspect of corruption and economic crime, is the negative impact that it has on the political system. Thus:

- It subverts the trust existing between the people and the government, and it weakens democratic participation given the ineffectual control and accountability outfits. This occurs through the recurring and expanding fuel crises that events have proven are for the most part contrived. This in turn leads to the weakening of the government's role in deterring those who trigger the crises and who are involved in smuggling, and in undermining the government's efforts to strengthen its position before the people, as it must resort to imports in order to meet local demands. As a consequence, the annual budget becomes weakened and the economic policies of the government become thwarted, while the reality becomes concealed from the people. This will reflect a contradiction with the principles of the democratic system, and would result in ineffectual state institutions, in particular the security institutions.

- At the same time, this phenomenon will harm the political institutions and the foreign relations they entertain, especially with the governments and organizations that could provide the financial assistance the country might need; instead these governments and organizations might place conditions that would undermine the sovereignty of the state.

**5.4 Social and Security Impacts:**

Corruption in general and smuggling in particular lead to the following:

- The corruption of oil installations employees by means of a corrupt environment that would entice them into following criminal elements.
- Smuggling money creates disparate social classes and imbalances in the social fabric because wealth is concentrated in the hands of one class of people who benefit from society and exploit it without regard for the interests of that society or the state, especially when some of that money is used to finance terrorism activities.
- Despair is exacerbated among citizens and a feeling of impotence becomes widespread. That is the reason combating smuggling and making the public aware of its negative consequences are extremely important. Moreover, opportunities for advancement, growth and sustainable development for the individual and society must be implemented.
- Rates of violence increase among citizens; we notice that these violent incidents become more frequent as the fuel crisis intensifies.
- The huge profits made from smuggling activities and the black market have attracted highly placed social, religious and political individuals, and introduce the latter into a cycle of corruption, which represents a very grave issue. Moreover, a great number of profit-mongers and smugglers are enticing these notables through financial assistance and bribes so that they provide them with protection.

## **6. Remedies Adopted by the Office of the Inspector General:**

- The formation of a Central Agency for Distribution Inspection upon the recommendation of the Office, and the Agency would currently be under the supervision of the Inspector General Office. This comes after the Office has recommended disbanding the inspection agency that belongs to the Oil Products Distribution Company, as a result of its inefficiency and the corruption existing among its members. The Agency is currently playing a great role in inspection operations targeting stations, warehouses, factories, and oil and gas distribution sites. Furthermore, it presents its reports to a ministerial committee set up to examine violations and which the Office had helped create. It must be independent from outside influences and be firm in assessing penalties against offenders given that diverting oil products from stations and warehouses is considered an important source of smuggling.
- The Office has been setting compatibility procedures with respect to products received and shipped by carriers to the warehouses. The Office has asked the oil companies concerned to take severe legal measures against carriers. It has also asked the Public Probity Commission and the Financial Control Bureau to join our Office in the inspection committee in order to undertake a comprehensive review of products' movements and identify the shortfalls that occurred in 2004 and 2005. Through the available statistics, we notice that products worth tens of millions of dollars were not received by the warehouses. This means that they were diverted to smuggling outlets.
- Recommending new contractual provisions with the product shipment contractors and having these provisions address the legal loopholes. Furthermore, assessing new fines for not delivering the oil products or for other violations. The ministry has ratified the new provisions and has distributed them to the oil companies concerned in order for these to implement them in lieu of the current contracts which contain many legal loopholes that are exploited in fraudulent and diversion activities pertaining to oil products and their smuggling.
- Planning to create an agency for combating smuggling in coordination with the oil, defense and interior ministries. The ministry has approved and endorsed this recommendation, which contains detailed mechanisms for the aforementioned agency's operations. Moreover, the agency is being created.
- The Office is monitoring all violations and abuses occurring along the distribution channels, as well as in product shipment activities. It is also examining the measures taken in that regard in addition to the solutions and the ways to stem these breaches by coordinating with the competent outfits.
- The formation of a committee for supervising the oil products import and export contracts at the Oil Marketing Company. This was done following the recommendation of the Office. The committee has implemented a mechanism for the sale of oil products with new terms that make it easier for the Iraqi private sector to buy and export products so that they undercut the efforts of the smugglers.
- A number of reports and recommendations regarding the smuggling phenomenon were submitted to the ministry, the National Assembly and the Public Probity Commission.

## **7. Measures Needed for Containing the Smuggling Phenomenon:**

### **7.1 Central Government Measures Needed:**

- The establishment of a department that is linked to the Interior Ministry and which is assigned to combat the smuggling of national resources. It should incorporate qualified and honest people and it would comprise intelligence outfits, armed forces, inspection units which would monitor roadways in addition to land and marine outlets. It would also encompass legal units that would have effective legal authority and would operate pursuant to a legislation that addresses activities that ruin the economy and those that concern the smuggling of national resources.
- Immediate instructions issued to eliminate all ports, docks and anchorages that are not officially licensed.
- Instructions for preventing boats loaded with general shipments and that are coming from abroad to anchor in unofficial places; those practices can be the cause of smuggling activities as small boats supply these ships with large amounts of smuggled gas. It is also necessary to comply with the international regulations which instruct that large ships must wait outside domestic waters, in the waiting area for ships. Afterward, those ships will leave their position and go to the official harbors without stopping and entering the customs area.
- It is necessary for the coast guard to be overhauled and provided with the necessary supplies in terms of boats, advanced weapons and other instruments that will enable it to fulfill its mission.
- Setting up a checkpoint at the end of Shatt el-Arab's estuary which will represent a genuine façade for Iraq and will comprise land and marine facilities equipped with advanced communications gears.

- Instructions for discontinuing the manufacture of fishing boats along with the conversion and replacement of engines with more powerful ones; moreover, licenses should not be granted anymore to the new small boats that are used as engines for stolen military vehicles.
- Instructions for implementing a solid plan for the protection of pipelines, as well as oil facilities and sites in coordination with the Oil Ministry and the Defense Ministry.
- Instructions for the formation of a joint operations center encompassing the Finance Ministry, the Oil Ministry and the Transportation Ministry, as well as other parties, in order to coordinate and maintain the supervision of smuggling activities.
- Implementing an incentives and rewards system for the control and supervisory staff, and for those who are employed in land and sea venues and outlets and who are tasked with supervisory, monitoring, control and inspection duties.
- Introducing new legislations that ensure the adequate level of deterrence and penalties for smuggling activities, given that they represent crimes that cause great harm to the economy.
- Establishment of agreements between Iraq and neighboring countries for coordination and cooperation in combating smuggling activities.

**7.2 Measures that Need to be Taken by the Oil Ministry:**

- The creation of a central compatibility department in the ministry's headquarters and which would have offices in the relevant sites. This department will be assigned the collection of information and data which it will have to submit for examination, analysis, comparison and conformance, indicating shortcomings at each site that it contacts through the Internet. This pertains in particular to the following sites:
  - All export and import harbors as well as the border outlets.
  - All warehouses.
  - All refineries and gas production factories.
  - Oil products loading sites.

The information is updated on a daily and weekly basis by all pertinent parties.

- Providing the necessary yardsticks (counters) and scales at sites where the oil products transit, and setting up a central unit that is responsible for the measurement system and that controls it, and which is linked to the department mentioned in (1).
- Reviewing the agreements pertaining to the shipment of products, in particular the terms concerning fines and penalties.
- Supplying laboratory and testing equipment according to the field circumstances existing at all sites.
- Reviewing the supply policy for all parties receiving oil products, exercising control and supervision over those parties, and implementing regulations that should address diversions, fraud and smuggling with respect to supplies.
- Endeavoring to efficiently and promptly repair, maintain and upgrade the Iraqi refineries as well as the network of oil pipelines.

- Overhauling the infrastructure of the distribution sector in order to ensure control over product movements, establishing responsibilities, eliminating overlapping and bolstering control and inspection activities.
- Establishing an efficient and speeding process for the concordance of quantities and qualities at the various levels and steps of product movement. Ministerial compatibility committees have been set up in the last period; however they were slow and were not able to reach effective solutions. A broader ministerial committee has been recently established in order to implement an accelerated plan within a limited timeframe and over several stages in order to achieve what the measurement operations require in terms of counters, valves and other yardsticks, as well as implementing conformance mechanisms among the parties that deal with these products (shipping and receiving).
- Establishing accountability principles and rules with respect to discrepancies and recommendations, in addition to determining responsibilities and calling to account those who are negligent.
- Seeking the assistance of international consulting bureaus with regard to auditing, control of product movements, in addition to measurement and computational systems.
- Reexamining imports from some outlets where fraud and smuggling activities are rife, such as the northern outlet from which Turkish vehicles enter and which has been known to shelter widespread fraudulent activities.
- Speeding the execution of the projects that are listed in the ministry's investment plans and that relate to the upgrade of refineries and the expansion of their storage capacities as well as those of pipelines and others, and of which only a small proportion has been executed in the past two years.
- Supplying citizens and legitimate end-users with oil products according to the card system (for all products) at the subsidized rate, while the sale price according to the market rate is greater than that.
- Bolstering the contracts pertaining to the import of products from the parties that export to Iraq with legal and judiciary measures addressing cases of fraud, swindle, and theft. These should lead to the impounding of the shipping trucks and the confiscation of the oil products, as well as referring those cases to the Iraqi courts and considering them as deliberate acts that aim to destroy the economy.