



# Iraq: Oil and Gas Sector, Revenue Sharing, and U.S. Policy

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## Summary

Development in Iraq's oil and natural gas sector is proceeding, amid ongoing debates. Iraqis differ strongly on a number of key issues, including the proper role and powers of federal and regional authorities in regulating oil and gas development; the terms and extent of potential foreign participation in the oil and gas sectors; and proposed formulas and mechanisms for equitably sharing oil and gas revenue. Concurrent, related discussions about the administrative status of the city of Kirkuk and proposed amendments to articles of Iraq's constitution that outline federal and regional oil and gas rights also are highly contentious.

Both the Bush Administration and the 110<sup>th</sup> Congress considered the passage of oil and gas sector framework and revenue-sharing legislation as important benchmarks that would indicate the Iraqi government's commitment to promoting political reconciliation and providing a solid foundation for long-term economic development in Iraq. Obama Administration officials and some Members of the 111<sup>th</sup> Congress have expressed similar views. In the absence of new comprehensive legislation to manage the energy sector and distribute energy export revenues, interim revenue-sharing mechanisms have been implemented, while both the national government and the Kurdistan Regional Government have signed oil and natural gas contracts with foreign firms.

The central importance of oil and gas revenue for the Iraqi economy is widely recognized by Iraqis, and most groups accept the need to create new legal and policy guidelines for the development of the country's oil and natural gas resources. However, Iraq's current Council of Representatives (parliament) did not take action to consider proposed energy sector reform legislation because of broader political disputes. Observers and U.S. officials remain focused on the outcome of the March 2010 Iraqi national election as an indicator of future trends.

In January 2010, the Council of Representatives adopted Iraq's 2010 budget, which includes a deficit of more than \$19 billion because of increased spending and stagnant oil production and export levels in Iraq. The budget also includes a controversial revenue distribution mechanism that will reward specific energy resource producing governorates. Iraq has secured a \$3.6 billion stand-by arrangement with the International Monetary Fund (IMF) and a total of \$500 million in loans from the World Bank to cover a portion of the expected 2010 deficit, as U.S. officials continue to warn that reduced revenues and spending may jeopardize Iraqi investments in infrastructure and security forces needed to fully stabilize the country.

The military strategy employed by U.S. forces in Iraq has sought to create a secure environment in which Iraqis can resolve core political differences as a means of ensuring national stability and security. However, it remains to be seen whether proposed oil and gas legislation and ongoing interim efforts to develop Iraq's energy resources will promote reconciliation or contribute to deeper political tension. U.S. policymakers and Members of Congress thus face difficult choices with regard to engaging Iraqis on various policy proposals, related constitutional reforms, and oil and natural gas development contracts, while encouraging Iraqi counterparts to ensure that the content of proposed laws, amendments, and contracts reflects acceptable political compromises. This report reviews policy proposals and interim contracts, analyzes the positions of various Iraqi political actors, and discusses potential implications for U.S. foreign policy goals in Iraq. See also CRS Report RL31339, *Iraq: Post-Saddam Governance and Security*, by Kenneth Katzman.

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## Background

Oil exploration and production in Iraq began in the 1920s under the terms of a wide-ranging concession granted to a consortium of international oil companies known as the Turkish Petroleum Company and later as the Iraq Petroleum Company. The nationalization of Iraq's oil resources and production was complete by 1975. From 1975 to 2003, Iraq's oil production and export facilities were entirely state operated. However, from the early 1980s until the toppling of Saddam Hussein's government in 2003, the country's hydrocarbon infrastructure suffered from the negative effects of war, international sanctions, a lack of investment and technology, and, in some cases, mismanagement and corruption. Iraq's highest-ever production level of 3.5 million barrels per day (mbd) was reached in 1990 immediately prior to the Iraqi invasion of Kuwait. Damage during the 1991 Gulf War and subsequent international sanctions limited overall production and exports until 2003 and beyond.

According to the *Oil and Gas Journal*, Iraq has 115 billion barrels of proven oil reserves, the world's third-largest after Saudi Arabia and Iran. Other estimates of Iraq's potential oil reserves vary, and the U.S. Department of Energy's Energy Information Administration (EIA) notes that current estimates "have not been revised since 2001 and are largely based on 2-D [two-dimensional] seismic data from nearly three decades ago."<sup>1</sup> Given the relative abundance of oil resources in Iraq and the relative ease with which Iraqi oil is extracted, many observers expect that new exploration using advanced technology will reveal further reserves, although estimates of potential additional reserves vary considerably.<sup>2</sup> Many oil industry professionals consider Iraq to have the world's largest, potentially most productive reserves that are not yet fully developed. Iraq's current proven reserves are concentrated (65% or more) in southern Iraq, particularly in the southernmost governorate of Al Basrah. Large proven oil resources also are located in the northern governorate of Al Tamim near the disputed city of Kirkuk. (See **Figure 1**, below.)

Iraq's current average oil production rate fluctuates around the March 2003 level of 2.5 mbd. However, the current export level of 1.97 mbd remains below the March 2003 level and the 2010 budget target of 2.10 mbd (see **Table 1**, below). At present, crude oil is the source of over 90% of Iraq's domestic energy consumption, and, according to the International Monetary Fund (IMF), oil exports generate approximately 85% of Iraq's government revenue. Declines in global oil prices from their 2008 high and reduced oil production led Iraqi leaders to amend their 2009 and 2010 revenue and budget assumptions from projected surpluses to projected consecutive \$15 billion deficits. The IMF expects Iraq's budget "to record significant, albeit declining deficits" in 2010 and 2011, "before returning to a surplus position in 2012."<sup>3</sup> Official U.S. assessments stress that continued fluctuations in oil prices and production may jeopardize Iraq's fiscal stability and the sustainability of its reconstruction and development plans, with uncertain follow-on effects on the economy and security.

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<sup>1</sup> U.S. Energy Information Administration (EIA), Country Analysis Brief: Iraq, June 2009.

<sup>2</sup> In August 2004, Iraq's then-Oil Minister Thamer al Ghadban claimed that Iraq had "unconfirmed or potential reserves" of 214 billion barrels, which includes the original 115 billion barrel base estimate. The U.S. Geological Survey's median estimate for additional reserves in Iraq (beyond the 115 billion barrel base estimate) is approximately 45 billion barrels. In April 2007, oil industry consultants IHS estimated that Iraq's proven and probable reserves equal 116 billion barrels, with a potential additional 100 billion barrels in largely unexplored western areas.

<sup>3</sup> IMF Public Information Notice No. 10/34, March 1, 2010.

Compared to other top oil producers, Iraq's current total output makes a significant contribution to global oil supplies. According to the U.S. Energy Information Administration (EIA), as of October 2009, Iraq's total production of 2.4 mbd accounted for nearly 3% of global supply and made Iraq the world's 11<sup>th</sup>-largest oil producer (see **Table 2**, below). Current Iraqi plans call for the expansion of oil production to 4 mbd by 2013 and then upward to 6 mbd by 2017. In December 2009, Iraq's Minister of Oil Hussein Shahrstani stated that "any increase will not be seen before 2011." International firms are not expected to begin to make investments and carry out substantial infrastructure work under the terms of recently agreed technical service contracts until after the Iraqi elections scheduled for March 2010.<sup>4</sup>

**Table 1. Key Oil Indicators**

Oil production and exports in million barrels per day (mbd), export revenue in current U.S. \$

Oil Production (current weekly avg.)	Pre-war Oil Production (2003)	Oil Exports (current)	Oil Export Target	Oil Revenue (2008)	Oil Revenue (2009)	Oil Revenue (2010)
2.45 mbd	2.50 mbd	1.99 mbd	2.10 mbd	\$61.9 billion	\$39.2 billion	\$5.0 billion

**Source:** U.S. Department of State, "Iraq Weekly Status Report," February 24, 2010.

Note: Oil export revenue is net of a 5% deduction for reparations to the victims of the 1990 Iraqi invasion and occupation of Kuwait, as provided for in U.N. Security Council Resolution 1483.

**Table 2. Top Global Oil Producers, October 2009**

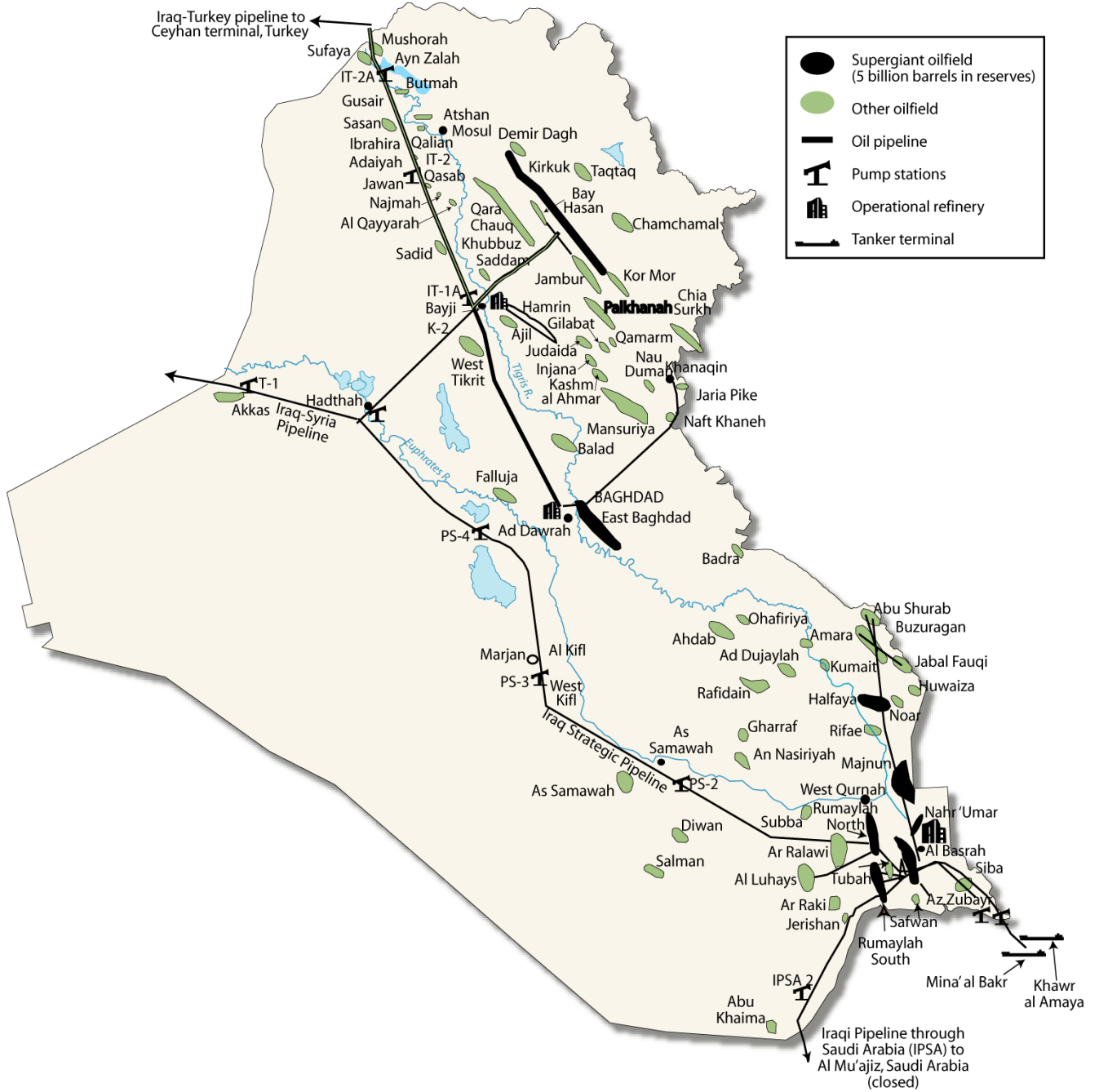
Country	Total Oil Production (million barrels per day)	% of Total Global Supply
Russia	10.076	11.812%
Saudi Arabia	9.936	11.648%
United States	9.278	10.876%
Iran	4.205	4.929%
China	4.010	4.701%
Canada	3.413	4.001%
Mexico	2.991	3.506%
United Arab Emirates	2.800	3.282%
Kuwait	2.510	2.942%
Venezuela	2.482	2.910%
<b>Iraq</b>	<b>2.434</b>	<b>2.853%</b>
Norway	2.369	2.777%

**Source:** U.S. Energy Information Administration (EIA), International Energy Statistics, Petroleum Production, October 2009. Available at: <http://tonto.eia.doe.gov/cfapps/ipdbproject/IEDIndex3.cfm?tid=50&pid=53&aid=1>.

**Notes:** 'Percentage of Total Global Supply' calculated by CRS on basis of EIA estimate of 85.301 million barrels per day of total global oil production as of October 2009.

<sup>4</sup> Dan Colover, Kate Dourian, Geoff King, Jacinta Moran, with Ben Lando, "Iraq Sees no Crude Output Rise before 2011; And does not expect talks on rejoining OPEC quota system caps," *Platts Oilgram News*, December 22, 2009.

**Figure I. Location of Iraq's Oil Reserves and Infrastructure**



**Source:** Adapted from U.S. Energy Information Administration (EIA), Energy Situation Analysis Report, June 26, 2003. See also EIA, Country Analysis Brief: Iraq, June 2009, available at: <http://www.eia.doe.gov/cabs/Iraq/Background.html>.

## Recent Developments

U.S. officials and many observers greeted Iraq's 2009 technical service contract bidding rounds (see below) as a signal that the Iraqi political leadership is committed to capitalizing on Iraq's resource potential and generating revenue to meet the country's significant development needs. The International Monetary Fund, World Bank, and others have argued that the fiscal shortfalls Iraq is facing as a result of stable oil production levels and moderate global oil prices will jeopardize the government's ability to provide needed services and could undermine security gains. Nevertheless, the political, security, and technical challenges described above leave most experts skeptical that Iraq will be able to meet its ambitious goals within the time frame currently outlined by the Maliki government.

### New International Agreements

In support of ambitious oil production expansion goals, Iraqi officials are conducting an international bidding and contracting process for oil field services and have renegotiated some Saddam-era oil production agreements. Iraq's government held two technical service contract bidding rounds in June and December 2009. Following the first tender in June, international firms sought per barrel fees far above what Iraq was willing to pay, and several potentially valuable service contracts for major fields were not awarded. Subsequent negotiations between Iraq and prospective foreign partners yielded more compatible fee offers from the international oil companies (IOCs), and several first round field contracts were initialed in late 2009. The second bidding round in December 2009 resulted in more closely aligned Iraqi offers and foreign bids, with many IOCs submitting highly competitive bids and proposing higher production volume pledges than Iraqi officials expected. Since December 2009, contract negotiations have proceeded rapidly. However, according to the U.S. Special Inspector General for Iraq Reconstruction (SIGIR), "to succeed, the winning bidders must overcome Iraq's aging infrastructure, rampant corruption, and fragile security."<sup>5</sup>

Under the terms of the new technical service contracts signed by the Ministry of Oil since mid-2009, IOCs will work in joint venture partnerships with Iraq's state-owned oil firms to manage and improve the production of specific oil fields, including many of Iraq's largest.<sup>6</sup> Iraq will compensate IOCs based on an agreed per barrel fee subject to contract conditions, such as the attainment and maintenance of targeted production levels for defined lengths of time. Once contracts are initialed by the Ministry of Oil, they are reviewed by Iraq's cabinet, the Council of Ministers. While the bidding processes have been conducted in a transparent, public manner, final contract details are being released to the public on an ad hoc basis as terms are agreed and approved by Iraqi officials. In all cases, terms may be subject to renegotiation, and clauses reportedly have been included allowing for adjustments required by potential future OPEC quota considerations. **Table 3** below provides an overview of recent Iraqi oil service contracts offered

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<sup>5</sup> U.S. Special Inspector General for Iraq Reconstruction (SIGIR), Quarterly Report to the United States Congress, January 2010.

<sup>6</sup> Iraq will receive initial revenue from contract signing fees paid by international firms and subsequent revenue from joint venture fees paid to state owned firms in the form of taxes charged on the per barrel fees paid to the international firms. Iraq's State Oil Marketing Organization (SOMO) will remain responsible for the sale of Iraqi oil on international markets, and revenues net of fees paid to the technical service providers will accrue to Iraqi state coffers.



and awarded in the June and December 2009 bidding rounds. Iraq also has decided to invest in some fields itself, in the absence of specific foreign interest.

### KRG Contracts

In late 2007, the Kurdistan Regional Government (KRG) finalized its own regional oil and gas investment law and signed new production sharing contracts (PSCs) with several international companies, including U.S.-based Hunt Oil.<sup>7</sup> Under the terms of the KRG's model PSC, foreign firms manage oil production in given fields, recovering their costs from the sale of specific percentages of the oil produced.<sup>8</sup> The KRG opposes proposals to require federal approval of its existing or future contracts, but notes that it is committed to revenue sharing as defined in the constitution (see below) and draft revenue-sharing legislation that has been considered to date. In May 2009, the national Ministry of Oil agreed to allow the KRG to export a limited quantity of oil using the national oil pipeline infrastructure from two fields, Tawke and Taq Taq, for which PSCs were signed prior to February 2007. However, a dispute over the compensation of the foreign firms involved in production at those fields has halted exports from KRG-controlled fields and has yet to be resolved (see below). Kurdish officials reportedly hope to expand oil production in the KRG region to 1 mbd by 2014.

**Table 3. Iraqi Technical Service Contracts and Select KRG Production Sharing Contracts**

Oil Field	Company/ Companies	Approximate Production Target (barrels per day)
Rumaila	BP (United Kingdom), China National Petroleum Corporation (CNPC)	2,850,000
Zubair	ENI (Italy), Occidental Petroleum (United States), Korea Gas Corporation (South Korea)	1,200,000*
West Qurna 1	ExxonMobil (United States), Royal Dutch Shell (United Kingdom, Netherlands)	2,325,000*
West Qurna 2	Lukoil (Russia), Statoil (Norway)	1,800,000*
Majnoon	Shell, Petronas (Malaysia)	1,800,000*
Halfaya	CNPC, Total (France), Petronas	535,000
Gharraf	Japex (Japan), Petronas	230,000
Badra	Gazprom (Russia), Petronas, TPAO (Turkey)	170,000
Qayara/Najmah	Sonangol (Angola)	230,000*
Select KRG Production Sharing Contracts		
Tawke	DNO (Norway)	NA

<sup>7</sup> Available at: [http://krg.org/uploads/documents/Kurdistan%20Oil%20and%20Gas%20Law%20English\\_\\_2007\\_09\\_06\\_h14m0s42.pdf](http://krg.org/uploads/documents/Kurdistan%20Oil%20and%20Gas%20Law%20English__2007_09_06_h14m0s42.pdf).

<sup>8</sup> Model contract available at: [http://krg.org/pdf/3\\_KRG\\_Model\\_PSC.pdf](http://krg.org/pdf/3_KRG_Model_PSC.pdf). The government and the IOCs receive further revenue in defined percentages from the sale of so-called “profit-oil”—the oil not sold on a cost recovery basis.

<b>Oil Field</b>	<b>Company/ Companies</b>	<b>Approximate Production Target (barrels per day)</b>
Taq Taq	Addax Petroleum (China – 100% acquired by Sinopec in 2009, formerly Swiss), Genel Enerji (Turkey)	NA
Dahuk	Hunt Oil (United States), Impulse Energy (United Arab Emirates)	NA

**Sources:** Created by CRS based on U.S. EIA and SIGIR reports and contract details reported by oil trade publications, the government of Iraq, the Kurdistan Regional Government, and Iraqi press sources.

**Notes:** Asterisks indicate winning bid targets that may exceed the Ministry of Oil’s proposed production target. All production targets are subject to negotiation pending final contract signature and cabinet approval. Targets and contract terms may be subject to renegotiation.

Small-scale U.S. government efforts continue to encourage development of legal and regulatory frameworks for the oil sector and to offer assistance to improve Iraqi budget execution. However, major U.S. programs to assist in the rehabilitation and security of Iraqi oil infrastructure are reaching completion. According to the most recent report of the SIGIR (issued January 30, 2010), “as of December 31, 2009, the United States had allocated \$2.06 billion, obligated \$1.93 billion, and expended \$1.91 billion ... to rehabilitate the oil and gas sector in Iraq.”<sup>9</sup> In addition, as of December 2005, the United States had administered over \$2.8 billion in Iraqi funds from the DFI for oil infrastructure projects.<sup>10</sup>

The SIGIR has reported that Iraq’s operational funds for its Oil Ministry increased over 800% from 2008 to 2009 reaching the level of \$950 million. Oil sector investment funding for 2009 remained roughly static at \$2.2 billion and is scheduled to grow to \$2.6 billion in 2010. Observers have noted that significant investments in port, road, rail, water, and power infrastructure also are necessary in order for Iraq to achieve its ambitious oil production expansion targets.

## Key Issues

The main points of contention among Iraqi politicians and citizen groups with regard to energy policy include the proper roles and authorities of federal and regional bodies, the terms and extent of potential foreign participation in oil and gas production and development, and potential formulas and mechanisms for equitably sharing oil and gas revenue. In addition, some Iraqi labor groups and elected officials have challenged the transparency and inclusiveness of legislative drafting and contract negotiation processes thus far. Concurrent negotiations regarding constitutional amendments have had direct implications for the hydrocarbon legislation debate, particularly efforts to clarify the specific authorities granted to federal and regional governments to regulate oil and gas development and export activities under Articles 111 and 112 of the Iraqi constitution.

<sup>9</sup> SIGIR, Quarterly Report to the United States Congress, January 2010.

<sup>10</sup> GAO, GAO-07-677, May 15, 2007, p. 15.

Overall, Iraqi, U.S., and other international observers have expressed concern that the violence and political tension that have prevailed in Iraq in recent years have not been conducive to careful consideration of detailed hydrocarbon sector legislation or new national oil and natural gas contracts. The November 4, 2009, U.S. Defense Department report on security and stability in Iraq stated that “fundamental differences remain over federal and regional authorities in contracting and management of the oil and gas sector.”<sup>11</sup> In the run-up to Iraq’s March 2010 national elections, candidates’ positions on oil- and natural gas-related policy questions received scrutiny from voters, although most candidates did not appear overly inclined to defend uncompromising positions on energy policy as a means of garnering popular support.

## **Political, Legal, and Constitutional Questions**

The Iraqi constitution’s ambiguity about the roles and powers of federal, regional, and governorate authorities has fueled division between the national government, the Kurdistan Regional Government (KRG), and other political actors. Articles 111 and 112 of the Iraqi constitution state that Iraq’s natural resources are the property of “*all the people of Iraq in all regions and governorates,*” and that “the federal government, *with the producing governorates and regional governments,* shall undertake the management of oil and gas extracted from present fields (italics added).”<sup>12</sup> These provisions were included as a means of ensuring consensus among Iraqis and the adoption of the constitution in 2005. In practice, differing interpretations of the constitution since that time drive an ongoing political impasse over oil issues that has prevented the adoption of comprehensive national oil legislation to date. Iraqi Kurds, acting through the KRG, initially demanded the right to sign oil development deals without national government interference, while the national government has proceeded with a technical service contract bidding process that some critics argue is unconstitutional.<sup>13</sup> Baghdad officials also have had to address popular nationalist concerns about the participation of foreign firms in Iraq’s energy sector and have sought to do so by using a technical service contract model, by requiring joint venture participation for Iraq’s state-owned oil firms, and by offering conservative payment terms to international partners. Iraq’s Federation of Oil Unions and its Southern Oil Company have publicly opposed the government’s bidding process, and many Iraqi Arabs question the legality of oil contracts signed by the KRG.

## **Resolving KRG-Baghdad Differences**

Disagreements between officials in the national government and the KRG continue to flare concerning the legality and terms of each government’s oil contracts with international investors.

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<sup>11</sup> U.S. Department of Defense, *Measuring Stability and Security in Iraq* – November 4, 2009, p. 5.

<sup>12</sup> Further complicating matters are Article 115, which provides regional authorities the power to override federal law in the event of conflicts with regional legislation, and Article 110, which grants powers to Iraq’s federal government to formulate “foreign sovereign economic and trade policy” and regulate “commercial policy across regional and governorate boundaries” similar to those granted to the United States Congress by the commerce clause of the U.S. Constitution. For one analysis of these issues, see Joseph C. Bell and Cheryl Saunders, “Iraqi Oil Policy—Constitutional Issues Regarding Federal and Regional Authority,” Memorandum, July 7, 2006. Available at <http://www.iraqrevenuewatch.org/reports/MEMORANDUMConstitutional%20Interpretation.DOC>.

<sup>13</sup> A lawsuit filed in December 2009 by a member of the Council of Representatives seeks to invalidate the Rumaila oil field technical service contract recently signed with BP and CNPC. The plaintiff argues that the contract should be nullified as unconstitutional because the parliament and governorates were not given the opportunity to approve it, among other reasons.

Although the national government has agreed to the export of some oil produced under KRG contracts with foreign firms, Baghdad maintains that the KRG is responsible for paying its foreign partners and that KRG contracts signed after February 2007 are considered “illegal” until reviewed and approved by the Ministry of Oil. KRG officials in turn argue that the Baghdad government is responsible for paying the foreign partners because the exports use national pipeline infrastructure and the oil ultimately belongs to the Iraqi people. In October 2009, KRG officials halted oil production for export in KRG territory pending a resolution of the payment dispute. In January 2010, Iraqi Prime Minister Nouri al Maliki indicated a willingness to resolve the dispute, and KRG officials offered to restart oil exports from KRG controlled fields if the national government reserved a portion of the proceeds of the sale to compensate the KRG’s foreign partners. In February, Oil Minister Shahrstani further suggested that the government could consider compensating the firms for their physical work on contracted fields but would not engage in the payment of profits due based on KRG-signed contracts. It remains unclear whether the new interest among Iraqi leaders in resolving the dispute will be enough to reach an agreement.

## **Hydrocarbon Sector Legislation**

A package of hydrocarbon sector and revenue-sharing legislation originally proposed in 2007 remains stalled amid ongoing disputes about broader political questions. The legislation would define terms and procedures for the management and development of the country’s significant oil and natural gas resources, while reforming state entities charged with overseeing and carrying out energy sector operations. U.S. officials and lawmakers have viewed such legislation as an important benchmark that would indicate the Iraqi government’s commitment to promoting political reconciliation and providing a sound basis for economic development.

Compromises reached in early 2007 allowed a legislative package to move forward toward formal consideration by Iraq’s parliament, but continuing disagreements about the relative powers of regional and national government authorities precluded further progress in adopting new laws. The legislative package preliminarily agreed to in 2007 included a draft hydrocarbon framework law that outlined a regulatory and policy development framework for future oil and gas exploration and production in Iraq. Three companion laws completed the package and would have established terms and mechanisms for revenue sharing, for the creation of a National Oil Company, and the reorganization of the Ministry of Oil. U.S. officials and Iraqi leaders now expect that the new Council of Representatives will consider hydrocarbon sector legislation after national elections in March 2010. At present, it remains unclear whether Iraqi officials intend to consider standing proposed legislation or whether they will seek to renegotiate key elements of the original compromise that allowed draft legislation to move forward in 2007. For more detailed analysis of the legislation proposed in 2007, see the **Appendix**.

## **Transparency, Fiscal Resources, and Revenue Sharing**

### **Transparency**

In August 2009, the U.N. Secretary General reported to the Security Council that “much remains to be done before a fully operational control and measurement system over oil production, distribution and export sales can be comprehensively implemented,” and added that, with regard to the installation of oil metering equipment to measure output and throughput, “indications from

the Ministry of Oil point to implementation by 2011 at the earliest.”<sup>14</sup> Several observers have questioned Iraq’s ability to efficiently and transparently manage its oil resources without adequate technical systems in place to account for the volume of oil produced, transported, and exported. On March 1, 2010, the IMF Executive Board stated that “completion of the oil metering system would help facilitate the full reconciliation of oil flows with financial flows between the state-owned oil companies and the budget.” In February 2010, Iraq began implementing the Extractive Industries Transparency Initiative (EITI) as an EITI candidate country.<sup>15</sup>

Iraq’s State Oil Marketing Organization (SOMO) remains responsible for the sale and export of Iraqi crude oil. Under the terms of United Nations Security Council resolution (UNSCR) 1483 (and renewed through subsequent Security Council resolutions), revenue from Iraq’s oil exports is deposited into an Iraq-controlled account held at the Federal Reserve Bank of New York (FRBNY). Five percent of the funds are reserved for a United Nations Compensation Fund for reparations to the victims of the 1990 Iraqi invasion and occupation of Kuwait.<sup>16</sup> The remaining 95% is deposited into a Development Fund for Iraq (DFI) account at the FRBNY and is then transferred to an Iraqi Ministry of Finance account at the Central Bank of Iraq for further distribution to Iraqi government ministries.<sup>17</sup> At Iraq’s request, UNSCR 1905 (adopted December 21, 2009) extended the mandate for the DFI and the International Advisory and Monitoring Board (IAMB) until December 2010. The IAMB provides periodic reports on Iraq’s oil export revenue, Iraq’s use of its oil revenues, and its oil production practices.<sup>18</sup> In July 2009, the IAMB stated that its completed 2008 audit, “continues to highlight key issues of concern regarding weaknesses in controls over oil extraction and use of the resources.”<sup>19</sup>

In October 2006, the Iraqi cabinet approved the creation of an oversight body known as the Committee of Financial Experts (COFE) to monitor oil revenue collection and administration. The president of the COFE inaugurated its activities in April 2007, and it currently is working alongside the IAMB on audit procedures. In April 2009, the IAMB stated that Iraq’s Committee of Financial Experts “is ready and capable to succeed the IAMB and conduct competent and independent oversight of the DFI.” A similar finding was reported to the UN Security Council in August 2009.<sup>20</sup>

Immunity provisions contained in standing UN Security Council resolutions prevent Iraqi funds deposited in the DFI from being subject to property attachment motions in lieu of legal judgments rendered against the former Iraqi regime. President Bush issued a continuation of the U.S. legal protections for the DFI and other Iraqi assets under Executive Order 13303 through May 20,

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<sup>14</sup> Oil production and exports were conducted without metering equipment throughout the U.S.-led Coalition Provisional Authority (CPA) period. First report of the Secretary-General pursuant to paragraph 3 of resolution 1859 (2008), S/2009/430, August 24, 2009.

<sup>15</sup> The EITI promotes extractive industry revenue transparency standards through the implementation and monitoring of accounting methodologies for member countries and companies. For more information, see EITI Fact Sheet, January 25, 2010. Available at [http://eititransparency.org/files/2010-01-25\\_EITI\\_Fact\\_Sheet\\_1.pdf](http://eititransparency.org/files/2010-01-25_EITI_Fact_Sheet_1.pdf).

<sup>16</sup> Iraq has sought to reduce the percentage paid to Kuwait to 1%. However, in October 2009, a proposal to channel paid reparation funds into joint investment projects was rejected by Kuwaiti parliamentarians.

<sup>17</sup> Ernst & Young, Development Fund for Iraq—Statement of Cash Receipts and Payments for the period from 1 July 2005 to 31 December 2005, September 19, 2006, p. 6.

<sup>18</sup> See <http://www.iamb.info/>.

<sup>19</sup> Statement by the International Advisory and Monitoring Board of the Development Fund for Iraq, July 31, 2009.

<sup>20</sup> First report of the Secretary-General pursuant to paragraph 3 of resolution 1859 (2008), S/2009/430, August 24, 2009.

2009, and President Obama extended the protections through May 2010.<sup>21</sup> Article 26 of the U.S.-Iraq security agreement commits the United States to continue to assist Iraq with its request to the UN to extend related protections for energy proceeds and the DFI.

## Fiscal Resources

The International Monetary Fund (IMF) warned in a January 2008 report that Iraq’s public finances have been “fragile” in recent years and added that, in light of considerable operations and reconstruction needs, the Iraqi government has “little room for fiscal slippage” until oil output increases. The 2008 IMF report explained how high oil prices had compensated for missed oil production expansion targets that had undermined revenue generation through late 2007. Increases in oil prices through August 2008 and expanded oil exports generated substantially higher than expected oil revenues for Iraq through most of 2008. However, drops in global oil prices after September 2008 drastically undercut Iraqi oil revenues, and this trend has forced the Iraqi government to scale back its 2009 and—in spite of recent price increases—its 2010 budget plans. The projected budget deficit for 2009 was \$15 to \$17 billion, and was financed in part through the use of reserve funds accumulated from prior budget surpluses. In a March 2010 follow up report, the IMF reiterated that “Iraq’s longer term economic outlook is strong as oil prices and production are projected to increase markedly in the coming years.” However, the IMF estimated that Iraqi budget deficits in 2010 and 2011 would create a \$5 billion financing gap after domestic resources have been tapped that will need to be met with international financial support.

In January 2010, the Iraqi Council of Ministers approved a 2010 budget of \$73.5 billion, based on an export level of 2.1 million barrels per day at an expected average oil price of \$62 per barrel. An expected \$15 billion 2010 budget deficit will be covered in part by funds raised through a planned Iraqi government bond issue and in part through recently negotiated external support agreements such as the IMF Stand-by Arrangement and World Bank loans.<sup>22</sup> **Table 4** below presents various potential revenue scenarios and illustrates that while significant oil revenue may be available to Iraq over the medium term, its availability remains a function of both Iraq’s production and export capacity and prevailing global market prices.

**Table 4. Potential Annual Iraq Oil Revenue**

Average annual price per barrel, potential gross revenue \$ billion

Potential Oil Exports (million barrels per day)	Potential Gross Revenue (\$ billion)		
	@ \$50/barrel	@ \$70/barrel	@ \$90/barrel
2 mbd	\$36.50	\$51.10	\$65.70
3 mbd	\$54.75	\$76.65	\$98.55
4 mbd	\$73.00	\$102.20	\$131.40
5 mbd	\$91.25	\$127.75	\$164.25

<sup>21</sup> The White House, *Notice: Continuation of the National Emergency with Respect to the Stabilization of Iraq*, May 20, 2008; and The White House, *Notice: Continuation of the National Emergency with Respect to the Stabilization of Iraq*, May 19, 2009.

<sup>22</sup> *Reuters*, “Iraq ups oil price in 2010 budget, lowers exports,” October 17, 2009; and, *Reuters*, “Iraq approves 2010 budget, plans bond issues,” October 13, 2009.

**Source:** CRS Calculation.

**Notes:** As of February 24, 2010, the U.S. Department of State reported that Iraq was exporting 1.99 mbd, and Basrah Light crude was priced at \$75.45 per barrel. Figures are estimates used to project potential gross revenue. Potential tax revenues, fees paid to technical service contractors, and payments to United Nations Compensation Fund for Kuwait are not reflected in the gross revenue estimates above.

## Revenue Sharing

The central role of the oil sector in Iraq's economy, the uneven geographic distribution of Iraq's oil resources, and the legacy of communal favoritism practiced under Saddam Hussein have created lasting concerns among Iraqis about the future equitable distribution of oil revenues. These concerns deepened in the atmosphere of violence and sectarian tension that gripped Iraq from mid-2003 through mid-2008. It continues to shape the dispute between the KRG and the federal government. The principles and mechanisms by and through which Iraq's oil revenues are to be collected and distributed remain contested. Most outside observers agree that an equitable, mutually accepted revenue distribution formula will be critically important to Iraq's future economic health and political stability. Article 112 of Iraq's constitution requires the Iraqi government to distribute revenues:

in a fair manner in proportion to the population distribution in all parts of the country, specifying an allotment for a specified period for the damaged regions which were unjustly deprived of them by the former regime, and the regions that were damaged afterwards in a way that ensures balanced development in different areas of the country, and this shall be regulated by a law.

The principal issues remain formulas for ensuring equitable distribution of revenues to Iraq's population and the mechanisms through which revenue will be collected and distributed. Debate over distribution formulas reflects efforts to agree on quantitative terms for ensuring equitable per capita distribution and providing for "damaged" and "unjustly deprived" regions in line with Article 112 of the constitution. Debate on distribution mechanisms focuses on whether or not regions or governorates should retain the right to make decisions about revenue from oil and gas produced in their territory and whether federal revenue distribution should be automatic and fixed or whether the federal government should retain discretion over the allocation of funding to regions and governorates.

At present, a baseline arrangement that sends 17% of revenues to the KRG has been reflected in recent budgets. The 2010 budget also includes a provision that will deliver \$1 to producing governorates for each barrel of oil and refined fuel they produce, leading some observers to warn that redistribution of financial resources from the central government could reduce the amount of funding available for needed infrastructure investments and create new opportunities for local corruption.<sup>23</sup> Since 2008, Iraq's annual budget legislation has required that a census be held to determine ratios for future revenue distribution. Broader political tensions and government capacity constraints have precluded the holding of a national census thus far.

Revenue-sharing mechanisms based on per capita population formulas may ensure formerly disadvantaged regions receive adequate shares of oil and gas proceeds, but could create new resentment in less populous governorates, including areas inhabited by Iraq's minority Sunni

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<sup>23</sup> See, for example, Reidar Visser, "Decentralisation Bonanza in the Iraqi Budget," available at <http://www.historiae.org>, January 27, 2010.

Arab population. Similarly, revenue distribution mechanisms that reward producing governorates may create resentment in non-producing areas.

## **Meeting Logistical and Technical Requirements**

By all accounts, Iraq will have to meet significant logistical and technical requirements in order to expand its oil production to planned levels. In January 2010, the SIGIR judged that “anticipated production increases cannot be accommodated by the existing pipeline and export infrastructure.”<sup>24</sup> Experts have identified three main areas where investments are needed: drilling rigs and pumping equipment, water supplies for oil field reinjection, and oil pipelines, storage facilities, and export terminals. The International Energy Agency’s (IEA) December 2009 Oil Market Report identified logistical constraints on export capacity as “a formidable issue that urgently needs to be addressed.” According to the IEA, “Experts estimate that current capacity constraints will limit exports to under 3.0 mbd until major infrastructure work can be completed in the southern region, with 2013-14 the earliest expansion work would be completed.”

Oil Minister Hussain al Shahrstani estimated in April 2009 that Iraq will need to attract \$50 billion in investment to expand oil production capacity from the current level of 2.4 mbd to 6 mbd. Energy experts expect Iraq to rely on an extensive contracting program with local, regional, and international entities to manage these investments. Both the U.S. and Iraqi governments are taking steps to improve public financial management and the coordination of U.S. assistance programs, partly in response to 2008 assessments from the SIGIR and others that argued that U.S. investments in capacity building could be “at risk” unless more integrated financial capacity development programming was implemented for Iraqi ministries.<sup>25</sup> Iraq has issued new decrees and reformed administrative bodies to grant greater contracting authority to ministries and provinces. The U.S. Embassy in Baghdad and the commanders of U.S. Forces-Iraq (USF-I) also have reorganized the management of existing U.S. and coalition budget assistance programs to improve coordination. In late June 2008, an interagency Public Finance Management Assistance Group (PFMAG) began work in an advisory capacity with a number of Iraqi ministries.

## **Maintaining Security**

Both the SIGIR and the U.S. Department of Defense report that the security of Iraq’s oil infrastructure has improved markedly since 2007 because of the introduction of an infrastructure protection system that includes several Pipeline Exclusion Zones (PEZs). U.S.-funded components of the PEZ program were completed in 2009. As new oil infrastructure and pipelines are constructed to support Iraq’s planned expansion of production, new investments in security infrastructure and security personnel will be necessary. The extent of needed investment will be determined in relation to the size and scope of the actual expansion and the broader security situation prevailing in Iraq.

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<sup>24</sup> SIGIR, Quarterly Report to the United States Congress, January 2010, p. 9.

<sup>25</sup> Special Inspector General for Iraq Reconstruction (SIGIR) Report 08-020, “Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts,” July 2008.



## Renegotiating Iraq's OPEC Quota

Prior to the 1990-1991 Gulf War, Iraq was a leading member of OPEC with a production quota that mirrored that of its neighbor, Iran. While Iraq remains active in OPEC, it has not operated under the group's quota system since 1991, and many observers expect that the eventual renegotiation of Iraq's OPEC production quota will be a contentious process. In light of Iraq's ambitious production expansion plans, this issue has attracted more analysis and commentary in recent months. The introduction of significant Iraqi oil supplies onto the international market absent corresponding cuts in production from other OPEC or non-OPEC producers could exert downward pressure on global oil prices, especially if global economic growth remains sluggish and oil demand remains relatively flat. In December 2009, Minister Shahrastani stated that he does not "expect any discussion until we reach a significant increase in production," adding his view that "there is a need to consider criteria such as the need for construction and development when studying quotas."<sup>26</sup> According to Shahrastani, Iraq intends to continue "coordinating its effort to be sure that Iraq and all other countries can maximize the revenues from their oil sales."<sup>27</sup> OPEC Secretary General Abdullah al Badri stated in December 2009, "when the time comes, we will sit and discuss this issue and we will be sure to accommodate Iraq."<sup>28</sup> Oil market experts have underscored the importance and potential difficulty of reaching such an accommodation. If global economic growth resumes at its pre-financial crisis rate, new demand for energy resources could ease the Iraq-OPEC transition. Should global economic activity remain relatively flat or demand for oil resources contract, OPEC members may face more challenging decisions about how to accommodate Iraq's planned production increases.

## Outlook and Future Prospects

U.S. officials and many observers greeted Iraq's 2009 technical service contract bidding rounds as a signal that the Iraqi political leadership is committed to capitalizing on Iraq's resource potential and generating revenue to meet the country's significant development needs. The International Monetary Fund, World Bank, and others have argued that the fiscal shortfalls Iraq is facing as a result of constant oil production levels and moderate global oil prices will jeopardize the government's ability to provide needed services and could undermine security gains. Nevertheless, the political, security, and technical challenges described above leave most experts skeptical that Iraq will be able to meet its ambitious goals within the time frame currently outlined by the Maliki government.

In December 2009, the International Energy Agency (IEA) revised its medium-term oil production outlook for Iraq upward to 3.1 mbd by 2014.<sup>29</sup> The IEA warned that this revised outlook is "extremely vulnerable to future revision" in light of "the many political and security risks that continue to challenge the government and industry." According to the IEA report, Iraq's

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<sup>26</sup> Dan Colover, Kate Dourian, Geoff King, Jacinta Moran, with Ben Lando, "Iraq sees no crude output rise before 2011; And does not expect talks on rejoining OPEC quota system," *Platts Oilgram News*, December 22, 2009.

<sup>27</sup> Ben Lando, "Iraq sees 12 million b/d output capacity in six years," *Platts Oilgram News*, December 15, 2009.

<sup>28</sup> Ibid.

<sup>29</sup> The International Energy Agency (IEA) is an intergovernmental organization which acts as energy policy advisor to 28 member countries, including the United States. International Energy Agency, *Oil Market Report*, December 11, 2009. Available at: <http://omrpublic.iea.org/>.

“production targets are arguably very ambitious and are near impossible to reach in the announced time frame given political, logistical, and technical hurdles.”

In the near term, experts and industry professionals are closely focused on the outcome of the March 2010 national elections, the makeup of the new Council of Representatives, and the formation of a new cabinet. While many expect that the new cabinet will continue along the oil sector management path outlined by the current government, some stakeholders harbor concerns that the terms for international investment in Iraq’s oil and gas sector could be significantly revised under a new administration or under pressure from members of the new parliament. The new government also will need to address long-standing political and constitutional questions that have remained unresolved in light of the pending election.

## **U.S. Policy and Issues for Congress**

The Obama Administration and many Members of the 111<sup>th</sup> Congress identify the promotion of political reconciliation and long-term economic development as key U.S. policy goals in Iraq. The current military strategy employed by U.S. forces in Iraq seeks to support Iraqi forces as they maintain a secure environment in which elected leaders can resolve core political differences. In Iraq, the ongoing debate over energy policy and legislation reflects Iraqis’ unresolved political differences over the powers reserved for federal and regional authorities, proper means for ensuring equitable distribution of hydrocarbon revenues, and long-standing, shared concerns about preserving Iraq’s unity and sovereignty.

In light of the U.S. military commitment and persistent Iraqi political differences, Members of Congress and U.S. policymakers face a number of challenging questions: As the U.S. role in providing security in Iraq diminishes, how will the United States influence the pace and content of Iraqi energy policy debates? How should U.S. diplomats engage with Iraqis regarding the management of Iraq’s sovereign economic resources? Should the United States encourage Iraqis to complete constitutional reforms that will resolve core political differences before promoting the adoption and implementation of hydrocarbon sector legislation? How can the United States effectively encourage Iraqis to adopt equitable revenue-sharing mechanisms? Should the U.S. government promote or facilitate U.S. and international investment in Iraq’s oil and gas sector and, if so, in what form, on which terms, and on what scale?

If constitutional disputes over federal and regional authority remain unresolved, the durability of compromises reached with regard to hydrocarbon legislation, revenue sharing, and new oil and gas contracts may be undermined. International investment and technology appear necessary in light of the current Iraqi government’s ambitious plans for the expansion of Iraq’s oil and gas production. However, the terms and conditions of international participation are likely to remain highly controversial, with powerful Iraqi interest groups taking opposing positions. The public positions that Members of Congress and Administration officials take on each of these questions may influence Iraqi attitudes toward the remaining U.S. presence in Iraq, toward Iraq’s proposed legislation and investment arrangements, and toward each other.

## **Congressional Benchmark and Other Legislation**

In recent years, Congress has sought to ensure that appropriated funds are not used to control Iraq's oil resources and has sought to influence the development and course of U.S. policy in Iraq by requiring the Administration to report on key oil and oil revenue related benchmarks.

### **Legislation in the 111<sup>th</sup> Congress**

Section 1221 of P.L. 111-84, the National Defense Authorization Act for Fiscal Year 2010, states that, "no funds appropriated pursuant to an authorization of appropriations in this Act may be obligated or expended ... To exercise United States control of the oil resources of Iraq."

Section 9008 of the FY2010 Defense Appropriations Act (P.L. 111-118) contain similar prohibitions.

Section 314 of P.L. 111-32, the Supplemental Appropriations Act, 2009 (June 24, 2009) states that "none of the funds appropriated or otherwise made available by this or any other Act shall be obligated or expended by the United States Government ... to exercise United States control over any oil resource of Iraq."

Senator John Ensign continues to advocate for the creation of an "Iraq Oil Trust" to ensure that all Iraqis share the proceeds of Iraq's oil exports equitably. S. 351, the Support for Iraq Oil Trust Act of 2009, would require the U.S. Department of State to provide the government of Iraq with a plan outlining options for the creation and implementation of different types of oil trusts. The bill would withhold 10% of U.S. Economic Support Fund assistance to Iraq until the Administration certified the delivery of such a plan. The bill mirrors the version introduced in the 110<sup>th</sup> Congress, S. 3470, the Support for Iraq Oil Trust Act of 2008, of which then-Senator and now Secretary of State Hillary Clinton was a co-sponsor.

### **Legislation in the 110<sup>th</sup> Congress**

Section 1314 of the FY2007 Supplemental Appropriations Act (P.L. 110-28) specifically identified the enactment and implementation of legislation "to ensure the equitable distribution of hydrocarbon resources of the people of Iraq without regard to the sect or ethnicity of recipients" and "to ensure that the energy resources of Iraq benefit Sunni Arabs, Shia Arabs, Kurds, and other Iraqi citizens in an equitable manner" as benchmarks on which the President was required to report to Congress in July and September 2007. Section 3301 of the act states that no funds appropriated by the act or any other act may be used "to exercise United States control over any oil resource of Iraq."

On July 12, 2007, the Administration released an interim report on the Iraq benchmarks stating that progress toward meeting the revenue-sharing benchmark "is unsatisfactory," and noting that the Administration remains "actively engaged" in encouraging Iraqi leaders "to expeditiously approve the draft [revenue sharing] law in the Council of Ministers and move it to the Council of Representatives." According to the report, "the effect of limited progress toward this benchmark has been to reduce the perceived confidence in, and effectiveness of, the Iraqi Government."<sup>30</sup>

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<sup>30</sup> The White House, Initial Benchmark Assessment Report, July 12, 2007. Available at <http://www.whitehouse.gov/> (continued...)

The September 2007 report stated that Iraq's government "has not made satisfactory progress toward enacting and implementing legislation to ensure the equitable distribution of hydrocarbon revenue." The report also stressed that "it is difficult to predict what further progress might occur" when Iraq's parliament reconvenes and considers proposed legislation.<sup>31</sup>

Section 8113 of P.L. 110-116, the Department of Defense Appropriations Act, 2008 (November 13, 2007) states that "none of the funds appropriated or otherwise made available by this or any other Act shall be obligated or expended by the United States Government ... to exercise United States control over any oil resource of Iraq."

Section 1222 of P.L. 110-181, the National Defense Authorization Act for Fiscal Year 2008 (January 28, 2008) states that "no funds appropriated pursuant to an authorization of appropriations in this Act may be obligated or expended ... to exercise United States control of the oil resources of Iraq." Section 1211 of S. 3001, the Duncan Hunter National Defense Authorization Act for Fiscal Year 2009 (September 27, 2008) and Section 8106 of P.L. 110-329, the Consolidated Security, Disaster Assistance, and Continuing Appropriations Act, 2009, contained similar prohibitive language. President Bush issued signing statements stating that the executive branch would "construe such provisions in a manner consistent with the constitutional authority of the President" because, in his view, the provisions "could inhibit the President's ability to carry out his constitutional obligations."

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nsc/iraq/2007/FinalBenchmarkReport.pdf

<sup>31</sup> The White House, Benchmark Assessment Report, September 14, 2007. Available at <http://www.whitehouse.gov/news/releases/2007/09/20070914.html>

## **Appendix. Draft Hydrocarbon Legislation**

### **Hydrocarbon Framework Law**

Beginning in mid-2006, a three-member Oil and Energy Committee working under the auspices of the Iraqi cabinet prepared draft hydrocarbon framework legislation to regulate Iraq's oil and gas sector. A political negotiating committee subsequently edited their draft. Following approval by the negotiating committee, Iraq's Council of Ministers (cabinet) approved a draft version of the hydrocarbon framework law in February 2007.<sup>32</sup> Subsequent negotiations among Iraqi leaders sought to clarify the responsibilities of federal and regional authorities as well as contracting procedures for oil fields. On July 3, 2007, Iraqi Prime Minister Nouri al Maliki announced that the Council of Ministers had approved a final version of the framework law and had forwarded the bill to the Council of Representatives for consideration.

The Council of Ministers' Shoura Council reportedly amended provisions of the bill to ensure their consistency with provisions of the Iraqi constitution. However, Kurdish officials protested the changes, arguing that they are substantive, rather than semantic, and have tentatively withdrawn their support for the legislation. The boycott of cabinet and parliamentary proceedings by various Iraqi entities at the time of the cabinet's approval of the law added to the controversy surrounding the proposed legislation.

As of November 2009, statements from Iraqi government officials and members of the Council of Representatives suggest that parliamentary consideration of the legislation continues to be delayed by disagreements between key political figures and likely will be delayed until the election of a new parliament in national elections scheduled for early 2010. The Council of Ministers reportedly is considering new draft legislation, but no timetable has been announced for its consideration. Skepticism about the performance of Oil Minister Shahrastani appears to be significant within the Council of Representatives, as is opposition to the conduct of the investment bidding round conducted in July 2009 and to contracts signed by the Kurdistan Regional Government. As such the applicability of the compromises reached prior to the announcement of draft legislation may be in doubt.

Note: The following analysis applies to draft legislation released in 2007 and may require substantial revision if new draft legislation emerges from the Council of Ministers in the coming weeks and months or under a new government elected in 2010.

### **Federal Oil and Gas Council**

The central element of the draft hydrocarbon framework legislation is the creation of a Federal Oil and Gas Council (FOGC) to determine all national oil and gas sector policies and plans, including those governing exploration, development, and transportation. The FOGC would become the most powerful body in Iraq's oil sector, with the power to review all contracts, and would operate according to a two-thirds majority decision-making system. The seats on the

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<sup>32</sup> In response to a June 2007 CRS inquiry, the U.S. Department of State referred to an English text of the draft legislation made available by the Kurdistan Regional Government as an official English draft version. It is available online at [http://www.krg.org/uploads/documents/Draft%20Iraq%20Oil%20and%20Gas%20Law%20English\\_\\_2007\\_03\\_10\\_h23m31s47.pdf](http://www.krg.org/uploads/documents/Draft%20Iraq%20Oil%20and%20Gas%20Law%20English__2007_03_10_h23m31s47.pdf)

FOGC are reserved for specific cabinet members, representatives of constitutionally recognized regional governments, hydrocarbon experts, and “producing governorates.”<sup>33</sup> A “Panel of Independent Experts,” open to Iraqi and foreign membership, would work with the FOGC in a non-binding, advisory capacity. The possibility that foreign energy experts or industry representatives could be chosen to participate on this panel has alarmed some Iraqis and foreign observers.

Although the draft law stipulates that the formation of the FOGC “shall take into consideration a fair representation of the basic components of the Iraqi society,” some observers have warned that the makeup of the FOGC specified in the draft law could potentially contribute to sectarian or regional tensions. Given the potential for the majority Shiite Arab community to directly or indirectly control the makeup of Iraq’s cabinet in Iraq’s democratic system and the ineligibility of Sunni Arab governorates to qualify for FOGC seats based on the other specified terms, some Sunni Arabs fear their interests may not be adequately represented in the powerful council. Other Iraqis may be encouraged to seek constitutionally recognized regional status in order to ensure their representation in the council.

### **Contract Type(s)**

The draft hydrocarbon framework law establishes several criteria that future “exploration and production contracts” must meet. The criteria are designed to preserve Iraqi control and maximize the country’s economic return. The draft law does not mandate the use of so-called “production-sharing agreements” as the sole model contract for future oil development in Iraq. The law states that contract holders may be given exclusive rights to exploration, development, production, and marketing of Iraqi oil for specified periods, subject to approval of the contract and a field development plan by Iraqi authorities. The law also outlines general terms and conditions for evaluating contracts and development plans designed to preserve the Iraqi government’s sovereign control of oil production, economic returns to Iraq, and “appropriate returns” to potential investors.<sup>34</sup> The FOGC’s Panel of Independent Experts would use these criteria to evaluate contracts signed by the Kurdistan Regional Government since 2003, and the Ministry of Oil, and the FOGC would use the criteria to evaluate contracts signed by the former regime with international oil companies (Article 40).

The contract provisions of the law have attracted significant attention because they would allow foreign participation and therefore represent, in principle, a reversal of the nationalization of Iraq’s oil sector. The specific details of model contracts developed by Iraqis and the terms of specific individual contracts negotiated between Iraq and potential foreign partners would determine the type of foreign participation and the specific long-term revenue benefits to Iraq or foreign companies. The draft hydrocarbon framework law does not mandate a specific form of contract or predetermine specific contract terms or details.<sup>35</sup> The FOGC would develop model

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<sup>33</sup> Article four of the draft framework law defines a “producing governorate” as “any Iraqi Governorate that produces Crude Oil and natural gas continually on rates more than one hundred and fifty thousand (150,000) barrels a day.”

<sup>34</sup> According to Article 9 of the draft framework, “All model contracts shall be formulated to honor the following objectives and criteria: 1- National control; 2- Ownership of the resources; 3- Optimum economic return to the country; 4- An appropriate return on investment to the investor; and 5- Reasonable incentives to the investor for ensuring solutions which are optimal to the country in the long-term related to a- improved and enhanced recovery, b- technology transfer, c- training and development of Iraqi personnel, d- optimal utilization of the infrastructure, and e- environmentally friendly solutions and plans.”

<sup>35</sup> The law explicitly states in Article 9 that “Model Contracts may be based upon Service Contract, Field Development (continued...)”

contracts for use in Iraqi oil and gas fields and evaluate agreements with foreign participants according to the stated criteria and the model contracts. According to Revenue Watch<sup>36</sup> Middle East director Yahia Said, “the aim of this law from beginning was to promote foreign investment in Iraq’s oil sector. Yet while the law opens the door for foreign companies, there are careful, deliberate mechanisms in place to maintain control in the hands of national government.”<sup>37</sup>

## **Petroleum Revenues and Sharing Arrangements**

The draft hydrocarbon framework law states that Iraq’s oil wealth belongs to all of its citizens, as reflected in the Iraqi constitution. However, the draft legislation does not contain specific guidelines or mechanisms for revenue sharing. The draft would create two funds for oil revenues: the first, an “Oil Revenue Fund,” and the second, a “Future Fund” to hold an unspecified percentage of oil revenue for long-term development goals. Both funds would be regulated and administered according to terms specified in separate federal revenue legislation.

## **Regional Authority and Oil Field Management Annexes**

Constitutionally recognized regional authorities would automatically qualify for seats on the FOGC under the terms of the draft oil sector legislation. The draft law originally was structured to grant regional authorities licensing powers with regard to oil fields specified in four annexes, subject to the terms of the draft law and in conjunction with the plans and procedures of the FOGC. Official versions of the draft annexes were not published.<sup>38</sup> However, Kurdish representatives made several public statements following an April 2007 conference in Dubai expressing their opposition to the draft annexes and threatening to withdraw support for the legislative package in the Council of Representatives.<sup>39</sup> The annexes reportedly were dropped from the draft legislation prior to its approval by the cabinet. Under the new arrangement—allegedly designed to meet demands of Kurdish negotiators—the management of specific oil fields would be decided by the members of the FOGC.

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and Production Contract, or Risk Exploration Contract.”

<sup>36</sup> Revenue Watch is an independent operating and grantmaking 501(c) 3 organization that monitors natural resource revenues and public expenditures and provides grants to local partners to improve transparency in oil and gas producing countries. For more information, see <http://www.revenuewatch.org/>.

<sup>37</sup> Yahia Said, Remarks at the United States Institute of Peace, May 18, 2007, as quoted in Christina Parajon, “USIPeace Briefing: The Iraq Hydrocarbon Law: How and When?,” June 2007.

<sup>38</sup> An unofficial transcript of the Dubai meeting is available at <http://www.revenuewatch.org/activities/April18IRW/April%2018%20transcript.pdf>. According to press reports, approximately 93% of Iraq’s proven oil reserves would have been subject to the jurisdiction of the federal government (Annexes 1, 2, and 4), while the Kurdistan Regional Government (KRG) would have exercised authority over the remaining 7% (Annex 3). Annex 1 listed 26 fields currently in production, Annex 2 listed 25 fields that are “close to production,” Annex 3 listed 27 fields not near production and open to international oil companies or the INOC, and Annex 4 delineated 65 exploration blocks. The KRG posted its analysis of the draft annexes on its website, available at [http://www.krg.org/pdf/Dubai\\_Oil\\_Law\\_Annexes\\_with\\_KRG\\_analysis.pdf](http://www.krg.org/pdf/Dubai_Oil_Law_Annexes_with_KRG_analysis.pdf).

<sup>39</sup> For example, Ashti Hawrami, Minister of Natural Resources for the Kurdistan Regional Government, said, “The annexes as they are written now will not be accepted by the KRG.... If I don’t get the lion’s share of fields (in the region) then it’s a bad law. If the law dilutes regional control then it is unconstitutional.” Simon Webb, “Iraq Oil Law to Go to Parliament, Kurds Wary,” *Reuters*, April 18, 2007.

## **Draft Revenue-sharing Law**

Article 112 of the Iraqi constitution sets qualitative criteria for the distribution of oil and gas revenues and requires the Iraqi parliament to pass a law regulating revenue distribution. In February 2007, some officials in Baghdad and Washington indicated that a broad agreement to share oil revenues among regions based on population had been reached. However, Iraqi leaders continued to negotiate the terms of the draft revenue-sharing law through June 2007. In line with the constitutional requirement, a separate draft revenue-sharing law has been prepared as a component of the hydrocarbon legislative package currently under consideration.

According to a draft of the revenue-sharing law published by the Kurdistan Regional Government on June 20, 2007,<sup>40</sup> the federal government would be empowered to collect all oil and gas revenue, with the stipulation that all funds be deposited into external and internal accounts based on their source. The federal government would have priority to allocate the funds in the accounts to support national priorities such as defense and foreign affairs, “provided that this does not impact the balance and needs of the governments of the Regions and the Governorates which are not organized in a region.” The remainder of the accounts would be distributed to regions and governorates automatically, on a monthly basis, based on agreed population-density-based percentages until a census can be completed. The Kurdistan Regional Government would receive a 17% share of the remaining funds deposited in two accounts at the Central Bank of Iraq branch in Irbil.<sup>41</sup> No specific provision is made in the draft for addressing requirements to meet the needs of “damaged regions” as required by Article 112 of the constitution.

The draft revenue law also would create a “Commission of Monitoring the Federal Financial Resources” composed of central government officials, experts, and representatives of each region and governorate. The Commission would monitor deposits and allocations from the central revenue fund, in addition to facilitating international audits and producing monthly, quarterly, and annual transparency reports. Article 7 of the draft revenue law reiterates the call for the establishment of a “Future Fund” for surplus revenue, but states that the operation of such a fund should be defined in a separate piece of legislation following further negotiation among federal, regional, and governorate representatives.

## **Ministry of Oil and Iraq National Oil Company Laws**

The final two components of the hydrocarbon legislative package are proposed laws that will reorganize Iraq’s Ministry of Oil and establish an Iraqi National Oil Company (INOC). Under the hydrocarbon framework law, the responsibilities and authorities of the Ministry of Oil and the INOC would be altered significantly, and the draft Ministry and INOC laws are necessary to ensure proper oversight, accountability, and separation of powers between the two entities. As of November 2009, a draft INOC law had been approved by the Council of Ministers, but was not considered by the Council of Representatives before the 2010 national election.

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<sup>40</sup> Available at [http://www.krg.org/pdf/English\\_Draft\\_Revenue\\_Sharing\\_law.pdf](http://www.krg.org/pdf/English_Draft_Revenue_Sharing_law.pdf).

<sup>41</sup> Ben Lando, “Iraqis Make Progress on Sharing Oil Sales,” *United Press International* (UPI), June 21, 2007.



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