Order Code RL34064

CRS Report for Congress

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

Updated April 2, 2008

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Prepared for Members and
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Summary

Iraqi leaders continue to debate a package of hydrocarbon sector and revenue sharing legislation that would define the terms for the future management and development of the country's significant oil and natural gas resources. The package includes an oil and gas sector framework law and three supporting laws that would outline revenue sharing, restructure Iraq's Ministry of Oil, and create an Iraqi National Oil Company. Both the Bush Administration and Congress consider the passage of oil and gas sector framework and revenue sharing legislation as important benchmarks that would indicate the current Iraqi government's commitment to promoting political reconciliation and long term economic development in Iraq.

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. The Administration reported to Congress on these benchmarks in July and September 2007. The draft framework law approved by Iraq's Council of Ministers (cabinet) in July 2007 does not include revenue sharing arrangements. Iraq's Council of Representatives (parliament) has not taken action to consider the legislation to date because of ongoing political disputes.

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. However, Iraqi critics and supporters of the proposed legislation 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 proposed amendments to articles of Iraq's constitution that outline federal and regional oil and gas rights also are highly contentious.

The current military strategy employed by U.S. forces in Iraq seeks to create a secure environment in which Iraqis can resolve core political differences. However, it remains to be seen whether the package of hydrocarbon legislation under consideration will promote reconciliation or contribute to deeper political tension. Administration policymakers and Members of Congress thus face difficult choices with regard to encouraging consideration of new hydrocarbon legislation and related constitutional reforms while attempting to ensure that the content of proposed laws and amendments reflects compromises reached by and acceptable to Iraqis. This report reviews the package of legislation currently under consideration, analyzes the positions of various Iraqi political actors, and discusses potential implications for U.S. foreign policy goals in Iraq. The report will be updated to reflect new developments. See also CRS Report RL31339, *Iraq: Post-Saddam Governance and Security*, and CRS Report RS22079, *The Kurds in Post-Saddam Iraq*.

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Background

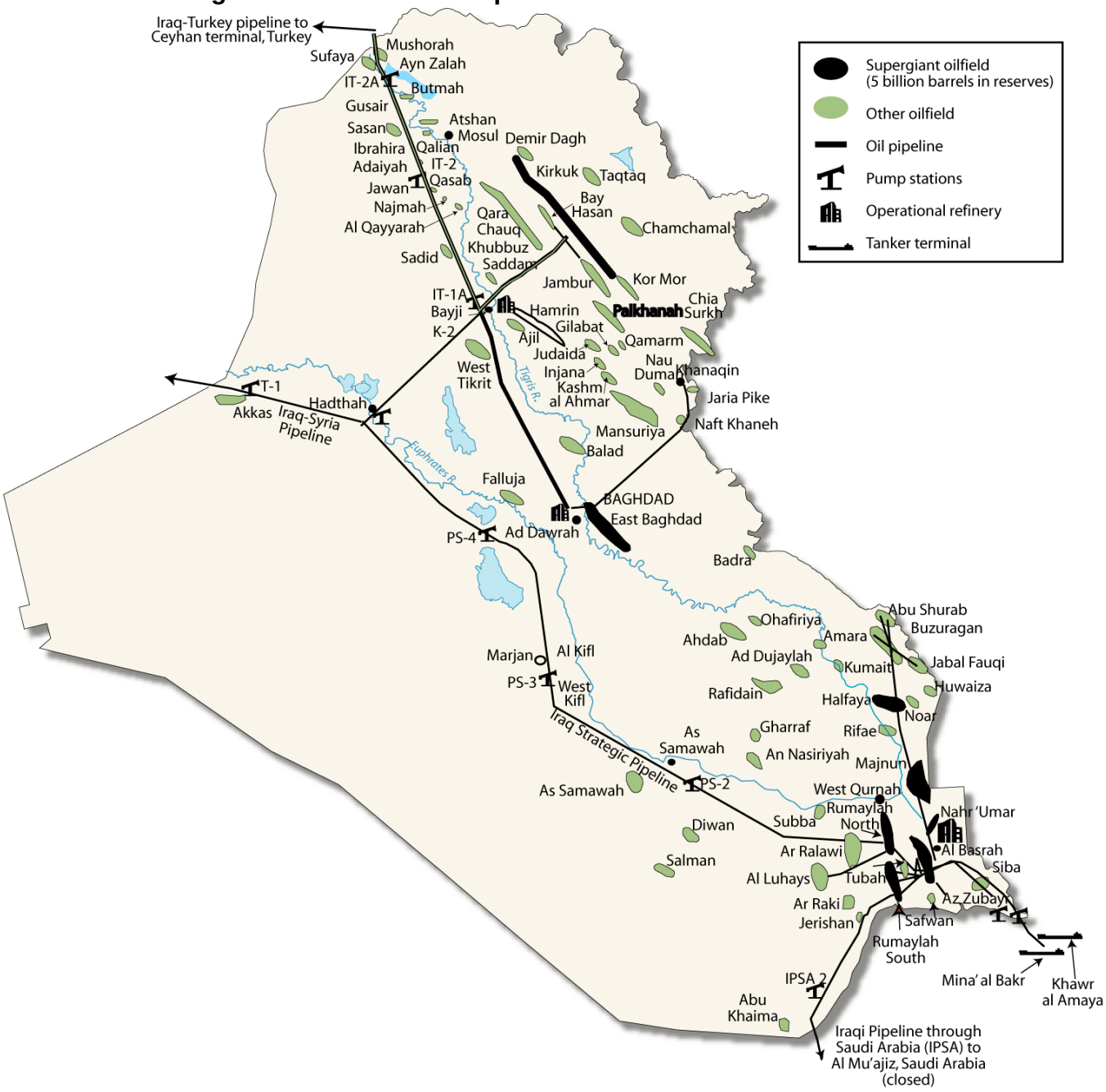
Oil exploration and production in Iraq began in the 1920s under the terms of a wide-ranging concession granted to a consortium of international oil companies known as the Turkish Petroleum Company and later as the Iraq Petroleum Company. The nationalization of Iraq's oil resources and production was complete by 1975. From 1975 to 2003, Iraq's oil production and export operations were entirely state operated. However, from the early 1980s until the toppling of 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.

According to the *Oil and Gas Journal*, Iraq has 115 billion barrels of proven oil reserves, the world's third-largest. Other estimates of Iraq's potential oil reserves vary. 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. The U.S. Geological Survey's median estimate for additional oil reserves in Iraq is approximately 45 billion barrels. In August 2004, Iraq's then-Oil Minister Thamer al Ghadban stated that Iraq had "unconfirmed or potential reserves" of 214 billion barrels. Iraq's proven reserves are concentrated largely (65 percent or more) in southern Iraq, particularly in the southernmost governorate of Al Basrah. Significant proven oil resources also are located in the northern governorate of Al Tamim near the disputed city of Kirkuk. (See **Figure 1**, below). Oil exports provide over 90% of Iraq's government revenue.

Draft Hydrocarbon Legislation

Iraqis continue to debate a package of hydrocarbon sector and revenue sharing legislation that would define the terms for the future management and development of the country's significant oil and natural gas resources. The centerpiece of the legislative package is a draft hydrocarbon framework law that would create a regulatory and policy development framework for future oil and gas exploration and production in Iraq. Three companion laws would complete the package by establishing terms and mechanisms for revenue sharing, creating the Iraq National Oil Company, and reorganizing Iraq's Ministry of Oil. Concurrent negotiations regarding constitutional amendments may have direct implications for the package of hydrocarbon legislation, 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.

Figure 1. 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, August 2007, available at [http://www.eia.doe.gov/cabs/Iraq/Background.html].

Table 1. Key Oil Indicators

Oil Production (current weekly avg.)	Oil Production (pre-2003)	Oil Exports (current)	Oil Exports (pre-2003)	Oil Revenue (2006)	Oil Revenue (2007)	Oil Revenue (2008, to date)
2.4 million barrels per day (mbd)	2.5 mbd	2.02 mbd	2.2 mbd	$31.3 billion	$41 billion	$14.4 billion

Note: Figures in the table from the U.S. Department of State "Iraq Weekly Status Report," March 26, 2008. 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.

Both the Bush Administration and Congress consider the passage of oil and gas sector management and revenue sharing legislation as important benchmarks that would indicate the current Iraqi government's commitment to promoting political reconciliation and economic development in Iraq. Iraqi critics and supporters of the legislative package differ over 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. The four elements of the package of hydrocarbon legislation remain at different stages of development and negotiation.

Iraqi, U.S., and other international observers have expressed concern that the atmosphere of violence and unresolved political tension prevailing in Iraq may not be conducive to careful consideration of detailed hydrocarbon sector legislation. Specifically, Iraqi labor groups have challenged the transparency and inclusiveness of the drafting and negotiation processes thus far, and some blocs within Iraq's Council of Representatives have vowed to oppose or attempt to significantly amend elements of the legislative package to reflect their priorities (see Players and Positions below).

Draft 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.[1] 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

[1] 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.]

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 existing controversy surrounding the proposed legislation. 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.[2] In the absence of a new legal and regulatory framework, the Baghdad government has announced its intention to proceed with oil exploration and production licensing under the terms of an interim registration process administered by the Ministry of Oil (see Interim Arrangements below).

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 FOGC are reserved for specific cabinet members, representatives of constitutionally recognized regional governments, hydrocarbon experts, and "producing governorates."[3] A "Panel of Independent Experts," open to Iraqi and foreign membership, would work with the FOGC in a nonbinding, 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

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[2] BBC Monitoring Middle East, *Al Arabiya Television* (Dubai), "Iraq Markets: Interview with Iraq Oil Minister Husayn al Shahristani," December 13, 2007.

[3] 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."

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.[4] 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.[5] The FOGC would develop model 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[6] 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."[7]

Petroleum Revenues and Sharing Arrangements. The draft hydrocarbon framework law states that Iraq's oil wealth belongs to all of its citizens,

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[4] 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."

[5] The law explicitly states in Article 9 that "Model Contracts may be based upon Service Contract, Field Development and Production Contract, or Risk Exploration Contract."

[6] 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/].

[7] 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.

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 (see below). The U.S. Department of Defense reported in March 2008 that the Iraqi government "continues to distribute oil revenues equitably to the provinces in the absence of this comprehensive legislation."[8]

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.[9] 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.[10] 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.

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

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[8] U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2008, Report to Congress in accordance with the Department of Defense Appropriations Act 2007 (Section 9010, P.L. 109-289), p. 4.

[9] 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 percent 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 seven percent (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].

[10] 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.

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,[11] 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.[12] 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.

Prospects for Future Revenue Sharing. A number of outside observers have emphasized the importance of proper oil revenue management and equitable oil revenue sharing as requirements for economic development and political reconciliation in post-Saddam Iraq. Some Members of Congress, such as Senator Hillary Rodham Clinton and Senator John Ensign, have advocated for the creation of an "Iraq Oil Trust" to ensure that all Iraqis share Iraq's oil wealth equitably.[13] The Iraq Study Group recommended that oil revenue accrue to the central government and not to regions (Recommendation 28). This principle appears to have been included in the draft hydrocarbon framework and draft revenue sharing legislation, which would create central accounts for oil and gas revenues.

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[11] Available at [http://www.krg.org/pdf/English_Draft_Revenue_Sharing_law.pdf.]

[12] Ben Lando, "Iraqis Make Progress on Sharing Oil Sales," *United Press International* (UPI), June 21, 2007.

[13] Senators Hillary Rodham Clinton and John Ensign, "An Oil Trust for Iraq," *Wall Street Journal*, December 18, 2006.

According to the drafts, revenue sharing will reflect a population-based system for revenue allocation, with automatic monthly distributions to regional and governorate authorities. Potential obstacles to revenue sharing on these terms include the lack of recent, reliable national census data and uncertainty over the terms of communal representation on hydrocarbon policy decision making and implementation bodies. One Iraqi politician reportedly referred to the arrangements agreed to in the draft revenue sharing law as the result of "political blackmail" by Kurdish politicians.[14]

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 January 2008, drafts of these laws had not been published and public reporting on their contents remains limited.

Prospects for Enactment and Implementation

Iraqi and U.S. officials hailed the Council of Ministers' February 2007 approval of the draft hydrocarbon framework legislation as an important step forward. However, the draft legislative package remains the subject of intense scrutiny from Iraqi and international observers: the draft framework law is imprecise on key issues, including contract terms and revenue sharing, and political observers have warned the legislation would create decision making structures that could contribute to sectarian or inter-regional tensions rather than defuse them. Both the U.S. and Iraqi administrations had hoped the hydrocarbon framework law would be approved by the parliament by the end of May 2007. However, differences over oil field management responsibilities and the revenue sharing formulas and mechanisms continue to preclude parliamentary consideration.

On July 3, 2007, Iraqi Prime Minister Nouri al Maliki announced that the Council of Ministers had formally approved a final version of the framework law and had forwarded the bill to the Council of Representatives for consideration. Iraqi officials stated that "linguistic" changes were made to the February 2007 draft, but precise details on what changes may have been included have not been made public. Kurdish leaders raised questions about the changes, and at least one Kurdish official claimed that Kurdish representatives were not consulted on the final version of the draft prior to its delivery to the parliament. On July 11, Kurdistan Regional Government (KRG) Natural Resource Minister Ashti Hawrami stated that the amendments to the draft law "reduce the powers of the (Kurdish) region and should

[14] Remarks attributed in an Iraqi press account to Usama al Najafi, a member of the Iraqiya parliamentary coalition associated with former interim prime minister Iyad Allawi.

not be approved."[15] Political groupings that favor strong central government control over production and revenue decision making also criticized the draft framework law.

The failure to achieve a regular quorum in the Iraqi Council of Representatives complicated efforts to consider or adopt legislation from late 2006 through September 2007.[16] At present, the draft hydrocarbon framework law has not been placed on the parliament's legislative calendar, primarily because of continuing political differences between the Shiite-led central government and the Kurdistan Regional Government (KRG) over federal and regional oil-related decision-making powers. Intense discussions among party leaders are ongoing, amid reports that some groups may be seeking to revisit core compromises that enabled the draft legislation to move forward in February 2007. In January 2008, the chairman of the parliament's Energy Committee stated that, "the Parliament awaits for the government's approval of any of the draft law's four copies."[17]

Within the parliament, criticism of a perceived fast-tracking of hydrocarbon legislation because of U.S. demands is prevalent. Iraq's ambassador to the United States Samir Sumaidaie has questioned whether there was "too much emphasis placed on the promulgation of these laws" by the United States and argued that "sorting out the complex issues of legislation needs time."[18] Once the parliament begins consideration of the legislation, potential amendments to the drafts could alter or jeopardize core compromises reached by negotiators and cabinet officials. The Iraqi government may face long-term challenges in implementing enacted legislation in light of persistent security threats and the strong opposition to proposed compromises voiced by some Iraqi groups (see Players and Positions below).

Interim Arrangements and Contracts

In the absence of new oil legislation and regulation, the Iraqi Ministry of Oil and the Kurdistan Regional Government have taken steps to move forward with hydrocarbon sector investment and development. These steps have contributed to the persistence of an atmosphere of controversy surrounding the draft hydrocarbon legislation, and international oil companies have been forced to consider investment decisions in an uncertain legal environment.

In late 2007, the KRG finalized its own regional oil and gas investment law and signed new production sharing agreements with several international companies, including U.S.-based Hunt Oil.[19] Some analysts believe that the Kurdish moves

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[15] *Associated Press*, "Kurds Speak Out Against Key Oil Law," July 11, 2007.

[16] A quorum in the Council of Representatives consists of half the 275 members plus one — a total of 139 members.

[17] *UPI*, "Iraq MP: Kurds, Government Stall Oil Law," January 10, 2008.

[18] Jeffrey Bartholet, "Plain Speaking: Amb. Samir Sumaidaie" *Newsweek Online*, September 24, 2007. Available at [http://www.msnbc.msn.com/id/20958064/site/newsweek/page/0/].

[19] *Bloomberg News*, "Dallas Oil Company Approved to Drill in Kurdistan," September 10, 2007. The KRG law is available at [http://www.krg.org/uploads/documents/ (continued...)

signal the KRG's intention to begin large scale oil development activities regardless of progress on federal legislation. 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 and the draft revenue sharing law. In September 2007 a State Department spokesman stated the Administration's view that the KRG deals "elevate tensions between the Kurdish regional government and the Government of Iraq," and "aren't particularly helpful" to the extent that they hinder consideration of a national oil law.[20]

Government officials from other parties have reacted negatively to the impasse and the KRG's recent activities. On September 8, Iraqi Oil Minister Hussein al Shahristani stated that the national government considers contracts signed by the KRG to have "no standing" and threatened that "if for any political reason the [hydrocarbon framework] law is delayed, we'll go ahead and start discussions with international oil companies" at the national level.[21] The KRG responded by stating that Al Shahristani's views were "irrelevant to what the KRG is doing legally and constitutionally in Kurdistan."[22]

Tensions appeared to escalate further after Minister Al Shahristani warned international oil companies that the national government would not allow the export of oil produced under KRG contracts.[23] The KRG responded by accusing Minister Al Shahristani of mismanaging the Oil Ministry budget and restated its opinion that its contracts were both constitutional and legal.[24] In November 2007, 60 Iraqi oil sector leaders wrote to the Council of Representatives to state that the KRG's unilateral signing of contracts constituted a "deliberate and dangerous action" and had no "legal or political standing whatsoever."[25] At least 120 members of the Council of Representatives from a wide range of political parties endorsed a January 2008 joint statement underscoring their opposition to the KRG contracts.[26]

In January 2008, Minister Al Shahristani directed the Ministry of Oil begin preparation for eventual exploration and production licensing by launching a

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[19] (...continued)
Kurdistan%20Oil%20and%20Gas%20Law%20English__2007_09_06_h14m0s42.pdf].

[20] U.S. Department of State Daily Press Briefing, Tom Casey, Deputy Spokesman, Washington, DC, September 28, 2007.

[21] Ben Lando, "Deeper Than an Oil Law in Iraq," *UPI*, September 10, 2007.

[22] James Glanz, "Compromise on Oil Law in Iraq Seems to Be Collapsing," *New York Times*, September 13, 2007.

[23] *Platts Commodity News*, "Iraq's Shahristani Says Hydrocarbon Law not Expected Soon," November 15, 2007.

[24] Kurdistan Regional Government, "KRG responds to Dr Shahristani's threats to international oil companies," 20 November 2007

[25] Radio Free Europe Documents and Publications, "Iraq: Baghdad, Kurds At Odds Over Oil Deals," November 30, 2007.

[26] Ned Parker, "Iraqi Political Factions Jointly Pressure Kurds," *Los Angeles Times*, January 14, 2008; and, *UPI*, "Iraq Factions Join Against Kurd Oil Deals," January 15, 2008.

pre-qualification review process for potential international investors. Oil companies interested in bidding on oil extraction and service licenses issued by the national government were required to submit a pre-qualification form to the ministry's Directorate of Petroleum Contracts and Licensing by February 18, 2008.[27] In March 2008, Minister Al Shahristani reported that approximately 150 companies had made submissions and predicted that contracts could be signed by the end of 2008 based on the terms of the draft framework law. Cabinet approval reportedly will be sought for contracts if the COR has not approved the draft law. The Ministry of Oil also is negotiating with major international oil companies, reportedly including Royal Dutch Shell, Chevron, Lukoil, ExxonMobil, BP and Total SA, on two-year technical contracts to provide technology, equipment and services for currently producing Iraqi oil fields.[28] These technical contracts reportedly will be based on studies that international oil companies completed for the Iraqi government under the terms of existing memoranda of understanding.[29]

Iraqi Perspectives

Core Issues

Iraq's Constitution: Federal and Regional Authority. According to Revenue Watch[30] Middle East director Yahia Said, "the most contentious issue in the legal framework is the division of authority between the federal center and the regions." The concept of federalism has been incorporated into Iraq's constitution and law, and Iraqi attitudes toward the draft legislative package often correspond with regional differences of opinion about the proper role and power of the federal government and regional and governorate authorities to make oil policy and revenue decisions. However, the constitution's ambiguity about the roles and powers of federal, regional, and governorate authorities has contributed significantly to the ongoing impasse over these issues.[31] Articles 111 and 112 of the Iraqi constitution

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[27] Faleh al Khayat, "Iraq Prepares Oil Licensing Round Without Federal Oil Law," *Platts Commodity News*, January 9, 2008. An Arabic and English version of the form is available at [http://www.oil.gov.iq/pcld.pdf].

[28] Mariam Karouny, "Oil firms line up for contracts in Iraq," Reuters, March 1, 2008.

[29] Vahe Petrossian, "Iraq Opens Door to Foreign Input," *Upstream*, March 28, 2008.

[30] Yahia Said, Director, Middle East and North Africa, Revenue Watch Institute, "Iraq Hydrocarbons Legal Framework," Statement Submitted to the House Subcommittees on the Middle East and South Asia and International Organizations, Human Rights and Oversight, July 19, 2007.

[31] 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

(continued...)

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)." These provisions were included as a means of ensuring consensus among Iraqis and the adoption of the constitution.

Iraq's Constitutional Review Committee (CRC) delivered its long-expected recommendations for constitutional amendments in late May 2007, but left many sensitive issues, including the distribution of oil revenue, to be decided by "the political leadership in the country, to settle them for the interest of the nation and to guarantee rights to all parties."[32] Reportedly, Kurdish representatives on the committee pressed for regional power to distribute oil revenue, while Sunni and Shiite Arab members supported central government control over revenue collection and distribution.[33] The CRC was expected to release a report with final recommendations on these and other sensitive issues by the end of August 2007. In September, the Council of Representatives extended the CRC deadline until December 31, 2007.[34] In December 2007, CRC Chairman Humam Hamoudi requested and received a further six-month extension.[35] According to one analysis of the CRC recommendations relating to Articles 111 and 112, the draft amendments would strengthen federal authority in case of oil and gas related disputes with regions; provide for automatic distribution of revenues according to legislated criteria; and clarify that provisions related to revenue and certain management responsibilities apply to all fields, not just "new" or currently producing fields.[36]

Some observers argue that without a mutually acceptable agreement on federal and regional power sharing as reflected in a constitutional amendment, passage of the current draft hydrocarbon framework and revenue sharing laws may not adequately ensure equitable distribution or contribute to political reconciliation or economic growth. To date, Iraqi Kurds, acting through their Kurdistan Regional Government (KRG), have demanded the right to sign oil development deals without much national government interference. Other sub-national groupings also may contest the right of Iraq's central government to control aspects of oil policy, including some

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[31] (...continued)
Regional Authority," Memorandum, July 7, 2006. Available at [http://www.iraqrevenuewatch.org/reports/MEMORANDUMConstitutional%20Interpretation.DOC].

[32] Damien Cave, "Iraqis Are Failing to Meet U.S. Benchmarks," *New York Times*, June 13, 2007.

[33] Mariam Karouny, "Iraq Lawmakers Deadlocked over Constitution Reforms," *Reuters*, May 22, 2007.

[34] U.S. Department of Defense, Measuring Stability and Security in Iraq - December 2007.

[35] Tina Susman and Asso Ahmed, "Kurds Delay Vote on Fate of Kirkuk as Iraq Goals Slip," *Los Angeles Times*, December 27, 2007; and U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2008, p. 4.

[36] Joseph C. Bell, Hogan & Hartson LLP, "Iraqi Oil Policy - Proposed Constitutional Amendments Regarding Federal and Regional Authority over Oil and Gas," July 16, 2007.

inhabitants of the oil-rich governorate of Al Basrah and members of the minority Sunni Arab community who fear that a Shiite Arab and Kurdish dominated national government may not administer hydrocarbon revenues fairly.

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 have deepened in the atmosphere of sectarian and ethnic violence that has gripped Iraq since mid-2003. The principles and mechanisms by and through which Iraq's oil revenues are to be collected and distributed remain contested. Nevertheless, most outside observers agree that an equitable 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.

Recent debate has centered on the content of draft revenue sharing legislation that must be considered and approved as part of the hydrocarbon package. 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. The U.S. Department of Defense reported in March 2008 that the Iraqi government "continues to distribute oil revenues equitably to the provinces in the absence of... comprehensive legislation."[37]

Foreign Participation. The sovereign control of Iraq's oil resources and revenues remains a subject of intense scrutiny, debate, and sensitivity in Iraq. Iraq completed the nationalization of its oil resources in 1975, and oil exploration, production, and exports were managed subsequently by state-run entities that employed thousands of Iraqis. Given the effects of war, sanctions, and mismanagement of the country's oil infrastructure since 1980, many energy experts believe Iraq will need significant infusions of investment, technology, and expertise in order to rehabilitate and eventually expand its oil production capacity in line with

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[37] U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2008, Report to Congress in accordance with the Department of Defense Appropriations Act 2007 (Section 9010, P.L. 109-289), p. 4.

the current government's plans.[38] Iraq's own oil revenues may provide a significant resource base for such investment and for attracting technology and expertise. However, some observers question the Iraqi government's capacity to effectively direct large amounts of its own resources toward hydrocarbon sector rehabilitation in light of its recent failures to manage and expend funds set aside in the federal budget for those purposes (see Revenues below).[39]

Over the short-term, Iraq's unstable security situation presents a significant barrier to large-scale investment by most international entities. Over the medium to long term, Iraqis face difficult choices about the character and needs of their oil and gas industries: preserving full control over all investment and technological inputs to the sector may not be compatible with its technical needs. Whereas some Iraqis oppose foreign participation on any terms, others support foreign participation in the form of technical service contracts, and still others favor production sharing agreements (PSAs), which would grant international companies exploration and production rights over specific areas for specified periods, subject to the terms of negotiated contracts.

Players and Positions

Iraqi attitudes on the future of the country's oil industry are shaped by a number of factors, including geography, ethnicity, political ideology, and party affiliation. Sectarian identity politics undoubtedly is one important factor, particularly with regard to the concerns of some members of the minority Sunni Arab community who fear exclusion from decision-making bodies and inadequate revenue sharing. However, viewing ongoing Iraqi debates over oil resources and revenue through a purely sectarian lens obscures other important nonsectarian dynamics. Constitutional questions relating to federal and regional authority concern many Iraqis, and members of some ethnic and sectarian groups oppose positions and compromises that their political leaders have suggested with regard to the package of draft hydrocarbon legislation. Many Iraqi oil experts, technicians, and powerful unions also have taken strong positions on the legislative package that do not correspond to apparent ethnic or sectarian affiliations or interests.

The Kurds: Regional Authority and Kirkuk. The Kurdistan Regional Government (KRG) has signed oil and gas production sharing contracts with several small international companies since 2003. Under the draft oil sector law now before Iraq's Council of Representatives, these existing contracts would be subject to review by the Panel of Independent Advisers of the Federal Oil and Gas Council (FOGC).

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[38] According to a May 2007 Government Accountability Office (GAO) report, "U.S. officials and industry experts have stated that Iraq would need an estimated $20 billion to $30 billion over the next several years to reach and sustain a crude oil production capacity of 5 million barrels per day. This production goal is below the level identified in the Iraqi 2005-2007 National Development Strategy — at least 6 million barrels per day by 2015." GAO, "Rebuilding Iraq: Integrated Strategic Plan Needed to Help Restore Iraq's Oil and Electricity Sectors," GAO-07-677, May 15, 2007.

[39] See U.S. Department of Defense, Measuring Stability and Security in Iraq - June 2007, pp. 9, 11-12.

Regional authorities would retain the right to license future international participation in oil and gas development in their region, subject to the terms of the hydrocarbon framework law, the Iraqi constitution, and the review of the FOGC. In early July 2007, the four draft annexes to the hydrocarbon framework law that would have divided Iraq's oil fields for federal and regional management were dropped in favor of future adjudication by the FOGC, reportedly in line with Kurdish demands. The KRG favors the establishment of an automatic revenue distribution mechanism based on a per capita formula in order to prevent political intervention at the federal government level that would limit allocations to the Kurdish region.[40] The KRG has adopted legislation outlining a regional oil and natural gas framework and a model contract for production sharing agreements with outside investors.

The Kurds, both through legal procedures as well as population movements, also are trying to secure political control over the ethnically and religiously mixed city of Kirkuk, which sits atop a large oil field in the northern governorate of Al Tamim. The Kurds supported insertion of language in Iraq's constitution (Article 140) requiring a vote by December 2007 on whether Kirkuk might formally join the Kurdish-administered region. The Iraq Study Group report stated that this referendum should be delayed (Recommendation 30). In June 2007, Kurdistan Regional Government president Massoud Barzani stated that, "we will never delay; we will never accept any delay in the implementation of Article 140."[41] However, tensions revolving around the Kirkuk issue abated somewhat after Iraqi officials agreed to a six-month extension of the deadline for a referendum "for technical reasons." According to the Department of Defense, the involvement of the United Nations Assistance Mission for Iraq (UNAMI) in technical assistance related to the Kirkuk question has opened the possibility of negotiation for a political agreement on the issue rather than a referendum.[42]

Sunni Arabs: Revenue Sharing and Foreign Participation. The Sunni Arab minority-dominated areas of Iraq have few proven crude oil or natural gas deposits, although petroleum geologists differ as to whether substantial oil deposits may be found in Iraq's western Al Anbar governorate in the course of future exploration. As such, the community's concerns have focused on ensuring equitable distribution of oil export revenues in the future. In some cases, Sunni parties also have taken a hard-line position on preventing feared exploitation of Iraq's oil resources by international companies or other third parties. Sunni negotiators opposed Iraq's new constitution in part because it empowers regions in oil production and revenue allocation policy. The Association of Muslim Scholars and the Iraqi Accord Front [Al Tawafuq], both Sunni groups, have criticized the draft oil

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[40] Yahia Said as quoted in Christina Parajon, "The Iraq Hydrocarbon Law: How and When?," United States Institute of Peace Briefing, June 2007.

[41] On June 12, 2005, Barzani was named "President of Kurdistan" by the 111-seat Kurdish regional assembly that was elected in January 2005. Articles 63 to 67 of the Iraqi constitution set general rules for the creation of executive authority by regional governments. *Radio Free Europe/Radio Liberty*, "Iraq: Kurdish Official Says Kirkuk Normalization To Proceed," June 22, 2007.

[42] U.S. Department of Defense, Measuring Stability and Security in Iraq-March 2008, p. 3.

legislation currently under consideration.[43] Representatives of the Al Tawafuq party have called oil and gas deals signed by the Kurdistan Regional Government with foreign companies "illegal."[44]

The United Iraqi Alliance: Investment and Development. The leading parties of the ruling Shiite United Iraqi Alliance (UIA) — the Dawa Party and the Supreme Islamic Iraqi Council (SIIC, formerly known as the Supreme Council for Islamic Revolution in Iraq, or SCIRI), have supported the adoption of the hydrocarbon legislative package as a means of reviving Iraq's oil sector and increasing government revenues. To date, ministries led by members of these parties have faced mounting criticism over allegations of oil-related corruption and mismanagement of export revenues. According to some analysts, differences within the UIA with regard to principles of federalism could have important implications for future oil sector decisions, particularly the SIIC's reported preference for establishing a large federal region encompassing all of the Shiite Arab majority governorates of southern Iraq.[45] However, at present, both the Dawa Party and the SIIC reportedly favor the centralization of authority in federal decision making bodies likely to be dominated by Shiite parties under Iraq's democratic system. The UIA also reportedly supports the creation of a strong Iraq National Oil Company to limit the influence of potential political challengers affiliated with Iraq's Southern Oil Company, the Iraq Federation of Oil Unions, and the Fadilah (Virtue) party.

Basrah: Industry Unions and the Fadilah Party. Al Basrah governorate holds most of Iraq's proven oil resources and, as such, local political actors exert influence over the hydrocarbon sector and consideration of the legislative package. Press reports suggest that competition between local politicians, militia groups, union members, and federal ministry representatives is fueling conflict that has intensified since mid-2007.[46] The 26,000 member Iraq Federation of Oil Unions has voiced its members' strong opposition to the current draft of the hydrocarbon framework legislation and has demonstrated a capacity to disrupt oil production and refinery operations with strikes.[47]

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[43] Sabah Jerges, "Iraqi Sunni Faction Calls for Ban on PSAs," *Platts Oilgram News*, Volume 85, Issue 81, April 25, 2007.

[44] James Glanz, "Compromise on Oil Law in Iraq Seems to Be Collapsing," *New York Times*, September 13, 2007.

[45] Reidar Visser, "Basra Crude: The Great Game of Iraq's 'Southern' Oil," Norwegian Institute of International Affairs, March 2007.

[46] Sam Dagher, "Basra Oil Fuels Fight to Control Iraq's Economic Might," *Christian Science Monitor*, September 19, 2007.

[47] In June, the Iraqi Federation of Oil Unions led a two-day strike against the Southern Pipeline Company over working conditions and threatened to spread the action to other unions and facilities. The Iraqi government responded by deploying military forces to the Company facilities and issuing arrest warrants for union leaders. See also, Ben Lando, "Unions Could Sway Iraq Oil Law," *UPI*, March 28, 2007; and *Associated Press*, "Iraqi Oil Workers Threaten Open-Ended Strike In South," June 6, 2007.

In May 2007, oil unions demanded participation in discussions of the draft hydrocarbon legislation with Prime Minister Nouri Al Maliki, who reportedly agreed to include the unions in future talks. By June 2007, the unions stated that Maliki's failure to do so was one contributing factor to their decision to launch a strike that halted oil operations in southern Iraq for days. In response, the federal government dispatched troops to the south, issued arrest warrants for union leaders, and ultimately agreed in negotiations to establish a formal mechanism for union input into the legislative drafting process.[48] Subhi al Badri, chairman of the Iraqi Federation of Union Councils, has described the draft framework law as "a bomb that may kill everyone," and vowed that "if the Iraqi parliament approves this law, [union members] will resort to mutiny."[49] In September, the Iraqi Federation of Southern Oil Unions (IFOU) vowed to shut down oil pipelines in southern Iraq if the parliament passed the draft hydrocarbon framework legislation in its then-current form.

The Fadhila (Virtue) party holds about 15 seats in Iraq's Council of Representatives and split from the ruling UIA coalition earlier this year. The Governor of Al Basrah governorate and the director of the influential Southern Oil Company are both Fadhila party members.[50] Fadhila leaders have voiced similar opinions to those of some oil union members and may support efforts to secure regional status for Al Basrah and adjacent oil producing governorates of Maysan and Dhi Qar that would increase southern Iraqis' influence over national oil and gas policy. Both the oil unions and the Fadhila party reportedly oppose the use of production sharing agreements with international companies and may support the introduction of foreign investment and technology on the basis of technical service contracts similar to those used by other Gulf region producers.

Sadr and Sunni Insurgent Groups. The Shiite Arab political faction associated with Moqtada al Sadr and at least two Sunni insurgent groups also have expressed their opposition to the draft legislation. Sadr-affiliated cabinet members continue to boycott cabinet proceedings, and, following the announcement of the cabinet's approval of the draft bill on July 3, Sadr representatives vowed to oppose the bill in parliament unless an amendment is passed precluding the signing of production sharing agreements. In September 2007, Sadr affiliated parliamentarians quit the ruling United Iraqi Alliance in protest over the government's policies. Since mid-June 2007, insurgents affiliated with the 1920 Revolution Brigades and the Jihad and Reform Front have released communiques condemning the draft legislation as a mechanism for foreign exploitation of Iraqi natural resources and threatening attacks against cabinet members and parliamentarians who vote for or otherwise support the bill.

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[48] Ben Lando, "Iraq Oil Strike on Hold, Troops Remain," *UPI*, June 8, 2007.

[49] *UPI*, "Iraq Unions Vow 'Mutiny' Over Oil Law," July 23, 2007.

[50] In May 2007, the Al Basrah provincial council voted to remove Governor Mohammed Al Waili, a Fadhila party leader, from office. He has refused to vacate the office and Prime Minister Maliki has declined to intervene.

International Energy Companies. The absence of an accepted hydrocarbon framework presents a procedural obstacle to international investment in Iraq's oil and natural gas sector. Some energy experts argue that the persistence of insecurity is a more fundamental concern to international energy companies. However, in December 2007 a U.S. Deputy Treasury Secretary Robert Kimmitt identified the lack of progress on the oil law as a primary barrier to investment by international oil companies and encouraged U.S. oil companies to refrain from signing contracts in Iraq until a new oil law is passed.[51] While some small international energy companies have signed limited production sharing agreements in the Kurdish-controlled region of northern Iraq, significant international investments in oil exploration and production elsewhere in Iraq have not been made since 2003. This may change in light of the licensing pre-qualification process currently being administered by the Ministry of Oil and negotiations with oil majors for technical service contracts on existing fields.

Saddam Hussein's government signed contracts with several major international oil companies, and under the draft hydrocarbon legislation currently under consideration, these contracts must be evaluated and re-approved by the Federal Oil and Gas Council.[52] In June 2007, Iraqi Oil Minister Hussein al Shahristani told reporters that a 1997 contract signed by the Saddam Hussein regime and China National Petroleum Corporation to develop the Al Ahdab oil field in Wasit governorate "is still valid" and that the current Iraqi government "will honor it," pending the resolution of ongoing technical discussions.[53] The president of Russian oil company Lukoil stated in January 2008 that his company is continuing its discussion with Iraq to resume operations in the West Qurna oil field.[54] Reportedly, the two sides agreed to establish a working group on the matter following a visit to Iraq by Russian Deputy Foreign Minister Alexander Sultanov and Lukoil president Vagit Alekperov.[55]

While the risks associated with investment in Iraq's established producing oil fields are relatively low, potential future investments in discovered but undeveloped or exploration blocks could carry more significant risks. Investors are therefore likely to seek contract terms that would provide adequate return and compensation,

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[51] Bradley Brooks, "A top US Treasury Official Says Stalled Oil Law, Not Insecurity, Hampering Iraq Oil Investment," *Associated Press*, December 4, 2007.

[52] Some of the presumptive contracts for oil exploration in Iraq, signed with the government of Saddam Hussein, include the following: Al Ahdab field — China National Petroleum Corporation (China); Nassiriya field — Agip (Italy) and Repsol (Spain); West Qurna — Lukoil (Russia); Majnoon — Total Fina Elf (France); Nahr Umar — Total Fina Elf (France); Tuba — ONGC (India) and Sonatrach (Algeria); Ratawi — Royal Dutch Shell (Britain and the Netherlands); Block 8 — ONGC (India). Dan Morgan and David Ottaway, "In Iraqi War Scenario, Oil Is Key Issue," *Washington Post*, September 15, 2002.

[53] Jamil Anderlini and Steve Negus, "Iraq Revives Saddam Oil Deal with China," *Financial Times* (UK), June 23, 2007.

[54] Interfax, "Lukoil Continuing Talks with Iraq to Resume Operations There — Alekperov," January 12, 2008.

[55] Vahe Petrossian, "Iraq Opens Door to Foreign Input," *Upstream*, March 28, 2008.

particularly terms that would allow for production sharing. According to some observers, concerns about corruption and the potential opacity of Iraq's regulatory and contracting processes may also deter some outside investment over the long term, particularly if key decision making powers are delegated to regional or governorate authorities.[56] Nevertheless, recent reporting suggests that there is significant interest among international oil companies to begin operations in Iraq, even subject to terms and conditions being set on an interim basis by the Iraqi Ministry of Oil.

Oil Revenue and Security Concerns

Revenues

Current Arrangements. 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 U.N.-administered compensation fund for reparations to the victims of the 1990 Iraqi invasion and occupation of Kuwait. 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.[57]

Under the terms of UNSCR1546 (and renewed by subsequent resolutions), the DFI is monitored by an International Advisory and Monitoring Board (IAMB), which provides periodic reports on Iraq's oil export revenue, Iraq's use of its oil revenues, and its oil production practices.[58] UNSCR 1790 of December 18, 2007, extended the IAMB monitoring of the DFI until December 31, 2008, subject to Iraqi government review by June 15, 2008. 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. The establishment of an audit oversight committee for the DFI and oil export revenues is a structural benchmark under Iraq's Stand-by Arrangement (SBA) with the International Monetary Fund currently satisfied by the extension of the IAMB arrangement and the creation of the COFE. The signing of the SBA was a requirement for Iraq's debt reduction agreements with the members of the Paris Club.[59]

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[56] *Oxford Analytica*, "Iraq: Oil Law Necessary but not Sufficient for IOCs," March 6, 2007.

[57] 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.

[58] The IAMB homepage is available at [http://www.iamb.info/.]

[59] See International Monetary Fund, Country Report No. 07/115, Iraq: Third and Fourth Reviews Under the Stand-By Arrangement, March 2007; and, CRS Report RL33376 - *Iraq's*

(continued...)

Resources, Expenditures, and Corruption. From its creation in May 2003 through June 30, 2007, the DFI had received over $98.8 billion in oil proceeds and other deposits.[60] Periodic audits conducted under the auspices of the IAMB have routinely found irreconcilable discrepancies in oil production and export figures and DFI account receipt and distribution amounts. Oil production and exports were conducted without metering equipment throughout the Coalition Provisional Authority (CPA) period. A May 2007 GAO report confirmed that reliable metering in Iraq's oil fields remained lacking and contributed to the lack of reliable data on Iraq's oil production and related revenue.[61] A January 2008 IAMB report stated that Iraq's Ministry of Oil "does not have in place a full operational loading and metering system at production and loading points in order to determine produced and loaded quantities [of oil] accurately."[62]

Completed financial audits through December 2005 found that "no comprehensive financial and internal controls policies and procedures manuals" were present in Iraqi ministries that were spending oil export proceeds delivered through the DFI system. Preliminary findings for 2006 identified weaknesses in Iraqi and U.S. accounting procedures and internal controls related to the DFI and state that Ministry of Finance internal accounting procedures and controls remained inadequate.[63] On June 12, 2007, the IAMB released a statement on the 2006 findings, noting that the audits demonstrated that "the overall financial system of controls is deficient." The audits found that there was "no overall comprehensive system of controls over oil revenues," and that "basic administrative procedures" were "outdated and ineffective."[64] These conditions may facilitate the type of widespread corruption that has been alleged against a number of Iraqi ministries spending distributed oil export revenue, often associated with weak contracting and cash management policies.

The United States has spent $1.6 billion in appropriated reconstruction funding on efforts to repair and secure Iraq's hydrocarbon production and export infrastructure since 2003.[65] In addition, as of December 2005, the United States had administered over $2.8 billion in Iraqi funds from the DFI for oil infrastructure

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[59] (...continued)
Debt Relief: Procedure and Potential Implications for International Debt Relief, by Martin A. Weiss.

[60] Ernst & Young — Summary of Preliminary Findings for the year ended December 31, 2007, published on January 14, 2008.

[61] James Glanz, "Billions in Oil Missing in Iraq, U.S. Study Finds," *New York Times*, May 12, 2007; and, GAO, GAO-07-677, May 15, 2007, pp. 26-7.

[62] Ernst & Young — Summary of Preliminary Findings for the year ended December 31, 2007, published on January 14, 2008.

[63] Ernst & Young — Summary of Preliminary Findings for the year ended December 31, 2006, published on July 10, 2007.

[64] Statement by the International Advisory and Monitoring Board on the Development Fund for Iraq, June 12, 2007.

[65] For more information about U.S. reconstruction spending and programs, see CRS Report RL31833 - *Iraq: Reconstruction Assistance*, by Curt Tarnoff.

projects.[66] The June 2007 U.S. Department of Defense Measuring Stability and Security in Iraq report states that the Iraqi government's "failure to execute several billion dollars of its own funds in oil sector capital investments" has limited the overall recovery of the sector. According to the report, Iraq's Ministry of Oil expended only $90 million of its $3.5 billion capital budget in 2006, and the Ministry's 2007 allocation of $2.38 billion is less than half of the ministry's own estimated maintenance and growth needs.[67] Although capital investment rates have increased since mid-2007, the March 2008 report stated that "a difficult security environment, fear among Iraqi officials of corruption charges and a lack of technical expertise prevented full execution of the budget in 2007 (resulting in lower total capital investment, particularly in oil and electricity infrastructure)."[68]

Security

Infrastructure Attacks and Smuggling. Iraq's oil infrastructure suffered little damage during the U.S.-led invasion (an estimated nine oil wells were set on fire), but insurgents and smugglers have targeted oil infrastructure for political and financial reasons since 2003. Iraq's total pipeline system is over 4,300 miles long, and most insurgent groups have focused their attacks on pipelines in northern Iraq that feed the Iraq-Turkey oil export pipeline as a means of reducing government export revenues.[69] Highly organized smuggling operations have leveraged supply and price imbalances in the Iraqi refined fuel market to create lucrative profit opportunities, some of which may benefit Shiite political parties and militia groups. In particular, smugglers have targeted pipelines in southern Iraq to force refining operations to transport fuel products using more vulnerable tanker vehicles that can be stolen, diverted, and manipulated.[70] The U.S. military reports that some members of the Iraqi Ministry of Defense Strategic Infrastructure Battalions and the Ministry of Oil Protection Force are "sometimes suspected of being complicit in interdiction and smuggling."[71] According to the Department of Defense, "increased security efforts, such as the construction of pipeline exclusion zones and the use of the oil

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[66] GAO, GAO-07-677, May 15, 2007, p. 15.

[67] U.S. Department of Defense, Measuring Stability and Security in Iraq - June 2007, pp. 9, 11-12.

[68] U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2008, p. 9.

[69] See Michael Knights, "Iraqi Critical Infrastructure Faces Sophisticated Threat," *Jane's Intelligence Review*, January 1, 2006.

[70] The Iraqi government imports refined fuels because it lacks sufficient refining capacity to meet local demand. Saddam-era price subsidies also remain in place, making Iraqi fuel products cheaper than those found in neighboring countries. See James Glanz and Robert F. Worth, "Attacks on Oil Industry in Iraq Aid a Vast Smuggling Network," *New York Times*, June 4, 2006.

[71] For example, the June 2007 Measuring Stability and Security in Iraq report states that, "As much as 70% of the fuel processed at Bayji was lost to the black market — possibly as much as US$2 billion a year."

protection force... enabled an increase in total exports for the year by 10% over 2006."[72]

U.S. Policy and Issues for Congress

Both the Bush Administration and Congress have identified political reconciliation and long-term economic development as key policy goals and benchmarks for the progress of U.S. efforts in Iraq. The current military strategy employed by U.S. forces in Iraq seeks to create a secure environment in which Iraqis can resolve core political differences. In Iraq, the ongoing debate over a package of four draft hydrocarbon laws reflects Iraqis' unresolved political differences over the powers reserved for federal and regional authorities, proper means for ensuring equitable distribution of hydrocarbon revenues, and longstanding, 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: To what extent does the U.S. investment in improving Iraq's security permit the United States to influence either the pace or content of Iraqi debates over the future 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 legislation? How can the United States most effectively ensure that Iraqis adopt equitable revenue sharing mechanisms? Should the U.S. government promote international investment in Iraq's oil and gas sector and, if so, in what form and on what scale?

To the extent that Iraqi factions perceive the United States to be promoting legislative solutions or processes opposed to or supportive of their interests, they may oppose or support the hydrocarbon legislation and U.S. preferences and policy goals. If constitutional disputes over federal and regional authority remain unresolved, the durability of compromises reached with regard to the hydrocarbon legislation may be undermined. 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 Arab population. International investment and technology may be 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 will likely influence Iraqi attitudes toward the U.S. presence in Iraq, toward the draft legislative package, and toward each other.

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[72] U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2008, p. 11.

Frequently Asked Questions

Privatization and Foreign Participation. Some U.S. and international press coverage of Iraq's draft hydrocarbon framework legislation has alleged that the draft law would require the Iraqi government to use contracts known as production sharing agreements in future dealings with international oil companies. While the draft legislation represents a reversal of the nationalization of Iraq's hydrocarbon sector insofar as it allows foreign investment and participation in exploration, production, and development, the legislation does not mandate the use of production sharing agreements or any other type of model contract. Rather, the legislation would require the Federal Oil and Gas Council to develop model contracts subject to terms of the law that seek to preserve economic return for Iraq, the sovereign control of oil and gas resources, and production plans in line with Iraq's long-term development. While Iraqis may choose to use production sharing agreements or service contracts in the future, the legislation currently under consideration would not require them to use one specific type or to agree to specific revenue, tax, or ownership terms with potential international partners.

Interim investment arrangements being implemented by Iraq's Ministry of Oil will offer "Long Term Improved Service Contracts" rather than production sharing contracts, which Natiq al Bayati, director general of the body implementing the licensing has called a "red line."[73] Contracts signed by the Kurdistan Regional Government with international companies have used a production sharing arrangement, offering a 12 to 15% production share to participants.

The broader questions of whether and on what terms international investment would be necessary or useful for Iraq remain open. Some Iraqis swift favor the development of unexplored oil fields as a means of maximizing potential revenue, while others, such as draft framework law co-author Tariq Shafiq have argued that "new oil is indeed not needed for over a decade," because Iraq's currently producing and discovered but nonproducing fields can provide adequate revenue if properly managed.[74]

U.S. Legal and Diplomatic Support.[75] Several press reports have alleged that U.S. government personnel, U.S. contractors, or international oil executives may have had a role in drafting or otherwise contributing to the creation of the draft hydrocarbon framework legislation. Administration officials deny that any U.S. official drafted any component of the legislation. At the direction of the United States Agency for International Development (USAID), the U.S. contractor BearingPoint prepared a study of potential oil management models for Iraq in

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[73] Platts Commodity News, "Iraq not Seen Offering Production-sharing Contracts: Document," January 10, 2008.

[74] Tariq Shafiq, testimony Before a Joint Hearing of the Subcommittee on the Middle East and South Asia and the Subcommittee on International Organizations, Human Rights, and Oversight of the House Committee on Foreign Affairs, July 18, 2007.

[75] This information is drawn from an interagency Administration response to a CRS inquiry, drafted by the U.S. Department of State Bureau for Near Eastern Affairs on March 19, 2007.

December 2003 entitled, "Options for Developing a Long Term Sustainable Iraqi Oil Industry."[76] In addition, a number of U.S. advisors, some of whom have been former international oil company executives, have worked closely with Iraq's Ministry of Oil and other energy officials in various capacities since 2003. Current advisory efforts with the ministry are focused on budget planning and outlay processes in light of the Iraqi government's difficulties in allocating its oil investment budgets over the last two years.

From mid-2006 to April 2007, USAID also funded a Baghdad-based Petroleum Legal and Regulatory Advisor on a contract basis.[77] The advisor worked with the U.S. Embassy and coordinated with five other contracted lawyers affiliated with the U.S. Department of Commerce (DOC), and the U.S. Department of Energy (DOE). Together the lawyers worked to "assist the Iraqis by providing commentary and case studies," which, according to USAID, were designed to "help lay the foundation for a legal, regulatory, and tax environment conducive to domestic and foreign investment in [Iraq's] energy sector." The legal advisory effort concluded in April 2007. In response to a March 2007 CRS inquiry, the Administration reported that the "U.S. Government did not provide any drafting input to the recent hydrocarbon law; the Iraqis have not asked for that kind of assistance on that law or on the revenue sharing law."

In July 2006, U.S. Secretary of Energy Samuel Bodman visited Baghdad and expressed his support for the drafting and passage of new legislation to govern Iraq's oil industry and to facilitate international investment. Later that month, Iraqi Minister of Oil Shahristani visited Washington, DC, and met with executives from major international oil companies at U.S. Department of Energy headquarters. In recent months, the U.S. Embassy in Baghdad has hosted and arranged a number of meetings among key Iraqi political figures to encourage discussion and compromise over outstanding legislative and constitutional reforms, including the package of hydrocarbon legislation. According to the U.S. Department of State, an "Energy Fusion Cell" made up of U.S. Embassy personnel, representatives of Multinational Force-Iraq (MNF-I), and Iraq's Ministry of Oil and Ministry of Electricity also is working to develop an integrated national energy strategy to better coordinate Iraqi budget allocations, reconstruction plans, and production goals.[78] According to a September 2007 Washington Post report, the Commerce Department has sought to hire an international legal adviser fluent in Arabic "to provide expert input, when requested" to "U.S. government agencies or to Iraqi authorities as they draft the laws and regulations that will govern Iraq's oil and gas sector."[79]

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[76] Available at [http://www.platformlondon.org/carbonweb/documents/Bearing_Point_Iraq_oil.pdf.]

[77] BearingPoint held the contract for this advisory coordinator position.

[78] GAO, GAO-07-677, May 15, 2007, p. 45.

[79] Walter Pincus, "Commerce Seeks Adviser for Iraq Oil Interests," *Washington Post*, September 10, 2007.

Congressional Benchmark and Other Legislation

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, 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."[80]

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.[81]

Section 8113 of P.L. 110-116, the Department of Defense Appropriations Act, 2008 (November 13, 2008) 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."

Other relevant legislation before the 110th Congress includes:

- Section 8 of H.R. 2574, the Iraq Study Group Recommendations Implementation Act of 2007, includes a detailed statement of policy on the oil sector in Iraq. The bill would require the Administration to report on the implementation of the bill's reformulation of the Iraq Study Group recommendations (including Section 8) 90 days after enactment.

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[80] The White House, Initial Benchmark Assessment Report, July 12, 2007. Available at [http://www.whitehouse.gov/nsc/iraq/2007/FinalBenchmarkReport.pdf]

[81] The White House, Benchmark Assessment Report, September 14, 2007. Available at [http://www.whitehouse.gov/news/releases/2007/09/20070914.html]

- Section 4 of S. 670, the Iraq Troop Protection and Reduction Act of 2007, would prohibit the provision of appropriated funds to the Government of Iraq for security purposes unless the President certifies to Congress that the GOI "provides for an equitable distribution of the oil revenues of Iraq."

- S.Con.Res.37 states that the United States should encourage Iraqis to adopt oil revenue sharing legislation as a "critical component of a comprehensive political settlement based upon federalism."

- H.Res. 835 calls on Iraq not to reopen the Kirkuk-Baniyas oil pipeline to Syria until Syria makes "significant progress" with regard to support for Lebanese Hezbollah, nonproliferation, and other issues.

- Other resolutions and bills include statements of policy declaring that it is not and shall not be the policy of the United States to control Iraq's oil resources. See H.Con.Res. 46 and H.R. 663.