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

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Summary

Development in Iraq's oil and natural gas sector is proceeding, in spite of continuing delays in agreeing to hydrocarbon sector and revenue sharing legislation to define new terms for the management of the country's significant oil and natural gas resources. Both the Bush Administration and the 110th 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. In the absence of new legislation, interim revenue sharing mechanisms have been implemented, while both the Iraqi national government and the Kurdistan Regional Government have signed oil and natural gas development 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 Council of Representatives (parliament) has not taken action to consider proposed legislation to date because of ongoing political disputes. Iraqi critics and supporters of various proposed solutions 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.

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 development 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 reflect 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 operations 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.

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, and the U.S. Department of Energy's Energy Information Administration notes that current estimates "have not been revised since 2001 and are largely based on 2-D seismic data from nearly three decades ago." 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 current proven reserves are concentrated largely (65 percent 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. (For a map of Iraq's oil resources, see **Figure 1**, below).

At present, crude oil is the source of over 90% of Iraq's domestic energy consumption and oil exports generate over 90% 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 revenue and budget assumptions from a projected surplus to a projected $15.9 billion deficit. Official U.S. assessments stress that continued fluctuations in oil prices and production could jeopardize Iraq's fiscal stability and the sustainability of its reconstruction and development plans. Current Iraqi plans call for the expansion of oil production to the level of four million barrels per day (mbd) by 2013 and then upward to six mbd by 2017. In support of those goals, Iraqi officials have opened an international bid process for service contracts and renegotiated a series of Saddam-era oil production agreements, including the transformation of a production sharing agreement into a service contract for Ahdab oil field with China National Petroleum Corporation (CNPC).

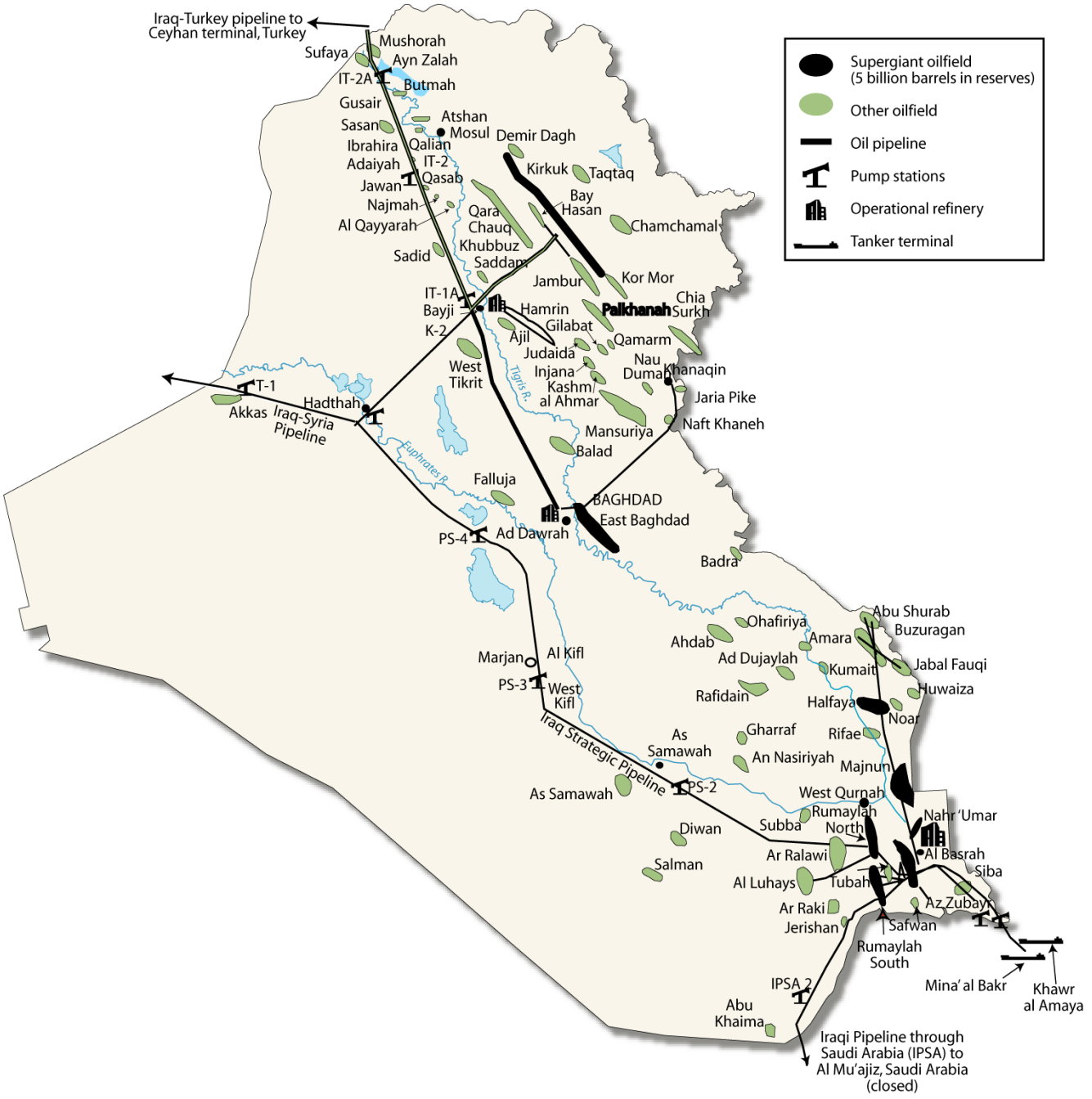
Table 1. Key Oil Indicators

Oil Production (current weekly avg.)	Oil Production (pre-2003)	Oil Exports (current)	Oil Exports (pre-2003)	Oil Revenue (2007)	Oil Revenue (2008)	Oil Revenue (2009, to date)
2.45 million barrels per day (mbd)	2.50 mbd	1.96 mbd	2.20 mbd	$41 billion	$61.9 billion	$16.2 billion

Source: U.S. Department of State "Iraq Weekly Status Report," July 15, 2009.

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.

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, June 2009, available at: http://www.eia.doe.gov/cabs/Iraq/Background.html.

Recent Developments

On June 30, 2009, Iraq opened a long-awaited first bidding round for 20-year service contracts on six of its largest oil fields and two large, undeveloped natural gas fields. Iraq pre-qualified 41 international companies to participate in the bidding process. In the run-up to the bidding round, political scrutiny of Iraqi Oil Minister Hussein Al Shahristani intensified as members of Iraq's Council of Representatives (Parliament) voiced strong concerns about the terms of the contracts on offer and about Shahristani's management of the oil sector to date. Calls for a vote of no confidence in Shahristani were rebuffed, although the Oil and Gas Committee in parliament has moved forward with plans to formally question the minister.

The bidding round reflected international interest in and apprehension about the terms of potential investment in Iraq and about prevailing political and security conditions. At the close of the bidding round on June 30, only one field bid had been accepted by Iraq's Oil Ministry—the joint bid by U.K. oil giant BP plc and China National Petroleum Corporation was chosen for the service contract for Rumaila, Iraq's largest oil field. Iraq's cabinet subsequently approved the proposed terms of the Rumaila bid and parliamentary leaders are stating their desire to review any related contract before its signature. Bids for the other five oil fields on offer in the first round demonstrated wide differences in negotiating positions between international oil companies and Iraqi officials. Iraq sought per barrel service payments at far lower dollar-per-barrel levels than nearly all bidders were prepared to accept, in some cases bids exceeded Iraq's offered terms by ratios of up to ten to one.

Iraqi officials, for both political and economic reasons, are seeking to maximize both the overall amount of production in order to meet planned expansion targets and the revenue that will accrue to the federal government to meet the country's considerable fiscal and investment needs. Iraq's Federation of Oil Unions and its Southern Oil Company publicly opposed the bidding process, and government officials appear to be seeking to address popular nationalist concerns about the participation of foreign firms in Iraq's energy sector. International investors are seeking contract terms that will balance the attractiveness of Iraq's relatively easy-to-produce, plentiful oil with persistent uncertainties surrounding the country's legal and tax regime and security conditions. These differences were also apparent during negotiations over potential contract terms during 2008 and early 2009.

The bidding took place in an atmosphere marked by several unresolved policy questions. Draft hydrocarbon legislation remains stalled in Iraq's Council of Representatives, without a pending resolution in sight. Iraqi critics and supporters of legislation proposed to date have differed 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 disputes 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 remain highly contentious.

Disagreements between officials in the national government and the Kurdistan Regional Government (KRG) continue to flare concerning the legality and terms of each government's oil contracts with international investors (see "Interim Arrangements and Contracts" below). 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 national Oil Ministry. KRG officials in turn have criticized the national government's contract bidding process as suboptimal from an economic point of view and have opened controversial negotiations for the potential future export of natural gas via the Nabucco pipeline.

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 Special Inspector General for Iraq Reconstruction (issued April 30, 2009), "as of March 31, 2009, the United States had allocated $2.05 billion, obligated more than $1.93 billion, and expended more than $1.88 billion in the oil and gas sector through projects to build, rehabilitate, and protect facilities and to provide technical training for Ministry of Oil employees." The SIGIR also reported that Iraq's operational funds for its Oil Ministry have increased over 800% in 2009 to $950 million, while investment funds have remained roughly static at $2.2 billion. The U.S. Department of Defense reported in its latest report on security and stability in Iraq (issued March 2009) 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), many of which are in their final stages of construction.

Key Issues

Draft Hydrocarbon Legislation

A package of proposed hydrocarbon sector and revenue sharing legislation proposed in 2007 remains stalled amid ongoing disputes among Iraqis about broader political questions. The legislation would define the terms for the management and development of the country's significant oil and natural gas resources and was viewed by the Bush Administration and the 110th Congress as an important benchmark that would indicate the current Iraqi government's commitment to promoting political reconciliation and providing a sound basis for economic development in Iraq. Compromises reached in early 2007 allowed the 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 have precluded further progress in adopting the new laws. The legislative package 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 by establishing terms and mechanisms for revenue sharing, creating the Iraq National Oil Company, and reorganizing Iraq's Ministry of Oil. At present, it remains unclear whether Iraqi officials intend to consider the proposed legislation in its current form or whether they will renegotiate key elements of their original compromise. For more detailed analysis of the legislation proposed in 2007, see the **Appendix**.

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. Some blocs within Iraq's Council of Representatives have opposed and/or attempted to significantly amend elements of proposed legislation and contracts to reflect their priorities (see "Players and Positions" below). 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.

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. In 2008, the Chairman of the Council of Representative's Oil and Gas Committee reportedly decided that the committee will not proceed with a first reading of draft hydrocarbon legislation until the federal government and the KRG reach a political agreement on the management of the sector.[1] The March 2009 Report to Congress on Security and Stability in Iraq prepared by the U.S. Department of Defense stated that "fundamental differences remain over federal and regional authorities in contracting and management of the oil and gas sector."[2] As the campaign season for Iraq's 2010 national elections unfolds, candidates' positions on oil and natural gas related policy questions are likely to receive considerable scrutiny from voters, and candidates may be inclined to defend uncompromising positions to garner popular support.

Interim Arrangements and Contracts

In the absence of new oil legislation and regulation, both the Ministry of Oil and the KRG have moved forward with hydrocarbon sector investment and development processes. In turn, new national government and KRG contracts have contributed to the persistence of an atmosphere of political controversy surrounding the hydrocarbon sector, as each side has questioned the validity and wisdom of the other's agreements with investors. In spite of these conditions, several international companies have chosen to pursue investment opportunities in Iraq in an uncertain legal and political environment.

Kurdistan Regional Government (KRG) Contracts

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.[3] 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 draft revenue sharing law. In September 2007, a State Department spokesman stated the Bush Administration's view that the KRG deals "elevate tensions between the Kurdish regional government and the

[1] U.S. Department of Defense, Measuring Stability and Security in Iraq - June 2008, Report to Congress in accordance with the Department of Defense Appropriations Act 2007 (Section 9010, P.L. 109-289), p. 3.

[2] U.S. Department of Defense, Measuring Stability and Security in Iraq – March 2009, p. 3-4.

[3] *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/Kurdistan%20Oil%20and%20Gas%20Law%20English__2007_09_06_h14m0s42.pdf.

Government of Iraq," and were not "particularly helpful" to the extent that they were hindering consideration of a national oil law.[4]

Many Iraqi government officials have reacted negatively to the impasse between the national government and the KRG and have condemned the KRG's contracting activities. In November 2007, Oil Minister Al Shahristani warned international oil companies that the national government would not allow the export of oil produced under KRG contracts, and the export ban persisted until June 2009.[5] The Ministry of Oil has since refined its position slightly to emphasize its firm opposition to contracts signed by the KRG after February 2007, when the initial compromise on hydrocarbon legislation was reached between the KRG and Baghdad. According to Shahristani, contracts signed before February 2007 with firms currently producing oil for domestic consumption would be considered valid after review and potential amendments. In May 2009, the Oil Ministry 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 KRG contracts were signed prior to February 2007. Under the terms of the recent agreement, the revenue from the sales accrues to the national government, but a dispute has emerged over the compensation of the foreign partners in the production operations: Baghdad is insisting that compensation is the KRG's responsibility.

KRG officials have long accused Minister Shahristani of mismanaging the Oil Ministry and have consistently stated their opinion that the KRG contracts are constitutional, legal, and "in the best interests of Iraq."[6] In January 2008, at least 120 members of the Council of Representatives from a wide range of political parties endorsed a joint statement underscoring their opposition to the KRG contracts.[7] The cross-sectarian and cross-party opposition appears to be motivated by concerns about the production sharing model used in the KRG contracts and the precedent set by KRG demands for regional autonomy in oil and revenue decision-making.

Ministry of Oil Contracts

In an effort to improve the output of Iraq's currently producing oil fields, the Ministry of Oil opened negotiations with major international oil companies on two-year technical service contracts (TSCs), but decided in September 2008 to drop further negotiations. Potential partners reportedly included Royal Dutch Shell, Chevron, BHP Billiton, Anadarko, ExxonMobil, BP and Total SA. Under the terms of the TSCs, international firms would have provided technology, equipment and services to increase the total output of currently producing Iraqi oil fields by 500,000 barrels per day.[8] The technical contracts reportedly were to be based on studies that international oil companies completed for the Iraqi government under the terms of existing memoranda of understanding.[9]

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

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

[6] Ben Lando and Alaa Majeed, "Load 'em up: fields in Iraqi Kurdistan begin," *Iraq Oil Report*, June 1, 2009.

[7] 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.

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

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

Instead, Minister Al Shahristani has proceeded with licensing rounds for long-term service contracts in a number of oil fields. In January 2008, the Ministry launched a pre-qualification review process for potential international investors. Oil companies interested in bidding on oil extraction and service licenses issued by Iraq's national government were required to submit a pre-qualification form to the ministry's Directorate of Petroleum Contracts and Licensing by February 18, 2008.[10] In March 2008, Minister Al Shahristani reported that approximately 150 companies had made submissions, and, by June 2008, 35 companies had been pre-qualified to bid for long-term service contracts.

The first bid round opened on June 30, 2009 and covered Iraq's main oil fields at Rumaila, Kirkuk, Zubair, West Qurna (Stage I), Bai Hassan, and Maysan, along with natural gas fields at Akkaz and Mansouriyah. According to Middle East Economic Digest, "although there was strong competition for phase one of the West Qurna field and the southern Zubair oil field, there was just one bid each for the Bai Hassan, Missan, Kirkuk and Akkas fields."[11]

As noted above (see "Recent Developments"), only one bid was accepted by Iraqi authorities – a joint bid by BP plc and China National Petroleum Corporation (CNPC) for the Rumaila service contract. Cabinet approval is being sought for long-term contracts in the absence of a hydrocarbon framework law, and the cabinet reportedly approved the Rumaila bid in July 2009, paving the way for contract negotiations. The Federation of Oil Unions of Iraq and the Federation of Workers Councils and Unions in Iraq are protesting the bidding process in general and the Rumaila proposal in particular.

Figure 2. Iraq's Oil Fields and Bidding Plans

Oil Fields for Bid In Iraq	
First Bidding Round	**Reserves (billion bbl)**
Rumaila	17
West Qurna, Phase I	8.7
Kirkuk	8.6
Zubair	4
Missan	2.5
Bai Hassan	2.3
First Round Total (billion barrels)	**43**
Second Bidding Round	
West Qurna, Phase II	12.9
Majnoon	12.6
East Baghdad	8.1
Halfaya	4.1
Gharaf	0.9
Najmah	0.9
Qayarah	0.8
Kifil	0.2
West Kifil	0.2
Marjan	0.2
Badra	0.1
Qamar	0.1
Gullabat	0.1
Naudoman	0.1
Second Round Total (billion barrels)	**41**

Source: U.S. Department of Energy, Energy Information Administration, Country Analysis Brief: Iraq, June 2009.

A second bidding round is scheduled for late 2009 to include eleven discovered but currently non-producing fields, including the major fields at Halfaya, Majnoon, East Baghdad, and West Qurna (Stage II). Interest reportedly remains high in the proposed bidding round, although industry executives are watching intently for signals from Baghdad about its plans to negotiate service contracts for the remaining fields from the first round, perhaps by including them in a rescheduled second round for an earlier date. The misalignment of Iraq's proposed compensation fees and the bids offered by international oil

[10] 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.

[11] Perry Williams, "A crushing blow to Baghdad's plans," *Middle East Economic Digest*, July 10, 2009.

companies in the first round suggest a need for serious consultation among Iraqi officials and between them and their prospective partners.

Prospects for Revenue Sharing and Current Arrangements

Outside observers and Iraqi experts have emphasized the importance of proper oil revenue management and equitable oil revenue sharing as requirements for economic development and political reconciliation in Iraq. 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. Under the drafts, revenue sharing would reflect a population-based system for revenue allocation, with automatic monthly distributions to regional and governorate authorities. Potential obstacles to revenue sharing on 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.

Current revenue sharing arrangements are outlined in Articles 17 through 19 of Iraq's 2008 Budget Law.[12] The budget prioritizes so-called "sovereign expenditures" for the Council of Representatives, the administration of the national Cabinet, the Ministry of Foreign Affairs, the Ministry of Defense, oil export production, and other national government functions. After these expenditures are provided for, 17% of the remaining budget is allocated to the Kurdistan Regional Government, and the rest is allocated for use by national ministries in other governorates on the basis of population percentages and specific needs. The law calls for the auditing of KRG government revenue to determine any funds that should be transferred to the national treasury and provides for the potential withholding of proportionate amounts of national budgetary funds from transfer to the KRG in the event of non-payment by the KRG of revenues due to the national government. Article 19 of the law states that the percentages of the budget allocated to the KRG and the governorates were to be "revisited" in the 2009 budget and called on the national government to "conduct a population census throughout Iraq no later than December 31, 2008." A nationwide census is currently scheduled for October 2009, although some Iraqis are asking that the census be delayed in light of population disruptions because of past and ongoing violence.

Iraqi Perspectives

Core Issues

Iraq's Constitution: Federal and Regional Authority

According to Revenue Watch[13] 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

[12] English translation of law provided to CRS Analyst by U.S. Department of State, September 15, 2008.

[13] 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.

toward the oil sector and proposed oil legislation 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.[14] 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)." 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."[15] 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.[16] 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.[17] In December 2007, CRC Chairman Humam Hamoudi requested and received a further six-month extension.[18] The CRC failed to produce a final report by June 30, 2008, and its deadline was been extended once again through the end of 2008.

The March 2009 Measuring Stability and Security in Iraq report to Congress stated that "the CRC's final report left all of the major constitutional issues, including revenue distribution, federalism, and the status of Kirkuk, entirely unresolved."[19] According to one analysis of the CRC recommendations relating to Articles 111 and 112, 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.[20]

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[14] 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.

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

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

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

[18] 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.

[19] U.S. Department of Defense, Measuring Stability and Security in Iraq – March 2009, Report to Congress in accordance with the Department of Defense Appropriations Act 2007 (Section 9010, P.L. 109-289), p. 3.

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

Some observers argue that without a mutually acceptable agreement on federal and regional power sharing as reflected in a constitutional amendment, passage of 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 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 deepened in the atmosphere of violence and sectarian tension that gripped Iraq from mid-2003 though mid-2008. It continues to shape the dispute between the KRG and the national 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.

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 the current government's plans.[21] Iraq's own oil revenues may provide a significant resource base for such investment and for attracting technology and expertise. However, some observers have questioned the Iraqi government's capacity to effectively direct large amounts of its own resources toward hydrocarbon sector rehabilitation in light of its past failures to manage and expend funds set aside in the federal budget for those purposes (see Revenues below).[22]

Until recently, Iraq's unstable security situation has presented a significant barrier to large-scale investment by most international entities. Saddam Hussein negotiated several oil investment agreements with international oil companies, but few were implemented, and to date, only one has been revised and renegotiated—the Al Ahdab contract with China National Petroleum Corporation (CNPC).[23] 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. Iraq's Ministry of Oil is moving forward with technical service contract awards, while the KRG has awarded controversial production sharing 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 is an 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 all Iraqis, and members of different ethnic and sectarian groups have formed coalitions to oppose positions and compromises 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.

[21] 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.

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

[23] 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.

The Kurds: Regional Authority, Revenue, and Kirkuk

The Kurdistan Regional Government (KRG) has signed oil and natural gas production sharing contracts with several international companies since 2003. Under oil sector legislation drafted in 2007, these existing contracts would be subject to review by a Panel of Independent Advisers of the Federal Oil and Gas Council (FOGC). 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, 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.[24] 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."[25] 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." The United Nations Assistance Mission for Iraq (UNAMI) and the U.S. Embassy in Baghdad continue to engage with Iraqi politicians on the Kirkuk question, and UNAMI recommendations are under consideration regarding proposed boundaries, political agreements, and a potential referendum. Temporary consensus was reached amid outbreaks of violence in Al Tamim, allowing the provincial elections law to move forward in September 2008. Special provincial elections for Kirkuk have yet to be scheduled. A service contract for the large Kirkuk oil field was included in the bidding round held in July 2009, in spite of the ongoing negotiations.

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

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

[25] 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.

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, criticized draft oil legislation put forward in 2007 and 2008.[26] Representatives of the Al Tawafuq party also have called oil and gas deals signed by the Kurdistan Regional Government with foreign companies "illegal."[27]

Dawa and Islamic Supreme Council of Iraq: Investment and Development

The leading parties of the ruling Shiite United Iraqi Alliance (UIA)—the Dawa Party and the Islamic Supreme Council of Iraq (ISCI)—have supported the adoption of proposed hydrocarbon legislation 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 ISCI's reported preference for establishing a large federal region encompassing all of the Shiite Arab majority governorates of southern Iraq.[28] However, at present, both the Dawa Party and the ISCI 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 and the Iraq Federation of Oil Unions.

Industry Unions and the Southern Oil Company

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. Ongoing efforts by some Basrah politicians aim to establish a federal region which could complicate decision-making regarding the development of local energy resources. Press reports suggest that competition between local politicians, militia groups, union members, and federal ministry representatives fueled conflict in the region through early 2008.[29] The 26,000 member Iraq Federation of Oil Unions has voiced its members' strong opposition to the proposed draft of the hydrocarbon framework legislation and has demonstrated a capacity to disrupt oil production and refinery operations with strikes.[30]

In May 2007, oil unions demanded participation in discussions of the draft hydrocarbon legislation with Prime Minister Al Maliki, who reportedly agreed to include the unions in future

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

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

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

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

[30] 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.

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.[31] 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."[32] In September 2007, 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. As noted above, the Federation of Oil Unions of Iraq and the Federation of Workers Councils and Unions in Iraq are protesting the recently launched oil service contract bidding process and have signaled their willingness to resort to strikes in order to prevent the implementation of contracts that they oppose.

In addition, Fayad Al Nema, the director-general of the influential Southern Oil Company (SOC) has opposed the service contract plan advanced by the Ministry of Oil. He apparently advised Oil Minister Al Shahristani that, "We in the South Oil Company, all of its leadership, reject the first bidding round (for oil service contracts) because it is against the interests of Iraq's oil industry," adding, "The service contracts will put the Iraqi economy in chains."[33] A controversy in mid-2008 was sparked by the Ministry of Oil's decision to remove then-SOC director Jabbar Al Luaibi, who was re-subsequently appointed as a special adviser with authority to "oversee operations and projects to sustain and increase oil and gas production and exports carried out by all operating companies in the southern region."

International Energy Companies

The absence of an accepted hydrocarbon framework presents a potential procedural obstacle to broad international investment in Iraq's oil and natural gas sector. Some energy experts argue that the persistence of insecurity has been a more fundamental concern to international energy companies. The Bush Administration identified the lack of progress on an oil sector 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 was passed.[34] 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 were not made from 2003 through 2008. This appears set to change in light of the service contract bidding process being administered by the Ministry of Oil.

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, and may seek 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,

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

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

[33] *Upstream*, "Licensing round 'will put economy in chains,'" June 19, 2009.

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

particularly if key decision making powers are delegated to regional or governorate authorities.[35] 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. The principal challenge, as evident during the first service contract bidding round, is reaching mutually acceptable terms that provide sufficient return to international investors who meet the Iraqi government's ambitious production expansion targets.

Oil Revenue and Security Concerns

Revenues from the sale of oil resources are the engine of Iraq's national economy and the lifeblood of its national budget. Iraq's state-owned oil production and marketing system ensures that revenue from the export and sale of Iraqi oil accrues to the Iraqi government, and the Iraqi people's elected representatives are now responsible for administering that revenue to meet the country's considerable development needs. The U.S. Department of the Treasury and the International Monetary Fund have expressed confidence that, over time, Iraq's oil revenues are likely to be sufficient to meet the country's development needs, if underlying conditions remain favorable for the expansion of oil production and if revenues are managed effectively. However, according to U.S., Iraqi, and international observers, shortcomings in Iraqi financial management capacity have prevented capital investment budgets from being spent effectively thus far and may continue to hinder reconstruction progress if left unaddressed. Changes in security conditions, Iraqi political reconciliation, and international supply and demand may affect the Iraqi oil sector's ability to fund Iraq's reconstruction over the medium to long-term.

Revenues and Arrangements

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 United Nations 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.[36] 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.[37] According to the IAMB, as of December 31, 2007, $23.43 billion had been disbursed from the United Nations Compensation Fund; Iraq owed $28.95 billion to the Fund. In 2008, Iraq contributed an additional $3 billion. As of mid-2008, the

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

[36] 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.

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

IAMB estimated that "at the present rate of Iraqi oil sales, it would take approximately 17 years for the compensation award to be fully paid."[38] Significant declines in the price of oil since that time have likely altered that estimate, although the IAMB has not issued a revised date.

U.N. Security Council Resolution 1859 (December 22, 2008) extends the IAMB authority only until December 31, 2009, making reference to a 2009 "transition to successor arrangements" for the DFI and the IAMD, to Iraqi-led auditing processes. 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.[39] 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."

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, 2009, and President Obama extended the protections through May 2010.[40] 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.

Oversight of Oil Production and Revenue Management

From its creation in May 2003 through December 31, 2007, the DFI had received over $121.7 billion in oil proceeds and other deposits.[41] Preliminary audit estimates suggest that an additional $58.8 billion in net export proceeds were received in 2008. 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. A lack of reliable oil output measurement has proven to be a fundamental and persistent problem. 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.[42] A January 2008 IAMB report stated that Iraq's Ministry of Oil "does not have in place

[38] Ernst & Young, Development Fund for Iraq—Summary of Audit Results for the year ended December 31, 2007, May 12-13, 2008.

[39] 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 Debt Relief: Procedure and Potential Implications for International Debt Relief*, by Martin A. Weiss.

[40] 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.

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

[42] James Glanz, "Billions in Oil Missing in Iraq, U.S. Study Finds," *New York Times*, May 12, 2007; and, GAO, GAO-(continued...)

a full operational loading and metering system at production and loading points in order to determine produced and loaded quantities [of oil] accurately."[43] A June 2008 IAMB report confirmed that "some metering has been installed at oil terminals, but there continues to be no metering in the oil fields."[44] In April 2009, the IAMB reported that "much remains to be done before a fully operational control and measurement system over the oil production, distribution and export sales, can be comprehensively implemented," and added that, "Indications from the Ministry of Oil point to implementation by 2011 at the earliest."[45]

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. On June 12, 2007, the IAMB released a statement on its 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."[46] These conditions may have facilitated 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 IAMB's preliminary findings for 2007 recognized Iraqi government's efforts to respond to IAMB recommendations, but found that "the overall financial system of controls in place in the spending ministries, the U.S. agencies in respect of outstanding commitments using DFI resources, and the Iraqi administration of DFI resources remain deficient."[47] The 2008 preliminary assessment, released in April 2009, concluded that "much remains to be done before a sound financial management system is operating effectively in Iraq." [48]

Oil Revenue and Budget Execution

The 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 IMF report explained how high oil prices had compensated for missed oil production expansion targets that had undermined revenue generation through late 2007. Further increases in oil prices through August 2008 and expanded oil exports generated substantially higher than expected oil revenues for Iraq through most of 2008. According to the U.S. Department of State, crude oil exports averaged 1.73 million barrels per day in the third quarter of 2008, at an average price of $110 per barrel.[49]

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07-677, May 15, 2007, pp. 26-7.

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

[44] Ernst & Young, Development Fund for Iraq—Summary of Audit Results for the year ended December 31, 2007, May 12-13, 2008.

[45] Statement by the International Advisory and Monitoring Board of the Development Fund for Iraq, April 13, 2009.

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

[47] International Advisory and Monitoring Board on Iraq, "Third Interim Report Covering the Year 2007," February 28, 2008.

[48] Statement by the International Advisory and Monitoring Board of the Development Fund for Iraq, April 13, 2009.

[49] Report to Congress Submitted Pursuant to U.S. Policy in Iraq Act, Section 1227(c) of the National Defense Authorization Act for Fiscal Year 2006 (P.L. 109-163), as amended by Section 1223 of the National Defense (continued...)

Sharp drops in global oil prices since September 2008 have drastically undercut Iraqi oil revenues, and this trend has forced the Iraqi government to scale back its 2009 budget plans. In March 2009, the COR approved a $58.6 billion budget for 2009, down from a planned $80 billion budget proposed in late 2008. The projected budget deficit for 2009 is $15 to $17 billion, and will be financed through the use of reserve funds accumulated from prior budget surpluses deposited in the DFI. The 2009 budget assumes an export level of 2 million barrels per day at a price of $50 per barrel. As of July 15, 2009, Iraq's Basrah light oil was priced at $60.43 per barrel, and Iraqi officials had announced their intent to increase 2009 spending by up to $3 billion over the budgeted level as a result of higher than assumed revenues.[50]

In order to provide Iraq with a sustainable revenue stream, the Ministry of Oil has set a goal of nearly doubling current oil production to 4 million barrels per day by 2013 and then increasing production to six mbd by 2017. Oil Minister Hussain Al Shahristani estimated in April 2009 that Iraq will need to attract $50 billion investment to expand oil production capacity from the current level of 2.4 mbd to 6 mbd. According to the April 2009 report of the Special Inspector General for Iraq Reconstruction, "as of March 31, 2009, the United States had allocated $2.05 billion, obligated more than $1.93 billion, and expended more than $1.88 billion in the oil and gas sector through projects to build, rehabilitate, and protect facilities and to provide technical training for Ministry of Oil employees." [51] 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.[52]

The June 2007 U.S. Department of Defense Measuring Stability and Security in Iraq report stated that the Iraqi government's "failure to execute several billion dollars of its own funds in oil sector capital investments" had limited the overall recovery of the sector.[53] Although capital investment expenditure rates in the oil sector and in other sectors reportedly have increased since mid-2007, broad shortcomings in Iraqi revenue management practices and capabilities have contributed to the accumulation of budget surpluses, which are now being used to cover the deficit projected for 2009.

According to the June 2008 Measuring Stability and Security report, the Ministry of Oil executed $1.1 billion of its $2.2 billion 2007 capital budget, and may face continuing challenges because of a lack of administrative capacity and international firms' reluctance to engage in long-term, multi-year development projects.[54] The March 2009 report the Iraqi government "has improved national and provincial budget execution and the distribution of essential services, although spending on capital projects continues to fall short of needed investment." The report noted that capital project spending "has also increased significantly over 2007 spending," but highlighted the fact that spending units in Iraqi ministries "continue to face difficulties with conducting feasibility studies,

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Authorization Act for Fiscal Year 2008 (P.L. 110-181), October 2008.

[50] U.S. Department of State, "Iraq Weekly Status Report," July 15, 2009; and, Hassan Hafidh, "Iraq To Add $2.8B-$3B to '09 Budget On Higher Oil Output, Prices," *Dow Jones Energy Service*, July 15, 2009.

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

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

[53] 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 $2.2 billion was less than half of the ministry's own estimated maintenance and growth needs. U.S. Department of Defense, Measuring Stability and Security in Iraq - June 2007, pp. 9, 11-12.

[54] U.S. Department of Defense, Measuring Stability and Security in Iraq - June 2008, p. 10.

negotiating contracts that follow Iraqi laws, and ensuring that letters of credit match approved contracts."

The U.S. State Department made similar assessments in January 2009. According to the Department's latest Section 1227 Report on Iraq Relief and Reconstruction, Iraqi "ministries and provincial governments continue to improve their ability to allocate and spend their own money, although impediments to full spending remain."[55] The report states that the primary factors limiting progress toward full spending are "technical capacity, security, bureaucratic bottlenecks, and absorption capacity."

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 Special Inspector General for Iraq Reconstruction (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.[56] Iraq has issued new decrees and reformed administrative bodies to grant greater contracting authority to ministries and provinces.[57] Iraq's 2008 Budget Law allowed provinces and government agencies to carry over their unused budget authority into the current fiscal year, although single year budgeting remains the standard in Iraq and complicates multi-year project planning. The U.S. Embassy in Baghdad and the commanders of Multi-National Forces-Iraq also have reorganized the management of existing U.S. and coalition budget assistance programs to improve coordination.

In late June 2008, the interagency Public Finance Management Assistance Group (PFMAG) began its work. The PFMAG's civilian-military Policy and Operations Committees now direct the activities of paired teams of Action Officers and Treasury Technical Assistance Advisors who work alongside Iraqis, collecting and analyzing data and helping to re-engineer and expedite payments and other budgetary processes.[58] These activities build on existing programs such as USAID's National Capacity Development Program (more commonly known by the name *Tatweer*, the Arabic word for development), the U.S. Embassy Iraq Transition Assistance Office (ITAO) Ministerial Capacity Development Program, and the work of the Multi-National Security Transition Command-Iraq (MNSTC-I) Embedded Advisory and Functional Capability Teams. Coalition partners, such as the United Kingdom's Department for International Development (DFID), participate in PFMAG decision-making, and U.S. officials report that expanded PFMAG coordination with international bodies such as the IMF and World Bank is underway.

[55] U.S. Department of State, Bureau of Near Eastern Affairs, Report to Congress Submitted Pursuant to U.S. Policy in Iraq Act, Section 1227(c) of the National Defense Authorization Act for Fiscal Year 2006 (PL 109-163), as amended by Section 1223 of the National Defense Authorization Act for Fiscal Year 2008 (P.L. 110-181) and Section 1213(c) of the National Defense Authorization Act for Fiscal Year 2009 (Public Law 110-47), January 2009.

[56] Special Inspector General for Iraq Reconstruction (SIGIR) Report 08-020, "Key Recurring Management Issues Identified in Audits of Iraq Reconstruction Efforts," July 2008.

[57] A Central Contracts Committee has now replaced Iraq's former contract approving authority. Decrees issued since January 2008 granted Governors and selected Ministers and Heads of Agencies authority to enter into contracts worth $50 million. The ministries selected were Defense, Interior, Oil, Trade, Health, Electricity, Industry and Minerals, Water Resources, Municipalities, and Public Works. Agencies not attached to ministries have been granted a $30 million contract approval ceiling. Iraq's governorates can now approve contracts worth up to $10 million. SIGIR Report 08-020, July 2008.

[58] Information provided to CRS by U.S. Treasury Attaché, Baghdad, Iraq, September 13, 2008.

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 attacks have focused on pipelines in northern Iraq that feed the Iraq-Turkey oil export pipeline as a means of reducing government export revenues.[59] Southern pipeline infrastructure also has been targeted as a means of making oil and refined products more vulnerable to theft and diversion. Prior to IMF-sponsored efforts to phase out Iraqi fuel subsidies, highly organized smuggling operations leveraged supply and price imbalances in the Iraqi refined fuel market to create lucrative profit opportunities. The Department of Defense has estimated that in once case, "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."[60]

In response, the Iraqi government and Coalition forces have launched several initiatives to improve the security of Iraq's oil infrastructure. Pipeline Exclusion Zones (PEZs) have been established between Kirkuk and the main refining center at Bayji, and new zones are nearing completion along pipelines linking Bayji with Baghdad and Doura with Hillah. In January 2008, the command of the 22,000-member Ministry of Oil Protection Force (OPF) was transferred to the Ministry of Interior, although disputes between the Ministry of Defense and Interior have delayed completion of PEZ barracks and watchtower projects.[61] According to the U.S. Department of Defense, "Security improvements have contributed to maintaining production, exports, and increased domestic distribution. Although there have been several minor pipeline interdictions over the last six months, none have impacted the production, export, or refining of crude oil."[62] In November 2008, a PKK attack on a oil pipeline in Turkey suspended temporarily Iraqi crude oil exports and underscored the vulnerability of the region's energy infrastructure.

U.S. Policy and Issues for Congress

The Obama Administration and many Members of the 111th Congress identify political reconciliation and long-term economic development as key policy goals for continuing U.S. efforts 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 longstanding, shared concerns about preserving Iraq's unity and sovereignty.

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

[60] U.S. Department of Defense, Measuring Stability and Security in Iraq, June 2007, p.13.

[61] The U.S. military has reported 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." U.S. Department of Defense, Measuring Stability and Security in Iraq, June 2007, p. 13.

[62] U.S. Department of Defense, Measuring Stability and Security in Iraq - March 2009, p. 13.

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 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, 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 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 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 111th Congress

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 percent 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 110th 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 110th 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."[63]

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.[64]

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."

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

[64] 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.[65] 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 July 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. 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 Shahristani appears to be growing 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. 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.

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."[66] A "Panel of

[65] 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

[66] Article four of the draft framework law defines a "producing governorate" as "any Iraqi Governorate that produces (continued...)

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.[67] 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.[68] The FOGC would develop model

(...continued)

Crude Oil and natural gas continually on rates more than one hundred and fifty thousand (150,000) barrels a day."

[67] 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."

[68] 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."

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[69] 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."[70]

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 (for more information on current arrangements see *Prospects for Revenue Sharing* below).

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.[71] 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.[72] 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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[69] 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/.

[70] 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.

[71] 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.

[72] 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,[73] 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.[74] 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 January 2008, drafts of these laws had not been published and public reporting on their contents remains limited.

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

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

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