

Putting Iraq-KRG Oil Relations on Solid Legal Ground

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Brief Analysis

Notwithstanding their decades of contention, the two governments must resolve their differences legally to make way for economic development and stave off public unrest.

Despite their country producing 4.3 million barrels of oil per day, Iraq's population remains poor. Gathering in the streets of southern towns, masses are protesting government corruption, power shortages, and high unemployment rates. Consequently, the government must refocus its attention on economic prosperity and the daunting financial demands of reconstruction following years of war against the Islamic State. To that end, it should resolve its dispute with the Kurdistan Regional Government (KRG) over management of the oil and gas sector. Doing so would be the first of many crucial steps toward injecting rule of law back into the energy industry.

Currently, a messy but promising case to adjudicate management rights over these disputed resources sits before Iraq's Supreme Court. Should the case progress constructively, it will pressure the newly elected parliament to prioritize passage of a national hydrocarbons law. This in turn would infuse much-needed confidence into Iraq's risk-laden energy sector and invite greater foreign investment to boost production and revenues. Moreover, Kurdish recognition of the federal court foreshadows a more realistic approach to energy—one that aims to salvage and de-risk the KRG oil industry through better coordination, if not integration, with the federal industry.

REENERGIIZED AMBIGUITIES

In 2005, Iraq's new constitution enshrined federalism and the equitable sharing of oil and gas revenues. As the basis for its case that the KRG is supposed to take part in this arrangement, Baghdad cites three articles of the Iraqi constitution. Article 110 stipulates that the federal government shall have "exclusive authorities" in formulating "foreign sovereign economic and trade policy," presumably including the trade in hydrocarbons, which account for over 95 percent of Iraq's exports. Article 111 establishes that oil and gas are owned by all the people of Iraq. And the first paragraph of Article 112 stipulates that "present" oil and gas fields shall be managed by the central government alongside "the producing governorates and regional governments," essentially continuing Saddam Hussein's arrangements at the time of the constitution's enactment.

Yet the second paragraph of Article 112 implies a distinction between old and new oil, with 2005 as the dividing line. It asserts that "the federal government, with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth." The KRG therefore premises all hydrocarbon production, excluding its claims to Kirkuk, on "new oil" provisions covered by the "together" phrase, which is not found in the article's first paragraph. In its view, this phrasing also supersedes the "exclusive authorities" granted to Baghdad in Article 110.

However these differing interpretations are ultimately reconciled, Article 112 clearly gives the government a mandate to pass legislation regulating the shared management of production, sale of crude oil, and the distribution of revenues. Due to constant power wrangling, though, these constitutional provisions have not yet been translated into regulations, let alone clear laws. In a major push during 2007-8, the United States offered to mediate a new hydrocarbons law, but both Baghdad and the KRG decided to stick with their self-serving interpretations of the constitution.

The Kurds, eyeing the exit door from Iraq, sought to build an independent petroleum industry, inviting international oil companies (IOCs) to look for hydrocarbons in their territory. They also began independently exporting oil in January 2014 and contracted with Turkey to export gas, in clear violation of Article 110. Today, the KRG independently exports almost 300,000 barrels of oil per day via Turkey.

For its part, Baghdad seeks to remain the locus of such decisionmaking; accordingly, it claims ownership of the KRG's oil exports and refuses to recognize Kurdish deals with IOCs. In effect, Baghdad acts as if Article 112 regulates all oil, including "new" oil—a stance that seems to violate the constitution just as surely as Erbil's unilateral exports do.

COURT BATTLE

In 2012, the federal government took the KRG to the Supreme Court over the legality of its oil contracts and independent exports. But the KRG deliberately neglected to appear before the court until April of this year.

So far, the court has not made any rulings, requesting more information on the petroleum value chain instead. While the next and, perhaps, final hearing will take place on August 14, both parties are encouraged by the proceedings thus far. Federal officials feel they have a strong case against the KRG, while Kurdish officials are pleased to see the court question the two constitutional articles cited by Baghdad as grounds for indictment. The court has also put the onus of formulating a national oil law on Baghdad, since the KRG passed its own natural resources law in 2007.

Moreover, past budget laws passed by the national parliament required the KRG to contribute certain oil export earnings to the country's overall exports—a practice that Erbil cites as clear recognition that its independent exports are legitimate. One deal in 2015 had the KRG and federal government equitably split the proceeds of 150,000 barrels per day produced in the Kirkuk fields, whose oil can only be exported via the Kurdish pipeline to Turkey. Today,

however, federal authorities refuse to export that oil, avoiding KRG infrastructure at all costs. By so doing, they limit Iraq's northern export outlet—a self-defeating approach at a time when protests could threaten the flow of crude from the south.

ONE COUNTRY, TWO INDUSTRIES

The ongoing legal vacuum has essentially bifurcated Iraq's energy industry. Although building an energy industry from naught was quite a feat for the KRG, its main goals—staving off the central government and building the economic foundation for an independence—led it to overreach at times, such as when it commandeered Kirkuk oil fields and revenues during the war against the Islamic State. The Kurdish energy industry also became increasingly less transparent as KRG officials sought to evade Baghdad.

Yet federal authorities refused to give the KRG a break from day one. They declared Erbil's production-sharing contracts illegal, blacklisted any interested IOCs, and sued buyers. Short-term and short-lived deals replaced law-based policy and strategy. Between 2013 and 2016, Erbil intermittently recognized Baghdad's determinant role by turning its oil over to the central government for export. In return, Baghdad's acceptance of this arrangement indirectly recognized the legality of the KRG's contracts. The Kurds also received their share of country-wide oil export earnings: around 17% in most budgets up until recently. But various technical disputes and instances of overreach by both sides scotched several of these initiatives.

The disputes have also opened a door for more Iranian influence (<http://www.washingtoninstitute.org/policy-analysis/view/iraqs-energy-future-lies-to-the-north>). Last month, Baghdad and Tehran agreed to swap 30,000 barrels of Kirkuk oil, with Iraqi oil feeding Iranian refineries and Iran delivering equal amounts of its own oil to Iraq's Persian Gulf ports. Warming oil relations could potentially enable Iran to evade U.S. energy sanctions, reminiscent of Baghdad's own evasion methods in the 1990s, when Iraqi oil tankers flew Iranian flags.

Going forward, the balance of power has clearly tipped in Baghdad's favor given Erbil's costly independence referendum, its loss of control over Kirkuk's oil fields, and its dire need for cash flow from Iraqi coffers. Yet Baghdad also realizes that the KRG energy industry is here to stay. And continuing to substitute gentleman's handshakes for regulated production handovers and revenue sharing is unsustainable. Mutually destructive approaches hamper the progress of the Iraqi oil sector, which seeks to reintegrate and recover in a competitive market. In standing before the Supreme Court, the KRG has an opportunity to cash out on the constitution, the forging of which was one of its main institutional and legal achievements in the post-Saddam era. And Baghdad cannot simply play the bully now that it is dealing with the KRG's international energy partners, which include Russia's Rosneft and Turkey's BOTAS.

TOWARD RULE OF LAW

Allowing courts to settle Iraq's oil disputes is a principle worth supporting, since a transparent, rule-based energy industry is in the interest of all parties. Among other benefits, resolving the oil issue would help untangle Baghdad and the KRG's disputes over territory. It would also undercut Iran's influence, limit its opportunities for oil smuggling, and aid efforts to spot its sanctions-busting efforts.

To that end, the priority of the next Iraqi government should be passing a national hydrocarbons law and constructing inclusive state institutions that reflect the constitution. Rationalizing Iraq's petroleum sector is necessary to maximize revenue and formulate economic policies needed to cope with recent public protests. The United States should resume the assistance it extended in 2007-8 toward passing an oil and gas law. It should also support the court proceedings as a positive precedent for conflict resolution, while offering the technical advice the court needs to pass a fair judgment. Baghdad and the KRG are both receptive to such assistance.

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