

# Iraq's Oil Future

by [Simon Henderson \(/experts/simon-henderson\)](/experts/simon-henderson)

Dec 3, 2012

## ABOUT THE AUTHORS



[Simon Henderson \(/experts/simon-henderson\)](/experts/simon-henderson)

Simon Henderson is the Baker fellow and director of the Bernstein Program on Gulf and Energy Policy at The Washington Institute, specializing in energy matters and the conservative Arab states of the Persian Gulf.



Brief Analysis

---

**The United States has a crucial role to play in defusing Baghdad's tension with the Iraqi Kurds and developing the country's longer-term oil policy -- two intertwined issues that are central to keeping Iraq united.**

**O**n November 26, Iraqi officials agreed to use coordinating committees to calm tension in the north between federal troops and local Kurdish *peshmerga* forces. The Baghdad crisis meeting -- attended by senior federal and Kurdish officials along with a U.S. Army lieutenant general representing the embassy -- was held in response to a November 16 clash in northern Iraq in which at least one person died. Although the incident followed Baghdad's establishment of a new military command in adjacent provinces, Kurdish oil policy is seen as the crux of the dispute.

## BACKGROUND

**C**onflict between Iraqi Arabs and Kurds is not new. During Saddam Hussein's rule, ending this constant threat to national unity was one of Washington's goals for the 2003 invasion, and those Iraqis resisting Saddam shared this aim, especially Kurds and Shiite Arabs. Only after Saddam's overthrow did full Kurdish participation in government emerge -- for example, current Iraqi president Jalal Talabani is a Kurd.

But resentment lingers. Arab Iraqis are suspicious of the semiautonomy enjoyed by the Kurdistan Regional Government (KRG), while Kurds want what they consider their rightful share of the national budget, which is primarily generated through oil exports (at present, they receive 17 percent of the country's net oil export earnings).

Iraq contains huge quantities of oil, with proven reserves of 143 billion barrels (rivaling neighboring Iran) and likely deposits that could equal Saudi Arabia's. But production was constrained for many years by war and sanctions. Although Baghdad now has ambitious plans to expand exports, it needs the help of international oil companies (IOCs). Yet its adherence to commercial nationalism -- the notion that oil profits should go to Iraqis alone -- has led it to offer the IOCs only an unattractive flat fee.

Although most of Iraq's oil reserves are located in the south, oil was first discovered in Kirkuk, a northern city with a large Kurdish population situated adjacent to KRG territory. Today, Kurdistan is estimated to hold more than 40 billion barrels of oil, as well as extensive gas reserves. The 2005 Iraqi constitution laid out the principle of joint KRG-federal management of so-called "new fields" such as those in Kurdistan, but bickering continues over the degree of Kurdish control and the benefits of production-sharing agreements. The Kurds are in favor of such agreements, Baghdad against. This has produced gridlock, blocking passage of a hydrocarbons law to implement the constitutional provisions.

To Baghdad's fury, the KRG has been offering equity production-sharing exploration contracts to IOCs without the central government's approval, and the firms have responded with alacrity to the favorable terms. Underlying this is a difference of opinion between KRG leaders and Baghdad on the degree of foreign sovereign involvement in Iraq's hydrocarbons sector, exacerbated by a personal dispute between the statist Iraqi deputy prime minister and energy czar Hussein al-Shahristani and his Kurdish counterpart, former oil executive Ashti Hawrami. There are also basic differences about the role of hydrocarbons in maintaining domestic peace and unity.

## THE U.S. INTEREST

**W**ashington has both short- and long-term priorities in Iraq's oil future. In addition to pressuring Iran on its controversial nuclear program, international sanctions have sought to ensure that world markets are adequately served by increased oil supplies from Iraq, Saudi Arabia, and other countries to make up for forced Iranian export cutbacks. And in the longer term, Iraq is perceived as being crucial to the world's energy future.

The latest forecast by the Paris-based International Energy Agency, an intergovernmental body that promotes energy security, predicted that Iraq will make "the largest contribution by far to global oil supply growth." The IEA *World Energy Outlook 2012*, published last month, noted that demand will barely rise in highly industrialized countries between now and 2035, but will grow globally by one-third over the same period, with China, India, and the Middle East accounting for 60 percent of the increase.

The IEA report was widely publicized for its predictions that the United States will become the world's largest oil producer by around 2020 and a net oil exporter by around 2030. Less notice was made of the agency's qualifying statements that no country is an "energy island," and that Saudi Arabia will likely reassert its position as the top producer around the mid-2020s. The report also projected that Iraq will become the second-largest global exporter after Saudi Arabia by the 2030s, and that "without this supply growth from Iraq, oil markets would be set for difficult times." Specifically, the IEA predicted that Iraqi production will exceed six million barrels per day by 2020 and rise to eight million by 2035, compared to around three million today. Washington must help Baghdad ensure that this rosy production scenario comes to fruition despite logistical challenges and likely Iranian pressure.

## IMMEDIATE CHALLENGES

**S**uch long-term forecasts are overshadowed by short-term challenges. For example, an intermittent spat between the KRG and Baghdad over federal payment for some 200,000 barrels of "Kurdish" oil has complicated the already-difficult discussions about the hydrocarbons law. In addition, Baghdad's relations with Turkey have been severely tested by Ankara's support for KRG oil activities, in which several private Turkish companies are involved. Rumors abound of Turkey facilitating Kurdish oil exports, including eventually through pipelines, thus bypassing Baghdad.

While the Kurds are grateful for this support -- which has already opened an export route by truck -- they worry about the permanence of Ankara's friendship given Turkey's troubled history of dealing with its own Kurdish community. The turmoil in Syria, which has its own Kurdish minority population, is another complicating factor. Moreover, Iraqi prime minister Nouri al-Maliki does not want to ruin his relations with Iran.

Progress in resolving tensions between Baghdad and the KRG requires goodwill on both sides. Competing new drafts of the hydrocarbons law were introduced in 2011, but no compromise was reached. Meanwhile, exploration has taken off in the KRG, and production has increased to 200,000 barrels per day. Kurdish leaders believe they could reach the significant milestone of one million b/d within a few years, though other estimates are more cautious.

This boldness in oil exploration continues despite the KRG's budgetary dependence on Baghdad. The central government has threatened to cut off the revenue flow to Kurdistan, reported to be over \$10 billion per year. Several IOCs have been equally bold, showing a willingness to forsake access to southern Iraq by accepting KRG offers. The central government has said it will not deal with any IOC that signs with the KRG. Baghdad is already upset with ExxonMobil for contracting to develop six fields in the north while operating in the south; Maliki even raised the issue in a June letter to President Obama.

## WAYS FORWARD

**P**rior to the mid-November military clash, the KRG and Baghdad had tentatively reversed their longstanding antagonism on hydrocarbons after intense negotiations brokered by Turkish and U.S. officials between August and October. Federal authorities agreed to tolerate some Kurdish exports via Turkey using the Baghdad-controlled Kirkuk-Ceyhan pipeline, and the two sides launched a new effort to resolve the impasse over the hydrocarbons law.

One major difficulty relates to cost recovery, or determining how much is owed to the Kurds for oil produced and exported. This involves complicated accounting procedures as well as goodwill on both sides. Another difficulty is the hydrocarbons law itself, which must be tweaked in a way that regularizes the Kurdish contracts and included equity agreements while defining the division of labor on oil policy between the central government and the provinces.

## THE U.S. ROLE

**W**ashington is the only outside actor with the power and experience to push Baghdad and the KRG toward formalizing the compromises achieved this summer. This continued involvement should be a priority for the second Obama administration. The prospect of all Iraqis -- from Erbil to Baghdad and Basra -- benefitting from potentially massive oil earnings over the next decade could serve as glue to hold the country together. But if the parties fail to reach this win-win outcome, further violence in northern Iraq and worsening relations between Baghdad and Ankara are likely. In the worst-case scenario, Iraq's very unity -- as well as the independence of its Shiite majority from Iranian control -- could be called into doubt.

To avoid this, Washington should keep repeating to Erbil and Ankara that it will not countenance a separate export regime with pipelines between the KRG and Turkey. But it should make equally clear to Baghdad that only American pressure will keep hydrocarbon exports -- and, ultimately, Kurdistan as a whole -- under the central government's aegis. In return, Baghdad must compromise with the Kurds to keep their oil flowing and their region inside Iraq. Any effort to exercise complete, intrusive federal control over all aspects of the country's hydrocarbon development is doomed to fail. If Baghdad is flexible, all will profit, and Iraq will remain united.

*Simon Henderson is the Baker fellow and director of the Gulf and Energy Policy Program at The Washington Institute.* ❖

---

## RECOMMENDED

---

## BRIEF ANALYSIS

### Unpacking the UAE F-35 Negotiations

Feb 15, 2022

Grant Rumley

(/policy-analysis/unpacking-uae-f-35-negotiations)



#### ARTICLES & TESTIMONY

### How to Make Russia Pay in Ukraine: Study Syria

Feb 15, 2022

Anna Borshchevskaya

(/policy-analysis/how-make-russia-pay-ukraine-study-syria)



#### BRIEF ANALYSIS

### Bennett's Bahrain Visit Further Invigorates Israel-Gulf Diplomacy

Feb 14, 2022

Simon Henderson

(/policy-analysis/bennetts-bahrain-visit-further-invigorates-israel-gulf-diplomacy)

#### TOPICS

Arab & Islamic Politics (/policy-analysis/arab-islamic-politics)

Energy & Economics (/policy-analysis/energy-economics)

Gulf & Energy Policy (/policy-analysis/gulf-energy-policy)

#### REGIONS & COUNTRIES

Iraq (/policy-analysis/iraq)

Turkey (/policy-analysis/turkey)