

2012

# Petrocapitalism in Iraqi Kurdistan: Leveraging Oil and Gas Firms in Post-War Iraq

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## Recommended Citation

Gray, Chase W., "Petrocapitalism in Iraqi Kurdistan: Leveraging Oil and Gas Firms in Post-War Iraq" (2012). *CMC Senior Theses*. Paper 337.  
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**CLAREMONT McKENNA COLLEGE**

PETROCAPITALISM IN IRAQI KURDISTAN:  
LEVERAGING OIL AND GAS FIRMS IN POST-WAR IRAQ

SUBMITTED TO

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AND

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BY

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FOR

SENIOR THESIS

SPRING 2012

APRIL 23, 2012



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## INTRODUCTION

Massoud Barzani, president of the Kurdistan Regional Government (KRG), met with President Barack Obama and Vice President Joe Biden in Washington on April 4, 2012 to discuss the United States' "close and historic relationship with Kurdistan and the Kurdish people, in the context of [America's] strategic partnership with a federal, democratic and unified Iraq."<sup>1</sup> Yet it has become increasingly difficult for the U.S. to maintain its strategic partnership with Iraq in the absence of a military presence. Additionally, the Department of State has been unable to wield American diplomatic power as effectively as it had hoped, even though the government still employs more than 17,000 diplomats and contractors in Iraq and the embassy in Baghdad is thrice as large as the Pentagon.<sup>2</sup>

American oil and gas companies are a critical third component of American foreign policy in Iraq. Energy companies hold significant sway in Iraq given its reliance on oil and gas exports and the internal political discord that has arisen due to its lack of a comprehensive policy on natural resource revenue distribution. Although the U.S. usually does not, and should not, dictate the actions and investment decisions of private companies, American multinationals are an important aspect of power projections abroad and should be treated as such.

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<sup>1</sup> The White House, Office of the Vice President, *Readout of the President and Vice President's Meeting with Kurdistan Regional Government President Masoud Barzani*, Press Release (Washington, DC, 2012).

<sup>2</sup> Sean Kane and William Taylor, "The United States in Iraq: Options For 2012," United States Institute of Peace, [http://www.usip.org/files/resources/The\\_United\\_States\\_in\\_Iraq.pdf](http://www.usip.org/files/resources/The_United_States_in_Iraq.pdf) (accessed March 24, 2012).

The first chapter of this paper introduces America's foreign policy goals in Iraq. Chapter two details America's policy toward Iraqi Kurds from the end of the Gulf War to the present. Chapters three and four provide a brief overview of the current state of affairs in Iraqi politics and Iraq's oil and gas industry, respectively. Chapters five through eight outline four arguments for supporting the KRG through private sector oil and gas development. The conclusion provides three specific policy prescriptions.

The primary aim of this paper is to determine how the U.S. government can best leverage the power of American oil and gas firms operating in Iraqi Kurdistan to achieve its foreign policy goals. To do so first requires a delineation of those goals. Based upon a reading of official statements and the analysis of independent experts, America's goals in post-war Iraq can be broken down into four key components: maintaining American influence and supporting domestic stability, regional stability, and territorial integrity.

American influence will be far more difficult to maintain now that the military withdrawal has been completed. What could once be achieved through force can now be achieved only through diplomatic and commercial channels. The United States hopes to support domestic stability in Iraq in an attempt to avoid creating a power vacuum that could turn Iraq into a safe haven for extremist organizations. The Strategic Framework Agreement signed by the United States and Iraq in November 2008 states as a primary goal "the need to...reinforce national reconciliation within the framework of a unified and federal Iraq."<sup>3</sup> The emphasis placed by both governments on federalism and unity is an important point. This suggests that while the United States continues to support the

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<sup>3</sup> "Strategic Framework Agreement for a Relationship of Friendship and Cooperation between the United States of America and the Republic of Iraq," November 17, 2008, *United States Treaties and Other International Agreements* (2008).

devolution of significant powers to provinces and regional governments, such as the KRG, it has a keen interest in maintaining the current borders and governing structure of the Iraqi state. Although American foreign policy pundits widely agree that an overly centralized Iraq would not lead to lasting peace, the government believes that everything from Zakho in the north to Basra in the south should be ruled at least nominally from Baghdad. The United States needs to strike a balance between supporting Kurdish autonomy and respecting the authority of the Government of Iraq (GOI).

Regional stability is probably the most important goal for the U.S. in the long-term. Iraq is at the heart of a turbulent region and its ethnic and religious compositions are a microcosm of the heterogeneity of the Middle East. A weak Iraq could lead to renewed civil war, breed domestic terror cells, or provide safe haven for foreign ones. An empowered Iraq, however, could prove equally destabilizing. A Shi'a dominated government might align itself closely with Iran, provide material support to Bashar al-Assad's failing Syrian regime, or antagonize its oil-rich Sunni neighbors on the Arabian Peninsula. The goal of the American government must be to mold an Iraqi state that is satisfied with its standing in the Arab world yet insufficiently powerful to harm its neighbors. A KRG with more authority over its oil and gas reserves would be better placed to limit the power of Shi'a centralization.

There are threats to America's goals in post-war Iraq, four of which stand out as particularly demanding of the U.S.'s attention. First are rising sectarian tensions between Shi'as, Sunnis, and Kurds. Although it is important to remember that Shi'as and Sunnis are religious groups while the Kurds are an ethnic group, these three distinct groups are the primary antagonists in Iraq's ongoing internal feuds.

Second is the status of Kirkuk. A referendum on whether Kirkuk Province would join the KRG was initially slated for 2007 but has yet to be held. Without a referendum on the status of Kirkuk, and the significant oil reserves that lie underneath it, the city will remain a serious point of contention between the KRG and the GOI.

Third is the failure of Iraqi politicians to pass a comprehensive hydrocarbons law. In the absence of one, the GOI, the KRG, provincial governments, and oil and gas companies have been drilling, exploring, and signing contracts in a legal grey area. All parties must agree to a set of rules that detail which has the authority to make agreements and how revenue should be shared. Taking steps to encourage foreign investment will strengthen Iraq's prospects for long-term oil-driven economic growth.

Finally, a Shi'a dominated central government could prove poisonous to both the domestic and regional political atmosphere. Prime Minister Nouri al-Maliki has been consolidating power and assigning Shi'a cronies to key posts. Further consolidation could lead to violence if the Sunnis or Kurds feel existentially threatened. The Shi'a-Sunni status reversal that occurred after the American invasion has been a key instigator of interethnic conflict. Additionally, a Shi'a Iraq could gravitate toward an Iranian sphere of influence, particularly if the cleric Muqtada al-Sadr is able to leverage his militia, the Mahdi Army, to push Baghdad closer to Tehran. The Mahdi Army has been inactive since 2008 but Iraqi intelligence analysts believe Sadr could recruit anywhere from 200 to "thousands" of fighters for renewed insurgency.<sup>4</sup>

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<sup>4</sup> Michael Howard, "Mahdi Army Commanders Withdraw to Iran to Lie Low During Security Crackdown," *Guardian*, February 14, 2007.  
<http://www.guardian.co.uk/world/2007/feb/15/iraq.iran> (accessed April 20, 2012).



Beneath Iraq's liabilities sit some of the world's most impressive reserves of oil and natural gas. Investment and exploration foundered under Saddam Hussein. Foreign oil companies have been rushing in ever since the security situation stabilized. Both the GOI and the KRG have signed deals with foreign firms, although to date the GOI has tendered only service agreements in pre-existing fields.

Many of the largest firms active in each region are American (ExxonMobil, Hess, and Marathon Oil among others) or have significant ties to former Bush administration officials (DNO and Gulf Keystone in particular). This paper will argue that the U.S. government can and should leverage the power and influence of these companies to ensure domestic and regional stability, territorial integrity, and continuing American influence in Iraq.

Natural resource firms have a poor reputation for corporate diplomacy. Extractive industries can be environmentally harmful, make easy targets for nationalist politicians, and engage in land- and capital-intensive deals inherently prone to bribery and corruption. Headline-grabbing scandals overshadow the positive influence companies can have, particularly in developing countries. Only ExxonMobil has signed contracts with Baghdad and Erbil, giving it substantial leverage with both the KRG and the GOI. Much has been made of Iraq's oil but far less has been said about the companies exploring for, developing, extracting, refining, transporting, and selling it. Private sector oil and gas firms are among the most important non-state actors in Iraq and it would be a foreign policy failure not to treat them as such.

The rest of this paper will discuss four things that investment in Iraqi Kurdistan's oil and gas industry can achieve. First, it will spur economic growth in Iraq. Second, it can

help maintain American influence in the country. Third, it can provide economic and strategic leverage to strengthen the bargaining position of the Kurds and force Baghdad to resolve the Kirkuk question and establish a comprehensive hydrocarbons law. Finally, it can provide a check on Shi'a influence and keep Iraq from allying too closely with Iran. While an active investment policy is fraught with difficulty and could be taken too far, each of these will help America achieve one or more of its goals if the steps taken are limited to those policy prescriptions suggested in the last chapter.

## **AMERICAN POLICY TOWARD IRAQI KURDISTAN, 1991 TO THE PRESENT**

An analysis of American political and business interests in Iraqi Kurdistan must first detail recent trends and inflection points in U.S. policy toward the key actors and parties involved in governing the region. This chapter will review Iraqi Kurdish history and America's Kurdish policies, statements, and actions from 1991 to the present.

Each American administration since that of George H.W. Bush has supported Kurdish rights and the protection of Kurds from hostile action by Baghdad. Their positions on Kurdish autonomy, however, have been mixed, representing the generally consistent viewpoint that the supreme American objectives in Iraq must be to maintain order and regional stability, ensure Iraq's territorial integrity, and prevent the country from devolving into civil war. Regardless, the Iraqi Kurds have taken many important steps toward autonomy since the end of the Gulf War, often with military or political backing from the United States.

### **Kurdish Rebellion in the Wake of the Gulf War**

As the Gulf War drew to a close in mid-February 1991, American president George H.W. Bush could be heard across Iraq on Voice of America, a CIA-sponsored radio station, suggesting "the Iraqi military [could] take matters into their own hands to force Saddam Hussein, the dictator, to step aside."<sup>5</sup> Taken alongside other statements made by

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<sup>5</sup> Kerim Yildiz, *The Kurds in Iraq: Past, Present and Future* (Ann Arbor, MI: Pluto Press, 2007), 34.

the president, some Shi'as and Kurds within Iraq saw Bush's words as a promise of American support, in the form of arms or other materiel, in the event of an uprising.

Rebellions began to occur soon after Iraqi and coalition forces signed a cease-fire on February 28, spreading quickly through regions with sizeable ethnic minorities or marginalized religious groups. Shi'as in the south and Kurds in the north staged uprisings against Saddam Hussein's 11-year-old regime, protesting over myriad grievances ranging from economic malaise to stifled demands for greater regional autonomy. As the revolt grew, troops from Kurdistan's independent militia, known as the *peshmerga*, began to overtake northern cities, including Sulaymaniyah, Erbil, and Kirkuk by March 24 of that year.

Expected support from America and its coalition allies never materialized, however, and Kurdish hopes for an overthrow of Hussein's government began to fade rapidly. The Iraqi military launched a counter-offensive in the north, sending troops and helicopters, some reportedly equipped with phosphorous bombs.<sup>6</sup> Outgunned, Kurdish forces fled, ceding control of cities back to the central government as they retreated into the mountains. The Iraqi army retook Kirkuk before the end of March and Sulaymaniyah shortly thereafter, on April 3, 1991.<sup>7</sup> Simultaneous town-by-town squelching of uprisings in the Shi'a south eradicated all remaining pockets of insurrection.

Although the true meaning of President Bush's statements and the motives of the American government remain unclear, it is likely that the United States cared more about

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<sup>6</sup> U.S. Department of Defense, Office of the Special Assistant for Gulf War Illnesses, *Possible Use of Phosphorous Chemical Weapons by Iraq in Kurdish Areas Along the Iraqi-Turkish-Iranian Borders; And Current Situation of Kurdish Resistance and Refugees*, Information Report (Washington, DC, 1991).

<sup>7</sup> Marion Farouk-Sluglett and Peter Sluglett, *Iraq Since 1958: From Revolution to Dictatorship* (London: I.B. Tauris, 2001), 289.

the maintenance of order and Iraq's territorial integrity than it did about removing Saddam Hussein from power. Replacing Hussein would have been preferable, but the costs and risks involved with providing support to an armed rebellion were simply too great to bear in the direct aftermath of Desert Storm. The United States also had little appetite to overstep the bounds of United Nations Security Council (UNSC) Resolution 678, which authorized the use of force to "uphold and implement resolution 660 (1990) and all subsequent relevant resolutions and to restore *international* peace and security in the area."<sup>8</sup> [Emphasis added.] The military force was a fragile coalition of six Arab and 26 non-Arab states. Each country defined the mission differently and Resolution 678 was the least-common denominator of agreement. Any military action beyond the specific scope of the UNSC's statement could have lead to the coalition's disintegration.

It is also likely that the Americans were in a hurry to end the Gulf War and wanted to finish it quickly and cleanly. On the day the Iraqi army retook Sulaymaniyah, the Security Council "temporarily set aside calls by France and Turkey for action to halt Iraq's suppression of Kurdish and Shi'ite Muslim rebellions...The United States, Britain, and the Soviet Union were reluctant to take up the issue immediately, insisting that the Security Council concentrate on approving a wide-ranging resolution setting terms for ending the Persian Gulf war."<sup>9</sup> American representative to the United Nations Thomas R. Pickering told *The New York Times* that same day "it is too early to speculate on the Kurdish question."<sup>10</sup>

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<sup>8</sup> U.N Security Council, 2963<sup>rd</sup> Meeting. "Resolution 678 (1990) [Iraq-Kuwait]" (S/RES/678). 29 November 1990.

<sup>9</sup> Paul Lewis, "After the War," *New York Times*, April 3, 1991.

<sup>10</sup> *Ibid.*

On April 5, however, the Security Council adopted Resolution 688 after further protestation by Turkey, France, and Iran.<sup>11</sup> The Iranian and Turkish representatives were particularly concerned about the flood of refugees crossing over the border into their own countries. Iraq's northern neighbors wanted to avoid shouldering the cost of a humanitarian intervention and a scenario in which Kurds might remain in Iran or Turkey on a semi-permanent basis. The Security Council was:

Gravely concerned by the repression of the Iraqi civilian population in many parts of Iraq, including most recently in Kurdish populated areas, which led to a massive flow of refugees towards and across international frontiers and to cross-border incursions, which threaten *international* peace and security in the region.<sup>12</sup>  
[Emphasis added.]

The new UNSC mandate provided the Americans with the rationale necessary to assist the Kurds. On April 13 the United States and Turkey agreed to establish 'Operation Provide Comfort' to bring aid and humanitarian assistance to the more than two million Iraqis who would flee to the borders with Iran and Turkey by the end of April.<sup>13</sup>

Although the operation was initially intended only to provide support until a UN mission could be established,<sup>14</sup> it was only another three days before President Bush announced:

Consistent with UNSC Resolution 688...I have directed the US military to begin immediately to establish several encampments in northern Iraq where relief supplies for these refugees will be made available in large quantities and distributed in an orderly way...Let me reassure [Kurds] that adequate security will be provided at these temporary sites by US, British, and French air and ground forces...I want to underscore that all we are doing is motivated by humanitarian concerns. We continue to expect the government of Iraq not to interfere in any way with this latest relief effort. The prohibition against Iraqi fixed- or rotary-wing aircraft flying north of the 36<sup>th</sup> parallel thus remains in effect...As I stated earlier, the relief effort being approached here today

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<sup>11</sup> U.N Security Council, 2982nd Meeting. "Resolution 688 (1991) [Iraq-Kuwait]" (S/RES/688). 5 April 1991.

<sup>12</sup> Ibid.

<sup>13</sup> Farouk-Sluglett and Sluglett, 289.

<sup>14</sup> Yildiz, 39.

constitutes an undertaking different in scale and approach. What is not different is basic policy. All along, I have said that the United States is not going to intervene militarily in Iraq's internal affairs and risk being drawn into a Vietnam-style quagmire. This remains the case. Nor will we become an occupying power with US troops patrolling the streets of Baghdad. We intend to turn over the administration of and security for these sites as soon as possible to the UN, just as we are fulfilling our commitment to withdraw our troops and hand over responsibility to UN forces along Iraq's southern border, the border with Kuwait.<sup>15</sup>

Bush's prescient statement underlined what had heretofore been America's limited interests in Iraqi Kurdistan.

While the principle of *non-refoulement* might have necessitated that America and others provide military support for a 'safe haven' north of the 36<sup>th</sup> parallel, the intervention had a broader effect, one that certainly impacted Iraqi domestic politics. While Massoud Barzani, leader of the Kurdistan Democratic Party (KDP), was in Baghdad negotiating power devolution with Saddam Hussein on behalf of the Kurdistan Front, his rival and leader of the Patriotic Union of Kurdistan (PUK), Jalal Talabani, called the summer of 1991 "the best chance we've had this century" to establish an autonomous Kurdish region within Iraq. Talabani wanted oil-rich Kirkuk to be included as the capital of any devolved Kurdish area, but Barzani was much more willing to cut a deal with Hussein, and in the end the city itself was not included, although some of Kirkuk province was controlled by the Kurds. The safe haven created by Operation Provide Comfort established a de facto Kurdish autonomous zone in northern Iraq by October 1991.<sup>16,17</sup> Operation Provide Comfort was replaced by Operation Northern Watch after 1996. Although broadly similar to previous operations, Northern Watch

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<sup>15</sup> George H.W. Bush, "US Expands Kurdish Relief Efforts" (lecture, White House, Washington, DC, April 22, 1991).

<sup>16</sup> Farouk-Sluglett and Sluglett, 289.

<sup>17</sup> *Ibid.*, 294.

slightly altered the mission of allied forces. France declined to participate and, at the behest of Turkey, allied missions were limited to aerial sorties, of which more than 36,000 took place by the end of the operation on March 17, 2003.<sup>18</sup>

### **Establishment of the Kurdistan Regional Government**

The KDP and the PUK, alongside many smaller political parties, soon stepped into the void created by the departure of most of the Iraqi government's civil and military personnel from the region. The KDP took control over most of the north while the PUK coalesced around its power base in Sulaymaniyah.<sup>19</sup> Elections held in May 1992 delivered a near even split between the KDP and the PUK in the new Kurdistan National Assembly (KNA) in Erbil. Both parties express center-left ideologies, although the PUK has gravitated closer to socialism. Voting split neatly along geographic lines, with the northern half voting for the KDP and the southern half voting for the PUK.

In response to the close election, the parties formed a power-sharing government known as the 50:50 system.<sup>20</sup> In the first Kurdistan Regional Government, formed on July 4, 1992, 13 of 31 cabinet positions went to the PUK, 14 to the KDP, and one each to the Assyrian Democratic Movement, the Kurdistan Toilers' Party, the Kurdistan Communist Party, and an independent, Marouf Ra'uf, who headed the justice ministry.<sup>21</sup> No party had both the ministerial and deputy ministerial positions in any government entity, effectively necessitating agreement on every issue.

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<sup>18</sup> Michael M. Gunter, "Turkey and Iran Face Off in Kurdistan," *Middle East Quarterly* 5, no. 1 (March 1998): 33-40, <http://www.meforum.org/384/turkey-and-iran-face-off-in-kurdistan> (accessed February 26, 2012).

<sup>19</sup> Charles Tripp, *A History of Iraq* (New York: Cambridge University Press, 2000), 271.

<sup>20</sup> Gareth R.V. Stansfield, *Iraqi Kurdistan: Political Development and Emergent Democracy* (New York: RoutledgeCurzon, 2003), 146.

<sup>21</sup> Kakai Falaq al-Din, "The Kurdish Parliament," in *Iraq Since the Gulf War: Prospects For Democracy*, ed. Fran Hazelton (London: Zed Books, 1994), 123-24.



The KDP was founded by Mulla Mustafa Barzani, father of Massoud Barzani, in the immediate aftermath of World War II. It was established to advocate for Kurdish autonomy, but, according to one Kurdish official, it was “more of a social and cultural gathering than a well-defined political party.”<sup>22</sup> Nevertheless, the party was politically active enough to incur the wrath of the Ba’athists who came to power in 1968. Early on in the party’s rule the Ba’athists spoke favorably of granting self-rule to the Kurds. Initial statements proved fictitious, however, as it soon became apparent the Ba’athists were rapidly centralizing power in Baghdad.<sup>23</sup> War broke out between the KDP and the Iraqi Army in 1974 and ended with Barzani and more than 100,000 Kurds escaping into Iran.<sup>24</sup> In 1975, Jalal Talabani established the PUK in Damascus as a KDP lookalike with Marxist tendencies.<sup>25</sup> A 2005 Congressional Research Service report downplayed the importance of KDP’s leftist ideology, stating:

Differences between the KDP and PUK center more on leadership than ideology. The KDP, generally more tribal and traditional, is strongest in the mountainous northern Kurdish areas. The PUK predominates in southern Kurdish areas. The two have differed over the degree to which they should accommodate the central government and over their relationships with Iran, sometimes swapping positions. But their biggest differences have resulted from disagreements over power and revenue sharing.<sup>26</sup>

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<sup>22</sup> Sa'ad Jawad, *Iraq* (London: Ithaca Press, 1981), 20.

<sup>23</sup> Colonel James R. Hoy Jr., “The Rise and Fall of the Renaissance Party: Implications of De-Ba'athification On Iraqi Society” (diss., U.S. Army War College, 2004), 2-3, in USAWC Strategy Research Project, <http://www.dtic.mil/cgi-bin/GetTRDoc?Location=U2&doc=GefTRDoc.pdf&AD=ADA423708> (accessed March 22, 2012).

<sup>24</sup> Benjamin Case and James Siebens, *Kurdistan in Iraq: History and Future Prospects* (THINK International and Human Security, January 2012), 4, <http://www.thinkihs.org/wp-content/uploads/2012/01/Case-Siebens-Kurdistan-2012.pdf> (accessed February 27, 2012).

<sup>25</sup> Michael M. Gunter, “The KDP-PUK Conflict in Northern Iraq,” *Middle East Journal* 50, no. 2 (Spring 1996): 224-41, <http://www.jstor.org/stable/4328927> (accessed February 26, 2012).

<sup>26</sup> U.S. Congressional Research Service, *The Kurds in Post-Saddam Iraq*, by Kenneth Katzman and Alfred B. Prados, CRS Report for Congress (Washington, DC, 2005), 2.

Those disagreements would prove to be the defining attribute in the relationship between the KDP and the PUK. Divisions are likely to cause further trouble in the future despite the united front the Kurds generally maintain in Baghdad.

State Department Spokeswoman Margaret Tutwiler said the United States hesitantly welcomed the 1992 elections, noting in a statement just before the election that the U.S. “welcome[s] public and private assurances by the Iraqi Kurdish leadership that these elections will deal only with local administrative issues and do not represent a move toward separatism...As we have said many times, we do not support the emergence of an independent political entity in northern Iraq.”<sup>27</sup> She did not elaborate on the definition of an independent political entity.

In any case, the election was probably an afterthought to many in the State Department. A journalist asked Tutwiler about the newly-formed government during a press briefing on July 6:

Q: How do you see the formation of a Kurdish government in northern Iraq? You know, it was announced two days ago that eventually they will put together a government – the Kurdish government – in northern Iraq. Do you see that as a development...

Ms. Tutwiler: I’m not aware of such an announcement. There was an announcement made of...

Q: By the Kurds.

Ms. Tutwiler: ...A formation of a new government?

Q: Or for a Kurdish government?

Ms. Tutwiler: I’ll have to check with the experts. I haven’t heard of such a thing.<sup>28</sup>

The 50:50 system began to break down soon thereafter when a number of minor parties merged to create the Unity Party of Kurdistan (UPK) under Sami Abdul Rahman. The

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<sup>27</sup> Margaret Tutwiler, “Northern Iraq Elections” (lecture, Department of State, Washington, DC, May 15, 1992).

<sup>28</sup> Margaret Tutwiler, “US Department of State Daily Briefing #102” (lecture, Department of State, Washington, DC, July 6, 1992).

UPK subsequently joined the KDP, upsetting the tenuous balance between the two primary parties. The KDP, now certain it commanded more than half of the electorate, called for new elections in January 1994.<sup>29</sup>

The political situation continued to deteriorate through 1994 as Ankara, Tehran, Baghdad, and others backed one party or the other. The Clinton Administration responded inconsistently to Turkish incursions into Iraqi territory, acknowledging Turkey's right to protect its citizens from attacks by the PKK, a Kurdish terrorist organization, yet reprimanding Ankara for the extended duration and intensity of many Turkish missions.<sup>30</sup> Clashes between PUK and KDP militants killed at least 300 people that May. In July the two parties met with American, French, and British observers in Paris to draft a new constitution.<sup>31</sup>

In 1995 the KDP pulled out of an Iraqi National Congress-led attempt, also involving the PUK, on the life of Saddam Hussein. Attempts by the United States, among other governments, to bring the two sides together failed miserably.<sup>32</sup> Relations reached a new low in 1996 when Barzani's KDP called upon Hussein to intervene in Kurdistan's nascent civil war. At least 30,000 Iraqi troops helped the KDP capture the PUK-held cities of Erbil, where the KDP was then immediately installed in power, and Sulaymaniyah, although the latter was recaptured by PUK forces a month later. Iraq justified its intrusion into Kurdistan by claiming, accurately to an extent, that the PUK had been coordinating attacks with Iran. The PUK had, in fact, allied with Tehran to attack the KDP-I, the Iranian wing of the KDP.

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<sup>29</sup> Stansfield, 152.

<sup>30</sup> Yildiz, 81.

<sup>31</sup> Yildiz, 49.

<sup>32</sup> Tripp, 272.

The United States protested at the incursion but did nothing immediately to stop it.<sup>33</sup> The U.S. eventually responded by firing 27 cruise missiles at military sites in southern Iraq. Britain also expanded its southern no-fly zone from the 32<sup>nd</sup> parallel to the 33<sup>rd</sup>, within 30 miles of Baghdad.<sup>34</sup> More than 6,000 pro-western Kurds and members of the INC, some of whom had been involved in a CIA-funded operation to overthrow the Hussein regime, were hurriedly evacuated to the United States.<sup>35, 36</sup> The U.S. sponsored talks between the warring parties in Ankara that October, but little came out of the meetings.<sup>37</sup>

KDP fought alongside Turkey in November 1997 against PUK and the Kurdistan Workers' Party (PKK), a Marxist-Leninist separatist group designated as a foreign terrorist organization by the U.S. State Department. The Turkish-KDP attack was successful in forcing a cease-fire on November 24, 1997. PUK established a government in Sulaymaniyah claiming to represent all of Iraqi Kurdistan. KDP established a government in Erbil claiming to do the same.

One primary factor in Kurdistan's troubled politics was continuing embargos by the UN and Iraq that squeezed the region from all sides and promoted smuggling. The political elite fought for control over lucrative border crossings, particularly the Ibrahim Khalil crossing in the north between Zakho and the Turkish district of Silopi. Although most Kurdish oil was smuggled over the Zagros Mountains into Iran, the Ibrahim Khalil crossing proved to be the best route through which foreign goods could enter the country.

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<sup>33</sup> Farouk-Sluglett and Sluglett, 299.

<sup>34</sup> U.S. Launches Missile Strikes Against Iraq, *CNN*, September 3, 1996. <http://edition.cnn.com/WORLD/9609/03/iraq.bombing/index.html> (accessed February 27, 2012).

<sup>35</sup> Farouk-Sluglett and Sluglett, 299.

<sup>36</sup> Tripp, 273.

<sup>37</sup> Yildiz, 49.

Control over the crossings provided much needed revenue to whichever party profited from smuggling oil and other commodities.<sup>38</sup>

No embargo-related distinction was made by the UNSC between Iraq and Iraqi Kurdistan, even after the latter formed a devolved government. Saddam Hussein also established a blockade along the border with the Kurdish region. As a result of the twin embargos, the price of goods skyrocketed. The price of rice, for instance, increased 80-fold.<sup>39</sup> In acknowledgement of unwarranted Kurdish suffering under the UN embargo, the international organization provided one important revenue source for the KRG through the Oil-for-Food Program, established in 1995 to allow Iraq to sell limited quantities of its oil in exchange for food, medicine, and other basic supplies. A portion of the revenue was given directly to the KRG, somewhat alleviating budgetary issues.<sup>40</sup> Yet even this did not work as smoothly as planned. At the time of the American invasion in 2003, \$4 billion owed to the Kurds was tied up in a French bank.<sup>41</sup>

### The Clinton Years

American policy toward Iraqi Kurdistan under President Bill Clinton was largely similar to that espoused by Clinton's predecessor, George H.W. Bush, after the Gulf War. The U.S. and Turkey continued to push the two main Kurdish parties closer to reconciliation, finally achieving significant success in 1998.<sup>42</sup> Clinton offered a rationale for American involvement in the process, stating:

We will continue our efforts to reach a permanent reconciliation through mediation in order to help the people of northern Iraq find the permanent, stable

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<sup>38</sup> Tripp, 272.

<sup>39</sup> David McDowall, *A Modern History of the Kurds* (London: IB Tauris, 1996), 378.

<sup>40</sup> Tripp, 262.

<sup>41</sup> Massoud Barzani and Jalal Talabani, "What Iraq Needs Now," *New York Times*, July 9, 2003.

<sup>42</sup> Farouk-Sluglett and Sluglett, 299.

settlement which they deserve, and to minimize the opportunities for Baghdad and Tehran to insert themselves into the conflict and threaten Iraqi citizens in this region.<sup>43</sup>

America's policy of ensuring Iraq's stability and territorial integrity now seemed to require a strong, unified Kurdish government that could withstand harassment from Saddam Hussein as well as foreign states.

A formal cease-fire was finally established in September 1998 when Barzani and Talabani signed the Washington Agreement. That document paved the way for the two sides to reconvene the KNA, set a date for elections, and discuss merging their *peshmerga* forces.<sup>44</sup> Most importantly, it established a basis upon which the KRG could build a truly democratic and stable regional government under the nominal authority of Saddam Hussein's dictatorial regime.

Containing Saddam Hussein remained the top priority. In 1998, Clinton promised that "the no-fly zones have been and will remain an important part of our containment policy...Because we effectively control the skies over much of Iraq, Saddam has been unable to use air power to repress his own people."<sup>45</sup> Clinton regularly used force against Hussein and launched significant bombing operations on at least three occasions: in 1993 after a failed plot to assassinate former president Bush, in 1996 after the Iraqi attack on Erbil and Sulaymaniyah, and in 1998 during Operation Desert Fox.<sup>46</sup>

Desert Fox was a four day bombing campaign meant to punish Iraq for failing to adequately reveal its nuclear, chemical, and biological weapons programs to inspectors

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<sup>43</sup> Michael M. Gunter, *The Kurdish Predicament in Iraq: A Political Analysis* (New York: Palgrave Macmillan, 1999), 100.

<sup>44</sup> Tripp, 273-4.

<sup>45</sup> Yildiz, 90.

<sup>46</sup> Yildiz, 91.

from the United Nations Special Commission. In a letter to the UNSC dated December 15, 1998, Richard Butler, then chairman of the commission, wrote:

From the inception of the Commission's work in Iraq, in 1991, Iraq's cooperation has been limited. Iraq acknowledges that, in that year, it decided to limit disclosure for the purpose of retaining certain prohibited weapons capabilities...In the light of this experience, that is, the absence of full cooperation by Iraq, it must regrettably be recorded again that the Commission is not able to conduct the substantive disarmament work mandated to it by the Security Council and, thus, to give the Council the assurances it requires with respect to Iraq's prohibited weapons programmes.<sup>47</sup>

Based on this evidence, the Clinton Administration decided to strike 100 Iraqi military and political targets. The operation received intense criticism, however, for its unclear goals and opaque rationale. France, Russia, and China opposed the attack and in its aftermath called for repealing the embargo against Iraq.

### **The Bush Administration Before the War**

George W. Bush entered the White House in 2000 with a cadre of individuals affiliated with the Project for the New American Century, a Washington-based think tank that promoted a neo-conservative ideology which heavily influenced the Bush Doctrine. Dick Cheney and Paul Wolfowitz co-authored a February 1992 draft of the Pentagon's *Defense Planning Guide for the Fiscal Years 1994-1999* which outlines their perspective on foreign policy and provides a useful look into the motives driving the Bush Administration in the years leading up to the 2003 invasion of Iraq. The section on the Middle East and Southwest Asia notes:

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<sup>47</sup> Richard Butler, "Letter Dated 15 December 1998 from the Executive Chairman of the Special Commission Established by the Secretary-General Pursuant to Paragraph 9(b)(i) of Security Council Resolution 687 (1991) Addressed to the Secretary-General," (December 15, 1998): 4, <http://www.undemocracy.com/S-1998-1172.pdf> (accessed March 1, 2012).

Our overall objective is to remain the predominant outside power in the region and preserve U.S. and Western access to the region's oil. We also seek to deter further aggression in the region, foster regional stability, protect U.S. nationals and property, and safeguard our access to international air and seaways. As demonstrated by Iraq's invasion of Kuwait, it remains fundamentally important to prevent a hegemon or alignment of powers from dominating the region. This pertains especially to the Arabian peninsula. Therefore, we must continue to play a role through enhanced deterrence and improved cooperative security.<sup>48</sup>

On the face of it, this doctrine seems remarkably similar to Clinton's Middle East policy. Fostering regional stability is hardly reactionary realpolitik. American policy in Iraq since the end of the Gulf War had been to maintain stability among myriad ethnic and religious groups for both domestic and regional purposes. Insurrection, among the Kurds or Shi'as in particular, could draw in Turkey, Iran, Saudi Arabia, or any number of countries to look out for their perceived regional interests.

Unlike his father or president Clinton, the younger Bush also considered removing Saddam Hussein from power a significant priority and necessary for the maintenance of regional stability. It is this aspect of the doctrine that provided a key impetus for the invasion and consequently for the dramatic destabilization of Iraq. Arguments in favor of and opposed to the Iraq War have been made elsewhere and will not be reiterated here. This paper will discuss the war solely with regard to its impact on America's Kurdish policy.

### The Iraq War

American relations with Turkey and the Iraqi Kurds were pivotal in the run-up to the invasion of Iraq in March 2003. The U.S. hoped to court the Kurds and the roughly 80,000 *peshmerga* the PUK and the KDP could collectively contribute. They also hoped

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<sup>48</sup> Dick Cheney and Paul Wolfowitz, *Defense Planning Guide For the Fiscal Years 1994-1999* (Department of Defense, February 1992), 21-22.



the Kurds would help eradicate Ansar al-Islam, a jihadist group with ties to al-Qaeda supposedly operating out of a few remote villages near the Iranian border.

Courting Kurds and Turks would prove exceedingly difficult. The U.S. wanted to move 62,000 troops into northern Iraq via Turkey in addition to using Turkish airbases for its aerial operations as it did during the Gulf War. Negotiations that took place throughout 2002, some of which included Paul Wolfowitz, then Deputy Secretary for Defense, made clear Turkey's worries about what effect the fall of Hussein's regime might have on an emboldened Iraqi Kurdistan.

Turkey had gone to great lengths to quell unrest among its own 14 million or so Kurds. It feared an independent Iraqi Kurdistan, particularly one that controlled the oil-rich cities of Mosul and Kirkuk. Arman Kuloğlu, a former Turkish general who headed the Eurasian Strategic Studies Institute in 2002, suggested that "Turkey may go [down] to the 36<sup>th</sup> parallel. It will want to control the area because of refugees and because it also doesn't want the towns of Kirkuk and Mosul to fall to the Kurds."<sup>49</sup> Turkish negotiators delivered just that ultimatum to the United States in February 2003. Turkey wanted to place troops in Iraqi Kurdistan to ensure that an independent Kurdish state did not rise out of the ashes of Hussein's Iraq. The Kurds, of course, rejected this proposition out of hand. In the end, posturing between the two sides mattered little. On March 1, Turkey's Grand National Assembly voted against allowing American troops on the country's southern frontier or in Turkish airspace.<sup>50</sup> The Turkish parliament changed its mind regarding the use of its airspace the day after American bombs began falling on Baghdad,

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<sup>49</sup> Jonny Dymond, "Turkey Deals a Blow to Action Against Saddam," *Guardian*, July 31, 2002. <http://www.guardian.co.uk/world/2002/aug/01/iraq.usa?INTCMP=SRCH> (accessed March 1, 2012).

<sup>50</sup> Yildiz, 109.

reversing its decision after just 20 days. It still insisted on sending troops into Iraqi Kurdistan.

Turkish troops crossed the Iraqi border sometime within the first few days of the war, although exactly when is not certain. On March 22 Turkish Prime Minister Recep Tayyip Erdoğan said his country would create a 20 kilometer buffer zone “aimed at controlling a possible wave of refugees into Turkey, to prevent certain provocations against our security, and to protect our borders.”<sup>51</sup> Zalmay Khalilzad, America’s special envoy to Iraq, traveled to Ankara the following day to establish guidelines for the Turkish buffer.

With Turkey’s position made clear, the U.S. finally began to coordinate with Kurdish *peshmerga*. In Operation Northern Delay, begun on March 26, 2003, more than 1,000 American paratroopers dropped into Iraqi Kurdistan. They met up with Kurdish troops and initiated an offensive against Ansar al-Islam, whose forces withdrew into Iran after being routed by the allies.

*Peshmerga* forces allied with both the PUK and the KDP took Kirkuk, Mosul, and many other cities with little resistance after the fall of Baghdad on April 9. The Americans, surprised that the Iraqi army had capitulated so quickly, were unprepared to administer all of the country and left the Kurds in charge of northern cities, including Kirkuk and Mosul. Turkey, nervous that the Kurds might be left in permanent administration of the area, amassed more than 70,000 troops along its border with Iraq. The KRG accordingly promised to relinquish control of both cities to American forces once they were capable of taking over.

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<sup>51</sup> *Turkish Troops in Northern Iraq? Yes, No, Perhaps* (The Open Society Institute, March 23, 2003), <http://www.eurasianet.org/departments/insight/articles/pp032403.shtml> (accessed March 1, 2012).

Turkish interference continued as officials in Ankara grew increasingly worried about the prospect of an independent Iraqi Kurdistan. A Turkish aid convoy, stopped at an American checkpoint in mid-April, was revealed to include Turkish Special Forces smuggling “grenades, night-vision goggles, and dozens of rifles”<sup>52</sup> to members of the Iraqi Turkmen Front, an ethnic Turkmen alliance then asserting its right to participate in the administration of Kirkuk.

Yet Kurdish leaders, cognizant of anxiety among the Turks, repeatedly stated their desired goal of maintaining an autonomous Kurdistan within a federal Iraq. Barzani and Talabani wrote in a July 9, 2003 op-ed:

The first building blocks of Iraqi federalism and democracy have already been laid in Iraqi Kurdistan. Thanks to protection from American and British air power, facilitated by Turkey, Kurds have had 12 years of a sometimes faltering, but ultimately hopeful, experiment in self-rule, openness and pluralism. With continued help from the United States, and with our work on the interim Iraqi administration, what has become known as the Kurdish experiment in democracy can be a model for all of Iraq.<sup>53</sup>

The KRG successfully maintained self-rule up through the departure of American troops in December 2011. It negotiated continued devolved power under both the Transitional Administrative Law (TAL, enacted in 2004) and the new Iraqi constitution (passed by referendum in 2006).

The TAL acknowledged the KRG as the ruling authority in all regions it controlled on March 19, 2003, including all or parts of Dohuk, Erbil, Sulaymaniyah, Diyala, and Ninevah provinces. It provided for the continuation of the post-1991 governmental structure in the autonomous region, mandating “the Kurdistan Regional Government

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<sup>52</sup> David Rohde, “U.S. Says Turks Tried to Smuggle Arms Into Northern Iraq City,” *New York Times*, April 27, 2003. <http://www.nytimes.com/2003/04/27/world/aftereffects-minorities-us-says-turks-tried-smuggle-arms-into-northern-iraq-city.html> (accessed March 2, 2012).

<sup>53</sup> Barzani and Talabani.

shall retain regional control over police forces and internal security”<sup>54</sup> and “the Kurdistan National Assembly shall be permitted to amend the application of any [federal law] within the Kurdistan region”<sup>55</sup> with restrictions. Article 25(E) of the TAL made mention of natural resource revenue distribution but was left sufficiently vague.

The constitution devolved even greater authority to the KRG. Many important issues were left deliberately unresolved by the constitution, however, and the years since its passage have seen regular friction between the KRG and the GOI regarding implementation of laws required under the constitution. In particular, both sides have failed to reach agreement over the status of Kirkuk and other disputed territories and establish a hydrocarbons law. Article 25(E) was copied from the TAL to the constitution nearly word for word, suggesting that negotiations made little progress during the two intervening years.

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<sup>54</sup> “Law of Administration For the State of Iraq For the Transitional Period,” The Coalition Provisional Authority, <http://web.archive.org/web/20090423064920/http://www.cpa-iraq.org/government/TAL.html> (accessed April 20, 2012).

<sup>55</sup> Ibid

## STATE OF AFFAIRS IN IRAQI POLITICS

Iraqi politics of late have been plagued by sectarian divisions that threaten to bring down the government and continue to incite violence across the country. Strife between opposing religious and ethnic groups, tense foreign relations, and an increasingly powerful Nouri al-Maliki could all upset the nation's tenuous balance. Continued unfavorable developments may lead to the emergence of an Iraq that is undemocratic, anti-American, or both.

On December 22, 2011, just four days after the last American troops withdrew from Iraq, more than 60 people were killed by at least a dozen bomb blasts that shook the country's nascent security establishment.<sup>56</sup> The attack was coordinated by the Islamic State of Iraq, an umbrella militant group to which al-Qaeda in Iraq belongs.<sup>57</sup> It was carried out on the heels of a political battle between the Shi'a Prime Minister Maliki and two senior Sunni political figures, presumably to stoke sectarian tensions and fears of insecurity among ordinary Iraqis.

The high-level row began when a deputy prime minister, Saleh al-Mutlaq, called Maliki "a dictator" and told CNN "there will be a day whereby the Americans will realize that they were deceived by al-Maliki...and they will regret that."<sup>58</sup> He continued:

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<sup>56</sup> *The Economist*, Sovereignty Without Security, December 31, 2011, <http://www.economist.com/node/21542200> (accessed March 20, 2012).

<sup>57</sup> Dozens Killed in Co-Ordinated Baghdad Attacks, *BBC News*, December 22, 2011. <http://www.bbc.co.uk/news/world-middle-east-16297707> (accessed March 20, 2012).

<sup>58</sup> Arwa Damon and Mohammed Tawfeeq, "Iraq's Leader Becoming a New 'dictator,' Deputy Warns," *CNN*, December 13, 2011. <http://www.bbc.co.uk/news/world-middle-east-16297707> (accessed March 20, 2012).

America left Iraq with almost no infrastructure. The political process is going in a very wrong direction, going toward a dictatorship. People are not going to accept that, and most likely they are going to ask for a division of the country. And this is going to be a disaster. Dividing the country isn't going to be smooth, because dividing the country is going to be a war before that and a war after that... We are in a real problem now. If we [the nonsectarian Iraqi National Movement] pull out of government, [Maliki] will be left to do what he wants to do, with us and with the others.<sup>59</sup>

Maliki responded to Mutlaq's statement by surrounding his home with tanks and asking the Iraqi parliament to deliver a vote of no confidence in the deputy prime minister. It declined to do so.

Maliki also found himself in a spat with Tariq al-Hashemi, Iraq's vice-president and, like Mutlaq, a Sunni leader of the Iraqi National Movement, more commonly known as Iraqiyya. The day after American troops withdrew from the country, Maliki's government ran a prime-time news special on state TV that accused Hashemi of running a death squad targeting government officials and police officers after the 2003 invasion. Hashemi was subsequently charged with terrorism. He denied the claims and escaped to Iraqi Kurdistan. Kurdish authorities have refused to send him back to Baghdad despite protestations from the prime minister.

Maliki came to power in 2006 and won re-election in 2010 even though his State of Law coalition lost the parliamentary vote to Iraqiyya by 91 seats to 89 (out of 325 total).<sup>60</sup> Voting was heavily divided along sectarian lines, with State of Law drawing its support almost entirely from Shi'a majority provinces (see Figure 1). The two coalitions were, however, able to form a near-majority governing coalition after eight months of deliberations. Iraqiyya agreed to allow Maliki to remain as prime minister as long as its

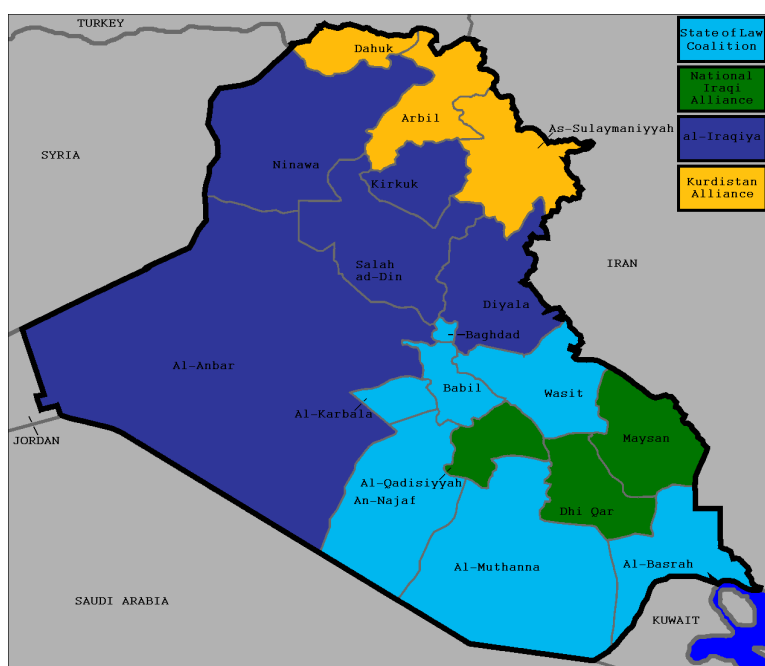
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<sup>59</sup> Ibid.

<sup>60</sup> <http://www.economist.com/node/21551111>

leader, Ayad Allawi, and other high-ranking Sunnis would be assigned to important posts.

The agreement was short-lived. Allawi's position, the chairmanship of a strategy council, was granted little real power. Maliki continues to run the ministries of the interior, defense, and national security affairs, thus retaining control of the military and police. In addition to the assaults on Mutlaq and Hashemi, Maliki's security forces are said to regularly harass and arrest other Sunni opposition figures.<sup>61</sup>



**Figure 1: Map of 2010 Iraqi Parliamentary Election Results.** Each governorate is colored according to the party that won the most votes in that province. State of Law and the National Iraqi Alliance are Shi'a coalitions.<sup>62</sup>

Sectarian divisions have only deepened since the last American troops left Iraq. Sunni fears of a brutal clampdown by a centralized

Shi'a authority in Baghdad seem to have trumped worries about a weakened federal Iraq.

The Sunni leadership in Diyala Province (northeast of Baghdad, see Figure 1) has proposed establishing a Sunni autonomous zone similar to the Kurdish region.<sup>63</sup> This posturing represents a radical departure from the past, when Sunnis vehemently opposed

<sup>61</sup> <http://www.economist.com/node/21551111>

<sup>62</sup> [http://en.wikipedia.org/wiki/File:2010\\_Iraqi\\_election\\_map.png](http://en.wikipedia.org/wiki/File:2010_Iraqi_election_map.png)

<sup>63</sup> Marina Ottaway, *Back from the Brink: A Strategy For Iraq* (Carnegie Endowment for International Peace, February 26, 2009), <http://dspace.cigilibrary.org/jspui/handle/123456789/6226> (accessed March 19, 2012).

devolved power, presumably because no Sunni-majority area holds significant oil reserves.

Maliki and others in the capital have little interest in ceding any more control to the regions or provinces. A recent bill proposed in parliament suggested life imprisonment and a \$40,000 fine for anyone who might adversely “affect the country’s interdependence and unity.”<sup>64</sup> Although Maliki probably wanted an American security contingent to remain in the country after troops departed at the end of 2011, sectarian politics made that impossible. U.S. Secretary of State Hillary Clinton said “There wasn’t the political will on the Iraqi side [to negotiate a troop extension] because of their difficult internal political calculations. They did not believe that they could provide the kind of Status of Forces Agreement that was required for us to keep military forces in Iraq.”<sup>65</sup> Much of the difficulty came from Muqtada al-Sadr, a cleric whose Shi’a Sadrist Movement controls the balance of power in parliament. Sadr refused to allow American troops to stay in the country after 2011 and threatened renewed insurgency from his supporters.<sup>66</sup> Sadr’s militia, the Mahdi Army, armed and funded by the Iranian government, could spark civil war if it chose to take up arms once again.

Sectarian divisions have made it exceedingly difficult for the country to pass a comprehensive hydrocarbons law and resolve the status of Kirkuk, a disputed city home to a roughly equal number of Kurds, Arabs, and Turkomens. The Iraq oil law was first proposed to the Iraqi Council of Representatives in May 2007 but still has not been

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<sup>64</sup> *The Economist*, Sovereignty Without Security.

<sup>65</sup> *The Economist*, An Interview with Hillary Clinton, March 22, 2012, <http://www.economist.com/blogs/lexington/2012/03/foreign-policy> (accessed March 23, 2012).

<sup>66</sup> *The Economist*, Rebellious Days, March 24, 2012, <http://www.economist.com/node/21551111> (accessed March 24, 2012).



passed. It would resolve many of the lingering disputes in Iraq's oil and gas politics, particularly the questions of how the central government and the regions will divide authority and how much influence the private sector will be allowed to wield.

Article 140 of the Iraqi Constitution mandates that the executive authority has the responsibility to establish "normalization and [hold a] census [that] concludes with a referendum in Kirkuk and other disputed territories to determine the will of their citizens, by a date not to exceed the 31<sup>st</sup> of December 2007."<sup>67</sup>

The government was supposed to hold a referendum in 2007 asking if Kirkuk's residents wanted to join the KRG. Initially, all parties agreed to postpone the referendum for six months due to security issues. Now, however, it has been put on hold indefinitely by the central government. The status of Kirkuk is a vital issue because of the vast quantities of oil and gas in the province. Until a referendum is held or the issue is resolved by agreement (in which case the KRG would assent to an amendment striking Article 140 from the constitution), Kirkuk will remain a physical and emotional hotspot for sectarianism.

Iraq's foreign relations are defined primarily by its dealings with Iran, on the one hand, and the assorted Sunni Arab countries, particularly Turkey and Saudi Arabia, on the other. Many Arab countries already deride Maliki's government as an Iranian puppet regime. Saudi Arabia refuses to send an ambassador and only appointed a non-resident ambassador in the lead-up to the Arab League summit in Baghdad in March 2012.<sup>68</sup> Iraq made positive gestures toward its Sunni neighbors, ostensibly to ensure their attendance at the summit. The country has stayed relatively neutral on the Syrian crisis and even

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<sup>67</sup> The Constitution of Iraq, Article 140.

<sup>68</sup> *The Economist*, *Rebellious Days*.

leans in favor of the opposition. Ayad Allawi suggested, however, that Iran “is becoming the dominant feature of Iraq.”<sup>69</sup> It remains to be seen whether Iraq’s overtures toward its Sunni neighbors were intended solely to attract them to the Arab League summit or if Iraqi leaders are actually nervous about overbearing Iranian influence.

Turkish meddling on behalf of Sunni Arabs, Turkomens, and, occasionally, Kurds has also irked Prime Minister Maliki. A diplomatic spat between Maliki, Turkish Prime Minister Erdoğan, and Turkish Foreign Minister Ahmet Davutoğlu ended with Davutoğlu suggesting that Maliki’s actions against Iraqi Sunnis might lead to civil war.<sup>70</sup>

Sectarian strife rules the day in Iraq. Sunnis dominated the political landscape from the country’s founding but now find themselves marginalized and vulnerable. Kurds are without American military protection for the first time since the Gulf War, but possess significant strength in their *peshmerga* militias, oil, and political bloc. One senior Western diplomat even suggested “Sooner or later, an independent Kurdistan is bound to emerge.”<sup>71</sup> Shi’as ally ever closer with Iran while Prime Minister Maliki continues to consolidate power and attack his enemies. The United States no longer has troops on the ground to enforce peace and achieve its goals and must use other means to do so.

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<sup>69</sup>Ben Birnbaum, “Allawi Says Iran 'swallowing' Iraq After Winning U.s. War,” *Washington Times*, March 23, 2012. <http://www.lexisnexis.com/lncui2api/auth/checkbrowser.do?rand=0.10038532434159975&cookieState=0&ipcounter=1&bhcp=1> (accessed March 24, 2012).

<sup>70</sup>*The Economist*, Problems With the Neighbours, January 28, 2012, <http://www.economist.com/node/21543591> (accessed March 23, 2012).

<sup>71</sup>*The Economist*, *Rebellious Days*.

## STATE OF AFFAIRS IN THE IRAQI OIL AND GAS INDUSTRY

Oil has been the critical factor in sustaining Iraqi economic growth since the American-led invasion in 2003. It has helped drive Iraqi per capita GDP from \$518 just before the fall of Saddam Hussein to \$3,306 by 2011.<sup>72</sup> The International Monetary Fund projects Iraqi real GDP will grow by 12.6% in 2012.<sup>73</sup> According to the U.S. Energy Information Administration, Iraq's crude oil export revenue made up more than two-thirds of GDP in 2009. That year, 90% of the GOI's revenues came from the oil and gas sector.<sup>74</sup>

Iraq was the world's 12<sup>th</sup> largest oil producer in 2009 but has the fourth-largest proven reserves, behind Saudi Arabia, Canada, and Iran. Years of sanctions and war have left Iraq's oil fields underdeveloped and largely unexplored. Iraq has 115 billion barrels of proven oil reserves (11% of the world's total proven reserves<sup>75</sup>) and 110 trillion cubic feet of proven natural gas reserves.<sup>76,77</sup> It is estimated that the country actually has the world's second-largest oil reserves if unproven fields are taken into account.<sup>78</sup> Some

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<sup>72</sup> *The Economist*, Sovereignty Without Security.

<sup>73</sup> "Program Note: Iraq," International Monetary Fund, <http://www.imf.org/external/np/country/notes/iraq.htm> (accessed March 25, 2012).

<sup>74</sup> "Iraq," Extractive Industries Transparency Initiative, <http://eiti.org/Iraq> (accessed March 25, 2012).

<sup>75</sup> Ibid.

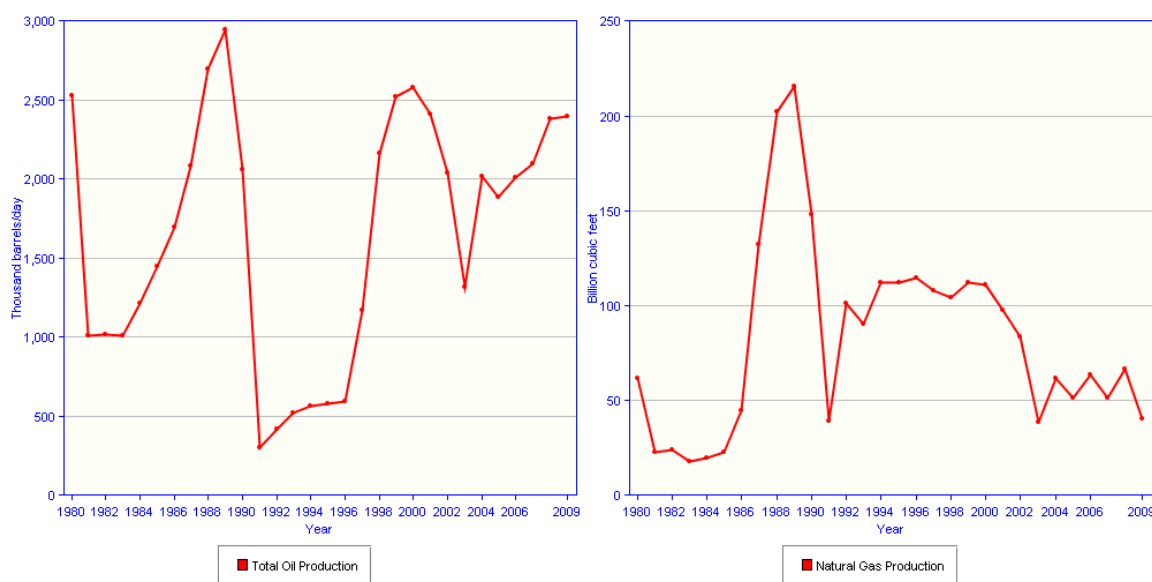
<sup>76</sup> "Iraq," U.S. Energy Information Administration, <http://www.eia.gov/countries/cab.cfm?fips=IZ> (accessed March 25, 2012).

<sup>77</sup> Muhammed Abed Mazeel, "Hydrocarbon Reservoir Potential Estimated For Iraq Bid Round Blocks," *Oil and Gas Journal* (March 5, 2012): 42.

<sup>78</sup> International Monetary Fund.

high-end estimates suggest that future exploration might yield as many as 350 billion barrels of oil and 500 trillion cubic feet of natural gas.<sup>79</sup>

Oil production has driven much of Iraq's economic growth during the past decade, yet it has grown only haltingly from its 1.3 million barrels per day nadir in 2003 (see Figure 2). Output did not surpass its pre-invasion high until 2011. Although output for 2012 is expected to average 3.0 million barrels per day, the highest in more than 30 years, most analysts expect Iraq to miss its target output level of 12 million barrels per day by the end of 2017.<sup>80</sup> Natural gas production has proven even more anemic due to depressed global prices and security concerns (see Figure 3).



**Figure 2: Iraqi Oil Production (1980-2009).**<sup>81</sup> **Figure 3: Iraqi Gas Production (1980-2009).**<sup>82</sup>

Iraq's failure to adequately develop its oil and gas industry comes down to three key factors: insecurity, political instability, and poor remuneration. Insecurity remains a

<sup>79</sup> Mazeel, 42.

<sup>80</sup> "Iraq Oil Output Over 3mln Bpd; First Time in Decades," Reuters, <http://www.reuters.com/article/2012/03/05/oil-iraq-idUSL5E8E518I20120305> (accessed March 26, 2012).

<sup>81</sup> "Iraq Country Analysis Brief," U.S. Energy Information Administration, <http://www.eia.gov/countries/country-data.cfm?fips=IZ&trk=p1> (accessed March 26, 2012).

<sup>82</sup> Ibid.

serious issue in Iraq outside of the Kurdish region. Domestic security experienced an unfortunate setback when the government was not able to come to terms with the United States regarding a Status of Forces Agreement that would have provided for a limited contingent of American troops to remain in the country beyond the end of 2011. Nevertheless, Iraqi security continues to improve and is the least important factor hampering oil production.

Political instability affects oil production in both Arab and Kurdish Iraq. Oil and gas firms are loathe to sign agreements or commit to investing huge sums of capital when there exists serious uncertainty over whether the contracts are even legal. In the absence of a comprehensive hydrocarbons law, companies have been relying on the opinions of political experts and the assurances of Iraqi politicians. Firms that have made agreements with the central government usually will not sign profit-sharing contracts (PSC) with the KRG out of fear of retribution from Baghdad. Even then, justice is meted haphazardly. American independent oil firm Hess was banned from bidding in Iraq's most recent licensing round after it signed a PSC with the KRG. The GOI recently announced that ExxonMobil will suffer the same fate during the next round of licensing, due to be held in May 2012, although for now the company has been permitted to continue operating the West Qurna-1 oil field, one of the world's largest, near Basra. Until the GOI and the KRG are able to come to an agreement over hydrocarbon revenue sharing, companies will remain wary of operating with either side.

Poor remuneration from the GOI is also an issue. Some firms, including ExxonMobil and Total in recent months, have begun shifting allegiances toward the KRG because of the favorable exploration terms granted to private firms by the regional government.

Hardly exploitative, the terms agreed upon in most of the PSCs (which are publicly available on the internet) are standard in much of the world, except where state firms control upstream operations. PSCs encourage exploration. Where the investor is successful the firm will find massive profits. Where it is unsuccessful it will earn nothing.

Contracts with the GOI, on the other hand, are service licenses that allow foreign firms to pump Iraqi oil but offer unattractive profit margins. ExxonMobil earns \$1.90 for each barrel of oil it pumps in the West Qurna-1 field. Lukoil, the second-largest Russian oil company, makes just \$1.15 in West Qurna-2.<sup>83, 84</sup> The international oil giants never believed, and probably still do not believe, that the servicing contracts would be permanent. They see the agreements as temporary terms that provide them with a network of Iraqi officials and a record of involvement in the country. They hope to leverage these soft assets once Iraq finalizes its hydrocarbons law and begins to seriously court international investment in its extractive industries. Nearly 30 months after the Exxon-led consortium won the rights to service West Qurna-1 that scenario has yet to play out.

Investing with the GOI is unattractive for other reasons as well. According to the U.S. Department of Commerce's *Doing Business in Iraq* guide, the GOI has "unclear land transfer policies, a lack of infrastructure coordination for investment projects, and

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<sup>83</sup> Ruba Husari, "The Real Winners," Iraq Oil Forum, <http://www.iraqoilforum.com/?p=1701> (accessed March 26, 2012).

<sup>84</sup> "2nd Round Bid: The Results - 12 December 2009," Iraq Oil Forum, <http://www.iraqoilforum.com/?p=1594> (accessed March 26, 2012).

[exhibits an inability among] provincial governments...to manage and facilitate investment projects”<sup>85</sup>

Industry developments have progressed quite divergently in the Kurdish north. Like the heavily Shi’a south, the region is blessed with copious natural resources. The KRG estimates that 45 billion barrels of oil and 200 trillion cubic feet of natural gas lie underneath the tracts of land where it has established PSCs with oil and gas exploration firms. As of November 2011, 44 international companies had signed PSCs with the KRG.<sup>86</sup>

At least six of those firms are American: ExxonMobil, Hess, HKN, Hunt Oil, Marathon Oil, and Murphy Oil. The latter five are smaller, independent firms that have never operated in Iraqi fields operated by the GOI. ExxonMobil, with its operations in the West Qurna-1 field, is the only exception. Smaller firms have been signing exploration agreement with the KRG for a number of years, although Hess signed its contract only in July 2011. While the GOI has long claimed that agreements reached with the KRG are illegal, tensions between the two governments reached a new high when ExxonMobil and Total, a French energy giant, initiated talks with the Kurds.

Whether in the Kurdish north or the Arab south, development of Iraq’s oil and gas industry is crucial. Peter Eigen, chairman of the Extractive Industries Transparency Initiative, stated “With well-managed oil resources, the future of the Iraqi people could

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<sup>85</sup> “Doing Business in Iraq: 2009 Country Commercial Guide For Us Companies,” U.S. Commercial Service, [http://export.gov/iraq/build/groups/public/@eg\\_iq/documents/webcontent/eg\\_iq\\_038635.pdf](http://export.gov/iraq/build/groups/public/@eg_iq/documents/webcontent/eg_iq_038635.pdf) (accessed April 5, 2012).

<sup>86</sup> “Kurdistan Oil and Gas Activity Map,” ShaMaran Petroleum, <http://www.shamaranpetroleum.com/i/pdf/Kurdistan-Map.pdf> (accessed March 30, 2012).

be very bright.”<sup>87</sup> With poorly-managed resources, however, their future will more likely be bleak.

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<sup>87</sup> “Press Release: Iraq Announces Plans to Implement the Eiti,” Extractive Industries Transparency Initiative, <http://eiti.org/news-events/press-release-iraq-announces-plans-implement-eiti> (accessed March 30, 2012).



## CHECK SHI'A INFLUENCE AND KEEP IRAQ OUT OF THE IRANIAN SPHERE

Roughly three-quarters of the world's Shi'a Muslims live in just four countries: Iran, Pakistan, India, and Iraq.<sup>88</sup> Iraq is also one of four countries (alongside Iran, Azerbaijan, and Bahrain) where Shi'as make up the religious majority.<sup>89</sup> Although 60-65% of Iraqis are Arab Shi'a Muslims, power has been concentrated among the Sunni minority under Ottoman rule and particularly since the end of the British Mandate in 1932. Kings Faisal I, Ghazi, and Faisal II, who ruled Iraq in succession until 1958, were Sunni Muslims. When Faisal II was toppled by the July 14 Revolution, he was replaced by Muhammad Najib ar-Ruba'i and Abd al-Qarim Qasim, both Sunnis. All others who served as presidents or prime ministers in the Republic of Iraq were Sunni as well. Iraq under Ba'ath Party rule saw two more Sunni presidents: Ahmed Hassan al-Bakr (1968-1979) and Saddam Hussein (1979-2003). Democratic elections were bound to bring Shi'as to power. All three prime ministers of the renewed Republic of Iraq, established in May 2004, have been Shi'as.<sup>90</sup>

Shi'as, and the Iranian-funded Islamic Dawa Party in particular, have become the dominant political force. Many Iraqis and foreign analysts fear Iraq is coming under significant Iranian influence. The Kurds are the best-suited group to check potential Shi'a

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<sup>88</sup> *Mapping the Global Muslim Population* (Pew Research Center, October 2009), 1, [http://www.pewforum.org/uploadedfiles/Orphan\\_Migrated\\_Content/Muslimpopulation.pdf](http://www.pewforum.org/uploadedfiles/Orphan_Migrated_Content/Muslimpopulation.pdf) (accessed April 1, 2012).

<sup>89</sup> *Ibid.*, 9.

<sup>90</sup> Ronen Zeidel, "A Harsh Readjustment: The Sunnis and the Political Process in Contemporary Iraq," *Middle East Review of International Affairs* 12, no. 1 (March 2008): 1, <http://meria.idc.ac.il/journal/2008/issue1/pdf/4.pdf> (accessed March 30, 2012).

hegemony. Empowering the Kurds through their oil and gas industry will help balance Shi'a power, thereby reinforcing regional stability and keeping Iranian influence at bay. As an added incentive for the U.S. and other Western governments, supporting Kurdistan's gas industry by building a pipeline for its natural gas to reach Europe would help check Russian power.

### Shi'a Power and Iranian Influence

Shi'as control many of Iraq's budding political institutions. Prime Minister Maliki is a Shi'a. Although Iraqiyya, a secular bloc, holds the most seats in the Council of Representatives, the government was formed under the leadership of the State of Law Coalition, a collection of Shi'a parties.<sup>91</sup> The National Iraqi Alliance, a Shi'a coalition that formed the third-largest group, won 70 seats. The two Shi'a coalitions won 42.4% of the popular vote and 48.9% of the Council of Representatives seats between them, less than their proportion of the Iraqi population but almost enough to rule Iraq without non-Shi'a support.

Maliki has concentrated executive power among his closest Shi'a deputies, his Islamic Dawa Party, and himself. State of Law and the National Iraqi Alliance head at least 15 of 31 government ministries, including the ministries of energy, defense, interior, oil, electricity, justice, transport, and water resources, among others. Maliki himself is acting minister of defense, which runs the army, and the interior, which runs the police force. Deputy Prime Minister for Energy Hussain al-Shahristani, an independent member

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<sup>91</sup> Timothy Williams and Rod Nordland, "Allawi Victory in Iraq Sets up Period of Uncertainty," *New York Times*, March 26, 2010. <http://www.nytimes.com/2010/03/27/world/middleeast/27iraq.htm> (accessed March 30, 2012).

of the State of Law coalition and another Shi'a Muslim, serves as acting head of the Ministry of Electricity.

Larry Diamond, writing in *Foreign Affairs* in 2004, worried “The American occupation could wind up paving the way for an ‘election’ of an Iranian-linked Islamist government in Baghdad.”<sup>92</sup> His fears have thus far proven overblown but not entirely off base. The prevalence of Shi'a parties suggests many Iraqis vote on religious and ethnic lines but does not imply that such a pattern will necessarily cause political instability. It is disconcerting, however, that many Iraqi Shi'a parties are funded openly by the Iranian government. These include the Islamic Dawa Party of Nouri al-Maliki.

Too much power in the hands of Shi'a parties, especially those linked with Iran, harms domestic stability because it worries Sunnis and Kurds and increases the potential for sectarian violence. The International Crisis Group wrote in a 2005 report that Iran has an interest in “encouraging a Shi'ite-dominated, friendly government”<sup>93</sup> and “promoting a degree of chaos but of a manageable kind (in order to generate protracted but controllable disorder”<sup>94</sup> but that Iran also “is intent on preserving Iraq's territorial integrity [and] avoiding all-out instability.”<sup>95</sup> In short, Iran wants a weakened, semi-stable Iraq run by an acquiescent Shi'a regime.

Competition for Iraq's natural resources and a restive Sunni minority make Iran's position untenable. The Kurds, who themselves have a tumultuous relationship with Iran, would not accept outright Shi'a control of the government and Iraq's oil and gas wealth.

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<sup>92</sup> Larry Diamond, “What Went Wrong in Iraq,” *Foreign Affairs* 83, no. 5 (September-October 2004): 34-56, <http://www.jstor.org/stable/pdfplus/20034066.pdf?acceptTC=true> (accessed April 1, 2012).

<sup>93</sup> *Iran in Iraq: How Much Influence?* (International Crisis Group, March 21, 2005), 1, <http://merln.ndu.edu/archive/icg/iraniniraq.pdf> (accessed April 1, 2012).

<sup>94</sup> *Ibid.*, 2.

<sup>95</sup> *Ibid.*, 1.

They could be convinced to yield more authority to Shi'as in Baghdad only if the capital's control over oil and gas revenues was limited. Sunnis have poor relations with both Kurds and Arab Shi'as and are nervous of Shi'a intentions now that eighty years of ruler-ruled relations have been reversed. Introducing democracy to Iraq flipped the politico-economic hierarchy on its head. In Iraq and elsewhere such status reversals have led to violent ethnic conflict.

Concentrating power in the hands of Shi'as also neglects to acknowledge the influence of Saudi Arabia and the Sunni-led Gulf monarchies. Saudi Arabia has often been the most vocal critic of Maliki's government. Neither Saudi Arabia nor Qatar has an official diplomatic presence in Baghdad. A highly decentralized Iraq with a weak government in Baghdad would provide the most stability at both the domestic and regional levels.

### **Empower the Kurds**

The U.S. should push for greater Iraqi federalism and provide support for political, religious, and ethnic groups capable of hedging against overly concentrated Shi'a authority in Baghdad. Supporting Sunni opposition groups would likely be an unsuccessful strategy. First, Sunnis remain antagonistic to the United States. Sunnis were "frightened by their sudden, dramatic loss of political power, social status, and economic well-being"<sup>96</sup> and led much of the resistance to American occupation that plagued Iraq until 2009. Iraq's Sunnis would be unlikely allies for the United States.

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<sup>96</sup> Sharon Otterman, "Iraq: The Sunnis," Council on Foreign Relations, <http://www.cfr.org/iraq/iraq-sunnis/p7678> (accessed April 2, 2012).

Second, the Sunnis do not have a resource that can be readily leveraged. Sunni-majority provinces lie predominately in the populous middle-third of the country and hold few oil and gas reserves. Most of Iraq's natural resource wealth is concentrated in the Shi'a south or the Kurdish north. The Western Desert, sparsely inhabited but shown as Sunni on most maps, is the lone exception. Oil analysts suspect significant reserves lie under the Western Desert but Baghdad has yet to open the region to foreign exploration. Sunnis have little power in Baghdad and poor prospects for the near future.

The best strategy for the U.S. is to empower the Kurds through their oil and gas resources. The Kurds are more adequately suited than the Sunnis to counterbalance Shi'a power. For one, they are more influential in parliament and in Baghdad's current government. Kurdish parties won 22.2% of the popular vote and 17.5% of seats in the 2010 parliamentary elections. Most of those seats went to the Kurdistan Alliance (a broad coalition including the PUK and the KDP) but some went to unaffiliated Kurdish parties, including the Movement for Change (also known as Gorran), the Kurdistan Islamic Union, and the Islamic Group in Kurdistan. The current Council of Representatives re-elected the PUK leader Jalal Talabani as Iraq's president.

The Kurds have their own regional government and can ignore Baghdad's authority on issues where the constitution has devolved power to regional governments, of which the Kurds have the only one. The KRG controls its own military and police force, maintains border crossings, and enacts legislation on issues where federal laws do not exist, among other things. Although Iraqis have discussed creating more regional governments, none have been officially proposed yet. Kurdish politicians in Erbil, Sulaimaniya, and elsewhere in KRG-controlled provinces can speak out freely against the

GOI. Recent actions taken by Maliki to harass or arrest Sunnis and other dissenters have shown that not to be the case elsewhere in the country.<sup>97</sup>

The KRG, unlike any Sunni authority, is also capable of driving a wedge between Iraqi Shi'a parties and their Iranian financial backers. Iran has Kurds of its own and is wary of Kurdish nationalism but it forged strong ties with Kurdish leaders in Iraq during the 1970s and 1980s.<sup>98</sup> In many ways Iran and the United States have the same goals for Iraqi Kurds. Iran wants a Shi'a-led Iraq but it wants the state to be weak so as not to challenge Iranian primacy. Tehran may support the KRG, to a limited extent, as long as the Kurds do not gain enough power to consider independence, which would have negative implications for Iran's internal Kurdish politics. The United States wants a strong Kurdish presence in Iraq but similarly dreads the implications an independent Kurdistan could have on regional stability.

Supporting the Kurds could also be beneficial to the Sunni minority. A recent incident involving the Sunni vice-president Tariq al-Hashemi is a good example. Maliki issued an arrest warrant for Hashemi, Iraq's most senior Sunni politician, in December 2011, accusing him of running a "death squad" targeting Shi'a figures during the violent years following the American invasion. Hashemi fled to Iraqi Kurdistan, where he remained before leaving for Qatar in April 2012. The KRG refused to turn him over to the GOI, despite protestations from Baghdad.

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<sup>97</sup> Tim Arango, "Iraq's Prime Minister Gains More Power After Political Crisis," *New York Times*, February 27, 2012. <http://www.nytimes.com/2012/02/28/world/middleeast/maliki-wields-more-power-in-iraq-after-crisis.html?pagewanted=all> (accessed April 3, 2012).

<sup>98</sup> Efraim Karsh, *The Iran-Iraq War 1980-1988* (London: Osprey, 2002), 8.

Independent analysts see the charges as entirely politically motivated.<sup>99</sup> Reider Visser, a fellow at the Norwegian Institute of International Affairs and an expert on Iraqi politics, said “Any leading Sunni politician seems now to be a target of this campaign by Maliki. It seems that every Sunni Muslim or secularist is in danger of being labeled either a Baathist or a terrorist.”<sup>100</sup>

### Support Kurdish Gas to Counter Russia in Europe

Supporting Kurdistan’s development of its own natural gas reserves could have an additional benefit unrelated to Iraq’s internal politics. Kurdish gas could provide a useful counterweight to Russian gas. According to Jonathan Stern, director of gas research at the Oxford Institute for Energy Studies, “Russian reserves overwhelm all other gas reserves available [to Europe] with the exception of [reserves from] Middle East countries.”<sup>101</sup> The vast majority of European natural gas is piped in from Russia and the continent is heavily dependent on Russian exports.

The European Union and the United States are planning construction of a pipeline that, if built, would bring Kurdish gas directly to European markets (see Figure 4). The benefits would be three-fold. First, it would increase economic interdependency between Iraqi Kurdistan and the European Union. Second, it would provide the Kurds with an outlet for their natural gas that does not require it being sent via the Kirkuk-Ceyhan pipeline (which runs from GOI-controlled Iraq to southwestern Turkey and is often out of commission) or delivered south to Basra. By controlling exports by itself, or in a

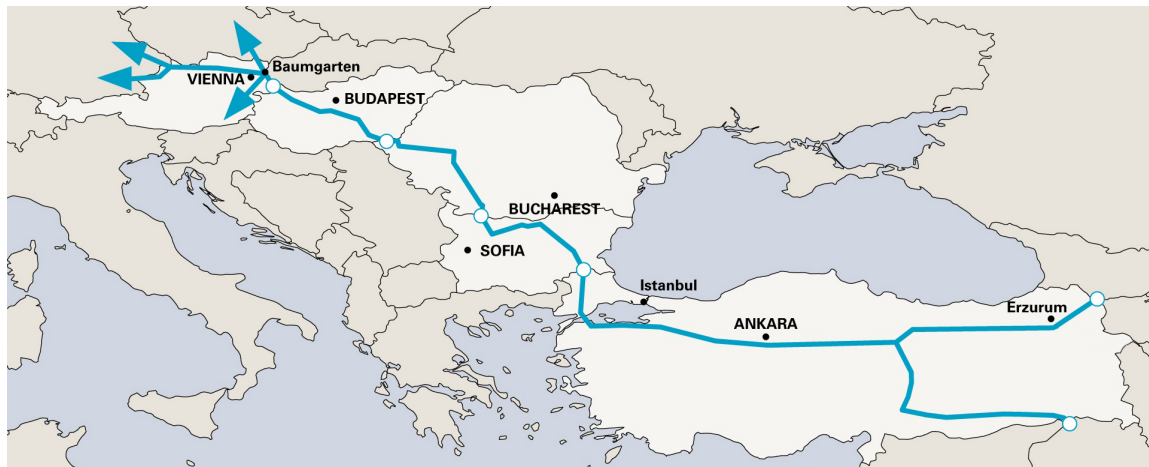
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<sup>99</sup> Jack Healy, “Arrest Order For Sunni Leader in Iraq Opens New Rift,” *New York Times*, December 19, 2011. <http://www.nytimes.com/2011/12/20/world/middleeast/iraqi-government-accuses-top-official-in-assassinations.html#> (accessed April 2, 2012).

<sup>100</sup> Ibid.

<sup>101</sup> Jonathan Stern, *Natural Gas in Europe: The Importance of Russia* (Oxford Institute for Energy Studies), 3, [http://www.centrex.at/en/files/study\\_stern\\_e.pdf](http://www.centrex.at/en/files/study_stern_e.pdf) (accessed April 1, 2012).

cooperative agreement with the GOI, the KRG could limit Baghdad's ability to undercount its exports and withhold its gas revenues.



**Figure 4: Proposed Nabucco pipeline.**<sup>102</sup>

Third, the pipeline would decrease European dependence on Russian oil and gas imports. In 2010 more than 38% of Europe's gas and nearly one-third of Europe's oil came from Russia.<sup>103</sup> Softening Europe's reliance on Russian oil and gas by providing a direct link from Austria to Iraqi Kurdistan would be mutually beneficial.

The United States should support oil and gas companies operating in Iraqi Kurdistan primarily to check Shi'a authority and Iranian meddling in Iraqi politics. The potential for instability in Iraq continues to increase as Maliki's Shi'a-led government aggregates power in Baghdad. Regional instability also becomes more likely if Sunni Arab states, Saudi Arabia foremost among them, become too concerned about Iranian influence in Iraq. A proxy war between the region's Shi'a and Sunni powers would be disastrous. To

<sup>102</sup> Map source.

<sup>103</sup> Andris Piebalgs and Sergey Shmatko, *Energy Dialogue Eu-Russia: The Tenth Progress Report* (Moscow: European Commission on Energy Issues and Ministry of Energy of the Russian Federation, November 2009), 5, [http://ec.europa.eu/energy/international/bilateral\\_cooperation/russia/doc/reports/progress10\\_en.pdf](http://ec.europa.eu/energy/international/bilateral_cooperation/russia/doc/reports/progress10_en.pdf) (access ed April 2, 2012).



mitigate the potential for instability, the U.S. should support Iraqi Kurdistan's development of its oil and gas reserves and move forward with construction of the Nabucco pipeline.

## **STRENGTHEN THE KURDISH BARGAINING POSITION WITH BAGHDAD**

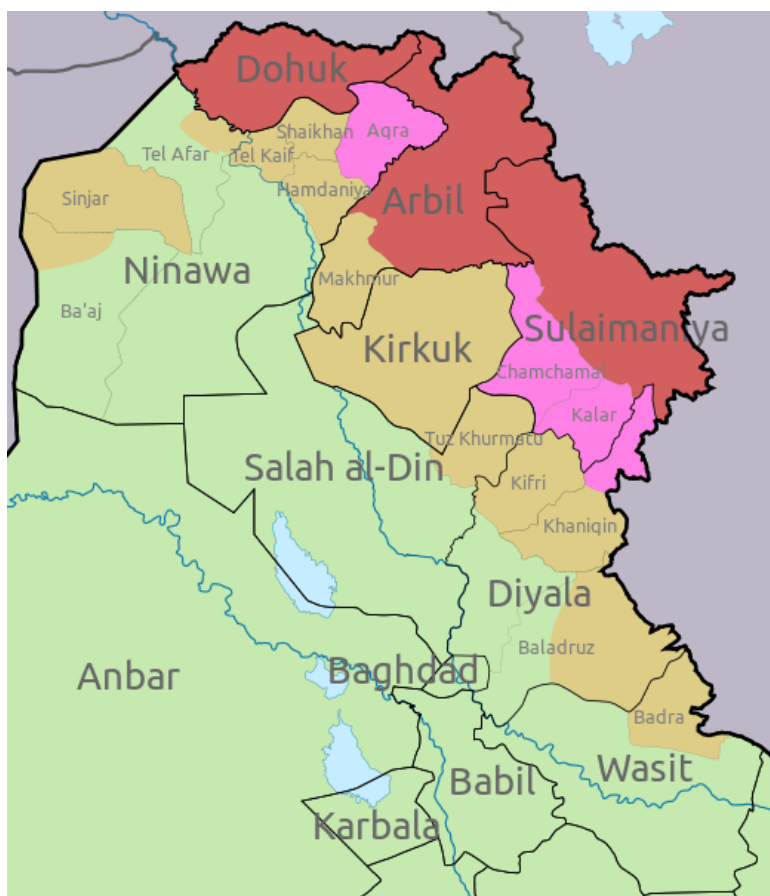
Two issues plague relations between the KRG and the GOI and threaten the peaceful existence of a Kurdish autonomous region within Iraq. The Council of Representatives must quickly resolve the status of Kirkuk and establish a national hydrocarbons law. Rapidly increasing oil production in the south and north of the country means the longer those two issues are left unresolved the more difficult they will be to deal with peacefully.

Iraq's central government has continually pushed back the date for the Kirkuk referendum. Initially the KRG agreed but in recent years Kurds have become increasingly bothered by what they see as Arab intransigence. Iraq's parliament has also continually failed to pass a comprehensive hydrocarbons law. Both issues, once settled, will make Iraq a more stable state with an established framework for sharing its most valuable resource and the profits and power that derive from it.

The Kurds are only one of the groups that must agree to any referendum or law. They cannot secure a referendum on the status of Kirkuk or the passage of a hydrocarbons law without support from a Shi'a political bloc. The status quo favors the Shi'a-led government in Baghdad, however, making it unlikely that either issue will be resolved soon. The best way for the U.S. to move the process forward is to support private sector development of Iraqi Kurdistan's oil and gas to provide the KRG and Kurdish parliamentarians with more leverage in negotiations with Baghdad.

## Resolve the Status of Kirkuk

Kirkuk Province is just a small part of a larger contested region in northern Iraq (see Figure 5). The legal status of the province, however, is particularly important because of the 16 billion barrels of proven oil reserves that lie beneath it.<sup>104</sup> A contentious decision by Kurdish *peshmerga* forces to approach the city in March 2012 sparked conflict with local Sunnis, Shi'as, and Turkomens.



**Figure 5: Contested Areas in Northern Iraq.** Contested areas according to Article 140 of the Iraqi Constitution. The Kurdish semi-autonomous region is shown in red. Kurdish-controlled contested areas are shown in pink. GOI-controlled contested areas are shown in gold.<sup>105</sup>

The KRG and the GOI each claim Kirkuk province. Kirkuk is an important symbol for many Kurdish nationalists, reflecting attempts to reclaim the city after decades of Arabization

<sup>104</sup> “Kurdistan Oil and Gas Activity Map”.

<sup>105</sup> “Disputed Areas in Iraq,”

Wikipedia, [http://en.wikipedia.org/wiki/File:Disputed\\_areas\\_in\\_Iraq.svg](http://en.wikipedia.org/wiki/File:Disputed_areas_in_Iraq.svg) (accessed April 2, 2012).

under Saddam Hussein.<sup>106</sup> Kurds have been encouraged to move back into the city since 2003 after having been pressured (and sometimes forced) to move out of it in the 1970s, 80s, and 90s.<sup>107</sup> Iraq's 1957 census shows that 187,593 Kurds lived in Kirkuk Province, comprising 48% of the population.<sup>108</sup> While the absolute number of Kurds living there did not drop dramatically over the next forty years, to 155,861 in 1997, their population as a percentage of the total fell to just 21%.<sup>109</sup> Arabization under Saddam Hussein saw the number of Arabs in the province rise from 109,620 (28% of the total) in 1957 to 544,596 (72%) by 1997.<sup>110, 111</sup> Arabs were provided with jobs, subsidized housing, and other incentives to move to Kirkuk. The province was even renamed at-Ta'mim (Arabic for 'nationalization') Province between 1976 and 2006 to reflect the status of its natural resource wealth.

Kurds have moved back to Kirkuk en masse since allied forces toppled Hussein's regime in 2003. The UN estimates that Kurds make up 52% of Kirkuk's population, Arabs 35%, and Turkomens 12%.<sup>112</sup> The Kirkuk Provincial Council has agreed to a temporary power-sharing agreement, proposed by the UN, that divides regional authority equally between the three major ethnic groups with additional minimal representation for other minorities.

Yet the Council of Representatives, Iraq's parliament, has repeatedly pushed back the date for a referendum to be held to officially resolve the status of Kirkuk Province. Iraq's

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<sup>106</sup> Liam D. Anderson and Gareth R.V. Stansfield, *Crisis in Kirkuk: The Ethnopolitics of Conflict and Compromise* (Philadelphia: University of Pennsylvania Press, 2009), 52.

<sup>107</sup> *Ibid.*, 52.

<sup>108</sup> 1957 Census of the Republic of Iraq.

<sup>109</sup> *Ibid.*

<sup>110</sup> *Ibid.*

<sup>111</sup> *Ibid.*

<sup>112</sup> U.N. Gives Iraq Report On Troubled Kirkuk, *USA Today*, April 22, 2009.

[http://www.usatoday.com/news/world/iraq/2009-04-22-iraq-report\\_N.htm](http://www.usatoday.com/news/world/iraq/2009-04-22-iraq-report_N.htm) (accessed April 2, 2012).

constitution required that a referendum be held by the end of 2007.<sup>113</sup> It was initially slated for November 15, 2007, pushed back six weeks to December 31, then delayed indefinitely. All sides initially agreed to delay the referendum for technical, not political, purposes. The influential *Iraq Study Group Report*, the product of a commission co-chaired by James Baker and Lee Hamilton, noted in 2006 “A referendum on the future of Kirkuk would be explosive and should be delayed.”<sup>114</sup> It suggested the “issue be placed on the agenda of the International Iraq Support Group as part of the New Diplomatic Offensive.”<sup>115</sup> That diplomatic offensive is the same one the government is now winding down. The status of Kirkuk has yet to be resolved.

The referendum on Kirkuk will be contentious but is unlikely to become less so in the future. The authors of the *Iraq Study Group Report* surely thought tensions would have subsided enough to hold the referendum by 2012 but Iraq’s turbulent politics have proven them wrong. In fact, development of Kirkuk’s oil fields by the GOI has continued. More will be at stake the longer Iraq waits.

The U.S. government should encourage American firms to drill in KRG territories but should discourage them from drilling in disputed Kirkuk Province until its status is resolved. Allowing the KRG to develop its oil fields in Dohuk, Erbil, and Sulaimaniya provinces may embolden its leadership but will decrease its prospective reliance on Kirkuk’s oil wealth. Discouraging development of Kirkuk’s fields will keep the stakes as low as possible for when a referendum is held.

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<sup>113</sup> Constitution of the Republic of Iraq, Article 140.

<sup>114</sup> James A. Baker III et al., *The Iraq Study Group Report* (United States Institute of Peace), 45, [http://media.usip.org/reports/iraq\\_study\\_group\\_report.pdf](http://media.usip.org/reports/iraq_study_group_report.pdf) (accessed April 1, 2012).

<sup>115</sup> *Ibid.*, 45.

It is vital that a referendum on Kirkuk be held as soon as possible. ExxonMobil and the other supermajors have rapport with both governments and could play an important role in ensuring that Kirkuk's referendum is held quickly and without violence by encouraging the KRG and the GOI to come to a mutually acceptable agreement regarding administering and sharing oil revenues in the province. As the only oil company operating in Kurdistan and southern Iraq, ExxonMobil could offer a joint field development plan with equity stakes held by Exxon and both governments. The *Iraq Study Group Report* recommends "international arbitration [over the status of Kirkuk]...to avert communal violence."<sup>116</sup> International arbitration should include non-governmental actors, particularly corporations and ExxonMobil chief among them. Without an agreement the GOI and the KRG will continue with unilateral development plans in Kirkuk Province, making a violent reckoning ever more likely.

### Pass a Hydrocarbons Law

Iraq does not yet have a comprehensive law detailing the rights and restrictions of the central and regional governments with regard to oil and gas revenues. The country is reliant upon a patchwork of legislation and constitutional articles to provide an interim framework. Baghdad and Erbil have each interpreted the rules (or lack thereof) to fit their own interests.

Articles 109-115 of the Iraqi constitution spell out rules regarding Iraq's federalist structure. Some of it is worth quoting at length. In particular:

Article 110: "The federal government should have exclusive authorities in the following matters:...regulating commercial policy *across* regional and governorate boundaries." [Emphasis added.]

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<sup>116</sup> Ibid., 45.

Article 111: “Oil and gas are owned by all the people of Iraq in all the regions and governorates.”

Article 112: “The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from the *present* fields, provided that it distributes its 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 federal government, with the producing regional and governorate governments, shall together formulate the necessary strategic policies to develop the oil and gas wealth in a way that achieves the highest benefit to the Iraqi people using the most advanced techniques of the market principles and encouraging investment.” [Emphasis added.]

Article 115: “All powers not stipulated in the exclusive powers of the federal government belong to the authorities of the regions and governorates that are not organized in a region. With regard to other powers shared between the federal government and the regional government, priority shall be given to the law of the regions and governorates not organized in a region in case of dispute.”<sup>117</sup>

A subsection of the *Iraq Study Group Report* entitled “The Politics of Oil” details some of the key issues. Article 112 dictates government authority over present oil fields only. It states that all regions and governorates should receive a proportion of oil and gas revenues based on their populations. The article becomes muddled, however, when it stipulates that “damaged regions which were unjustly deprived” of revenues under Saddam Hussein’s regime deserve more than a proportional share. Iraqi Kurds, who faced an embargo along the Green Line after the Gulf War, were certainly deprived of revenues under Hussein. Article 112 entitles them to a greater share than their population would suggest, although up until May 2011 the KRG received only a 17% share of oil revenue, equal to its proportion of the Iraqi population. Since then it has received nothing.

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<sup>117</sup> Constitution of the Republic of Iraq, Articles 110-15.

Adding to the confusion, Article 112 only covers “present fields” and does not define the term. Iraqi Kurdistan was largely unexplored until the 2003 invasion, meaning that northern fields are much younger on aggregate than their southern counterparts. New finds occur regularly and most exploration contracts (including all of those with American companies) have been signed only since the security situation began to improve dramatically in 2009, two years after the constitution was approved by referendum. Unfortunately, the constitution does not explain what “present” means. Implications for revenue sharing depend on whether present fields are defined as those that have yet to be discovered, developed, or contracted out to a foreign exploration firm. There is much ambiguity for both the KRG and the GOI to exploit. For now, as mentioned above, Iraqi Kurdistan receives a share only proportional to its population for all oil and gas revenues, whether from new or old fields.

The authors of the *Iraq Study Group Report* recommend:

Oil revenues should accrue to the central government and be shared on the basis of population. No formula that gives control over revenues from future fields to the regions or gives control of oil fields to the regions is compatible with national reconciliation.<sup>118</sup>

This is unreasonable and unreflective of developments that have occurred in the six years since the report was published. First, their proposition requires an effective mechanism for collecting and sharing revenues. Such a mechanism does not exist. It is ludicrous to believe an agency overseen by a Shi’a-led government would distribute oil revenues fairly. Iraq placed 175<sup>th</sup> in Transparency International’s 2010 Corruption Perceptions

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<sup>118</sup> Baker III et al., 45.



Index, ahead of only Afghanistan, Myanmar, and Somalia.<sup>119</sup> The KRG already claims that Baghdad undercounts its oil exports by 25,000-35,000 bpd. Additionally the GOI, unlike the KRG, does not publish its oil contracts. All PSCs signed between the KRG and foreign oil companies are downloadable on the natural resource ministry's website in Kurdish, Arabic, and English.

Second, the Iraq Study Group considered the Iraqi state incapable of providing security and basic services at the time it wrote its report. After five years under Nouri al-Maliki that is no longer the case. Although the state may remain somewhat ineffective it is no longer politically weak. Al-Maliki has coalesced significant power around himself and his Shi'a Islamic Dawa Party. If anything the central government needs less power, not more, to preserve the tenuous balance between Iraq's Kurds, Shi'as, and Sunnis. "National reconciliation" is poorly defined by the Iraq Study Group. Reconciliation does not necessitate centralization and in Iraq's case it should not.

American oil and gas firms can help in three ways. First, they can emphasize the importance of transparency in dealing with the GOI and the KRG. Transparency can decrease graft and rent-seeking. It is in the best interests of foreign operators because it ensures that all companies receive fair deals and decreases the likelihood the government will change or cancel the contract, as the GOI has threatened to do with ExxonMobil.

Second, oil and gas firms' continuing and expanding operations in Iraqi Kurdistan make it ever clearer that the KRG is getting a raw deal. ExxonMobil should also continue to make clear its opinion that it is not breaking any Iraqi laws by entering into PSCs with the KRG. Another reason companies are hesitant to invest in Iraq is the tumultuous

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<sup>119</sup> "Corruption Perceptions Index 2010 Results," Transparency International, [http://www.transparency.org/policy\\_research/surveys\\_indices/cpi/2010/results](http://www.transparency.org/policy_research/surveys_indices/cpi/2010/results) (accessed April 3, 2012).

political environment. Investors are worried expenditures on physical capital might simply be lost if contracts are annulled. They should continue to pressure Iraqi parliamentarians to resolve the biggest questions and open the door to greater FDI inflows.

Third, by refusing to operate in Kirkuk Province until a referendum is held or the issue is resolved in parliament (a possibility left open by the constitution), oil companies can push the KRG and the GOI to reach an agreement. Although some companies, not including ExxonMobil, are preparing to explore in Kirkuk province, they should cease doing so until the Kirkuk question is resolved. The American government can pressure American companies that may be considering such actions.

It matters greatly that Iraq resolve the status of Kirkuk and pass a hydrocarbons law. What matters less is the actual final status of the city or the content of a hydrocarbons law. The specific details of a resolution are much less important than simply reaching a resolution in the first place. Although this paper generally supports greater autonomy for the KRG within a federal Iraq, stability and security are the most important goals for the U.S. government. American support for oil and gas firms can help push Iraq toward finally passing a hydrocarbons law and clarifying the relevant articles in its constitution. Resolving that issue and the status of Kirkuk will make Iraq a more stable state by establishing an unambiguous rule for how oil revenues should be shared.

## **PROMOTE ECONOMIC GROWTH THROUGH HYDROCARBON EXTRACTION**

U.S. government support for American oil and gas firms in Iraqi Kurdistan would spur economic growth that could lead to enhanced Iraqi security and provide much needed tax revenues for the KRG and the GOI. Investment in drilling and exploration creates jobs, boosts consumption, and could tie Iraqi Kurdistan more efficiently into the global economy. By increasing employment and social mobility, investment can also decrease the likelihood of Kurds upsetting domestic stability by committing acts of terrorism or otherwise engaging in crime or violence. Additionally, natural resource extraction is extremely profitable and readily taxable. Increased exploitation of Iraqi Kurdistan's natural resources would provide Baghdad and Erbil with revenues to spend on policing, healthcare, and education, each of which increases security and domestic stability, thereby contributing to the possible success of one of America's key goals in Iraq.

### **Drive Economic Growth**

The primary goal of any foreign firm investing in Iraqi Kurdistan is, of course, to earn a profit. Much of the revenue derived from oil and gas extraction, however, goes to the government. The KRG owns a direct equity stake in at least four drilling fields in its own name and through the Kurdistan Exploration and Production Company, a government-owned firm.<sup>120</sup>

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<sup>120</sup> "Kurdistan Oil and Gas Activity Map".

The KRG established its regional hydrocarbons law on August 6, 2007 in the absence of a nationwide agreement over revenue-sharing, the types of contracts which could be signed, and which governments had the authority to sign them. The KRG first used its self-granted authority to sign contracts when, in 2009, it came to terms with Hunt Oil, a Dallas, Texas-based company, to explore for oil in northern Ninevah Province.<sup>121</sup> This first contract was particularly contentious because the KRG has only *de facto* control over the area covered by Hunt's contract. Although the area is behind the Green Line, a boundary delineating the territory controlled by KRG, Article 140 of the Iraqi Constitution states that northern Ninevah is a disputed region and its status, like that of Kirkuk, should thus be decided by referendum.<sup>122</sup>

Erbil and Baghdad are both sensitive to oil and gas agreements because of the incredible economic growth that can be catalyzed by natural resources extraction. The KRG recently halted oil exports after the GOI withheld more than \$1.5 billion in export revenue to which Erbil believes it is entitled. The KRG collects oil revenues from Baghdad because Iraqi Kurdistan is landlocked and as yet has no pipeline connecting it to external markets. Only oil it consumes itself does not go through the Kirkuk-Ceyhan pipeline or the Basra or Khor al-Amaya terminals, all of which are controlled by the GOI. Nevertheless, oil and gas provide significant revenues and their extraction is pivotal to Iraq's continued economic rebound.

An important driver in the development of Iraqi Kurdistan's oil fields is the preferential terms granted by the KRG to oil and gas companies relative to the terms

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<sup>121</sup> Ministry of Natural Resources, Kurdistan Regional Government-Iraq, *Ain Sifi Block Kurdistan Region*, PSC Hunt Oil (Erbil, Iraq, 2009).

<sup>122</sup> *Iraq and the Kurds: Trouble Along the Trigger Line* (International Crisis Group, July 8, 2009), 1, <http://www.aina.org/reports/iatktatl.pdf> (accessed April 3, 2012).

granted by the GOI. While the GOI has signed only TSAs with foreign firms, the KRG signs PSCs. The PSC is a widely used framework for oil and gas exploration and field development in the Middle East and Central Asia, particularly in countries where the state does not have the human or physical capital to operate on its own. Saudi Arabia, for instance, does not offer PSCs to foreign firms because the Saudi Arabian Oil Company (Saudi Aramco), the state oil behemoth, has the requisite knowledge and infrastructure to search for and develop new fields.

Baghdad can offer stingy TSAs because some of the world's biggest fields had already been discovered and partially developed in the south of the country under Saddam Hussein. Little new infrastructure was required to begin pumping oil so companies were willing to take measly payments, often less than \$2 per barrel, or 4.8 cents per gallon.<sup>123</sup> In Iraqi Kurdistan, however, few known fields existed prior to 2003 because embargoes from the UN and the GOI made production for export nearly impossible.

Without pre-existing infrastructure oil firms would not sign TSAs. To make their fields more attractive to investors, the KRG needed to offer PSCs. PSCs split revenue into two main tiers: cost petroleum and profit petroleum. The first oil out of the ground is cost petroleum. Revenues derived from it are used to pay back the private operator for production (operating costs), exploration, and development, in that order.<sup>124</sup> The firm takes all the upfront risk with the understanding that it will receive a majority of revenue

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<sup>123</sup> “2nd Round Bid: The Results - 12 December 2009.”

<sup>124</sup> *Model Production Sharing Contract For Exploration and Production in Kurdistan* (Kurdistan Regional Government), 40, [http://www.krg.org/pdf/MODEL\\_PRODUCTION\\_SHARING\\_AND\\_EXPLORATION\\_PRODUCTIO\\_N\\_IN\\_KURDISTAN.pdf](http://www.krg.org/pdf/MODEL_PRODUCTION_SHARING_AND_EXPLORATION_PRODUCTIO_N_IN_KURDISTAN.pdf) (accessed April 4, 2012).

until its costs have been paid off. In Iraqi Kurdistan the operator receives 55% to 70% of revenues during this stage.<sup>125</sup>

The second stage, known as the profit petroleum stage, begins once the operator has recouped its initial investment. At this point the revenue it earns drops sharply, to 15% to 30% for crude oil and 18% to 35% for natural gas, quality dependent, according to the KRG's 2009 agreement with Hunt Oil.<sup>126</sup> In most countries, the rest of the revenue goes directly to the government's coffers.

It is a bit trickier for the KRG to claim revenues owed to it and foreign operators because the revenues are collected upon export by the GOI. If Iraqi Kurdistan were a sovereign state it would receive the balance of the revenue from profit petroleum. Under Baghdad's authority, however, petroleum revenues are doled out based on population, pending an official hydrocarbons law. Under the status quo, Iraqi Kurdistan receives 17% of oil revenue. At present it gains from this agreement because of exports from southern fields. As more of its own fields come on line it will begin to feel shortchanged. Under the Hunt agreement, the KRG receives just 11.9% to 14.45% of profit petroleum once the operator and Baghdad have each taken their share.

In the first quarter of 2012 the KRG exported just 65,000 barrels per day, although the KRG claims the central government has been skimming 25,000-35,000 bpd off the top of that figure. Ashti Hawrami, the Minister of Oil and Natural Resources for the KRG, hopes that Iraqi Kurdistan will produce 400,000 bpd by the end of 2012, 1 million

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<sup>125</sup> Ibid., 41.

<sup>126</sup> *Ain Sifi Block Kurdistan Region-Iraq*, 56.

bpd by 2014, and 2 million bpd by 2019.<sup>127</sup> If the KRG is able to maintain that growth in production, serious conflict could arise between Erbil and Baghdad if the Iraqi Parliament is unable to pass a comprehensive hydrocarbons law. Even now, the GOI is withholding both cost and profit petroleum revenues from the KRG, leaving many investors, particularly Norway's DNO, scrambling to recoup investment costs. The GOI has yet to transfer a single cent to the KRG in 2012.<sup>128</sup>

It is worrying that firms are not receiving payments for cost petroleum produced because the ramifications extend far beyond the government's revenue base. Production is a labor-intensive process and much of that labor is trained and hired on site.<sup>129</sup> The number of local jobs created can prove a boon to the local economy and can help to counteract the negative image that oil firms often garner, sometimes fairly, as extractive raiders. The Iraqi Oil Ministry estimates that 100,000 local jobs will be created from TSAs signed for extraction in West Qurna-1, a field with reserves of a similar size to all of those in Iraqi Kurdistan put together. If all Iraqi Kurdish fields were exploited it could be reasonably expected that more than 100,000 new jobs would be available due to the more labor-intensive nature of PSCs.

That many new jobs would prove hugely beneficial in Iraqi Kurdistan. The region has fewer than 5 million residents and an official unemployment rate of 14%.<sup>130</sup> New jobs and training, combined with a KRG law which requires that at least 75% of employees at private-sector firms hold Iraqi citizenship, will help relieve complaints about the Iraqi

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<sup>127</sup> Kurdistan to Produce 400,000 Bpd by End-2012, *Iraq Business News*, March 12, 2012. <http://www.iraq-businessnews.com/2012/03/12/kurdistan-to-produce-400000-bpd-by-end-2012/> (accessed April 4, 2012).

<sup>128</sup> Ibid.

<sup>129</sup> *Oil and Gas Production* (Library of Congress Business Reference Services, 2005), <http://www.loc.gov/rr/business/BERA/issue5/production.html> (accessed April 3, 2012).

<sup>130</sup> Kurdistan Regional Government population data, May 2010.

Kurdish labor force's lack of "skills, experience, and worth ethic"<sup>131</sup> that currently plague the Ministry of Labor and Social Affairs' efforts to attract FDI. Further benefits would be derived from increased ties to the global economy, particularly if construction begins on the proposed Nabucco pipeline (discussed in detail in chapter 5), which would connect Iraqi Kurdistan to European gas markets via southeastern Turkey and the Central European Gas Hub in Baumgarten an der March, Austria.<sup>132</sup>

### Enhance Domestic Security

Most important for American interests is the impact that economic growth and job creation can have on Iraqi security and stability. Although Iraqi Kurdistan can hardly be called a hotbed of extremism it has not been immune to political upheaval and violence. The worry in Iraqi Kurdistan is not that a foreign terrorist group will use the region as a base for an attack on America or of one its allies, but that internal conflict or violence between Iraqi Kurds and Arabs could pull the United States back into the country. The most troubling aspects for Iraqi Kurdistan's security and stability are its demography (it is young), its geography (it is landlocked), and its relationship with Baghdad (it bargains from a weak position). Each of these issues can be mollified through the development of its oil and gas industry.

More than half of Iraqi Kurds are under the age of 20.<sup>133</sup> Only three countries outside of sub-Saharan Africa (Yemen, Laos, and Guatemala) are younger.<sup>134</sup> Without boosting

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<sup>131</sup> Aiyob Mawloodi, "A Chaotic Kurdistan Labor Market," *Kurdish Globe*, June 26, 2010. <http://www.kurdishglobe.net/displayArticle.jsp?id=80B2AAF682BAB5BF2AD3A7D719276907> (accessed April 4, 2012).

<sup>132</sup> Andra Timu and Ercan Ersoy, "Nabucco Says Iraq Probably 'Most Real' Supplier for Natural Gas Pipeline," *Bloomberg*, September 30, 2010. <http://www.bloomberg.com/news/2010-09-30/nabucco-says-iraq-probably-most-real-supplier-for-natural-gas-pipeline.html> (accessed April 4, 2012).

<sup>133</sup> Kurdistan Regional Government population data, May 2010.



employment and social mobility many of these youths could end up disaffected. The Arab Spring has shown that civil unrest can occur in Iraqi Kurdistan.<sup>135</sup> Worryingly, protests in some towns induced clashes between supporters of the KDP and the PUK. Civil war in Syria has also adversely affected stability.<sup>136</sup>

The KRG has stipulated in its PSCs that foreign companies must train and employ a local workforce.<sup>137</sup> Ensuring continued growth in employment opportunities in the oil and gas industry will be crucial to providing work for the one million or more youths who will transition into the labor force in the next decade. Many of them will otherwise end up unemployed, underemployed, or in the informal sector where work is often ephemeral.

Crime is causally connected to both economic growth and income inequality. Economic growth can decrease crime rates, but an increase in income inequality can have the opposite effect.<sup>138</sup> For that reason, it is crucial that oil and gas exploration and production create as many local jobs as possible at all levels of the production process. Additionally, extraction revenues could prove a serious boon to the KRG if it were able to recoup them from Baghdad. Cardenas and Rozo showed in a 2008 paper for the World Bank that expenditures on public security, healthcare, and education are particularly

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<sup>134</sup> “CIA World Factbook,” Central Intelligence Agency, <https://www.cia.gov/library/publications/the-world-factbook/fields/2177.html> (accessed April 5, 2012).

<sup>135</sup> Mohammed Raja, “In Iraqi Kurdistan, Some Call For Arab Spring,” *UPI*, February 23, 2012. [http://www.upi.com/Top\\_News/Special/2012/02/23/In-Iraqi-Kurdistan-some-call-for-an-Arab-Spring/UPIU-1271329361880/](http://www.upi.com/Top_News/Special/2012/02/23/In-Iraqi-Kurdistan-some-call-for-an-Arab-Spring/UPIU-1271329361880/) (accessed April 4, 2012).

<sup>136</sup> Roy Gutman, “Syrian Military Kills Civilians in Reprisals, 'executes Own Troops,' Defectors Say,” *Boston Herald*, April 3, 2012. [http://www.bostonherald.com/news/international/middle\\_east/view/20120403syrian\\_military\\_kills\\_civilians\\_in\\_reprisals\\_executes\\_own\\_troops\\_defectors\\_say/srvc=home&position=recent](http://www.bostonherald.com/news/international/middle_east/view/20120403syrian_military_kills_civilians_in_reprisals_executes_own_troops_defectors_say/srvc=home&position=recent) (accessed April 4, 2012).

<sup>137</sup> *Model Production Sharing Contract For Exploration and Production in Kurdistan*.

<sup>138</sup> Francois Bourguignon, *The Poverty-Growth-Inequality Triangle* (The World Bank, 2004), 3.

influential in reducing crime.<sup>139</sup> The KRG provides these services in Iraqi Kurdistan with little support from Baghdad.

Increased security initiates a virtuous cycle of increased FDI, economic growth, and even more security. Investment by the private sector in Iraqi Kurdistan's oil and gas industry and investment by the KRG in policing, healthcare, and education will be crucial to encouraging long-term growth, maintaining stability, and adequately dealing with the coming boom in the size of the labor force. Achieving both security and economic growth will be key to ensuring Iraq's Kurds a bright future.

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<sup>139</sup> Mauricio Cardenas and Sandra Rozo, *Does Crime Lower Growth? Evidence from Colombia* (International Bank for Reconstruction and Development, 2008).

## MAINTAIN AMERICAN INFLUENCE

The U.S. Embassy in Baghdad houses more than 2,000 diplomats and 14,000 contractors. A \$750 million price tag and 104-acre campus make it the world's largest diplomatic mission. It is clear that the United States has a keen interest in maintaining a strong presence in Iraq and must use diplomatic and commercial channels to do so in the absence of American forces.

Yet in recent months the U.S. government has admitted it is struggling to leverage the mission effectively and announced plans to cut the number of contracted staff by half.<sup>140</sup> Kenneth M. Pollack, Director of Research at the Saban Center for Middle East Policy, noted "It's increasingly becoming clear that [the U.S. Embassy in Baghdad is] horribly overstaffed given what [it is] able to accomplish."<sup>141</sup> The State Department has categorically failed to establish the relationships necessary to maintain a strong presence in Baghdad. The departments of defense and state did not ensure a seamless transition upon the troops' departure. Contacts between high-level Iraqi officials and American military officers were often lost once ground forces left the country.

Additionally, Iraqis remain nervous about America's intentions. Ammar al-Hakim, leader of the Shi'a Islamic Supreme Council of Iraq, asks of the American diplomatic corps: "What is the relationship [between the U.S. and Iraq]? We're still waiting for more

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<sup>140</sup> Tim Arango, "U.s. Is Planning to Slash Iraq Embassy Staff by as Much as Half," *New York Times*, February 7, 2012. <http://www.nytimes.com/2012/02/08/world/middleeast/united-states-planning-to-slash-iraq-embassy-staff-by-half.html?pagewanted=all> (accessed April 5, 2012).

<sup>141</sup> Ibid.

information.”<sup>142</sup> Communication failure has led many Iraqis, including Iraqiyya parliamentarian Nahida al-Dayni, to believe “The US had something on their mind when they made [the embassy] so big. Perhaps they want to run the Middle East from Iraq, and their embassy will be a base for them here.”<sup>143</sup> The limited success of America’s diplomats should call for a rethink about how the U.S. might achieve its foreign policy objectives.

American firms operating in Iraq’s oil and gas industry are a crucial resource that can be used to maintain influence in the country. They forged strong ties with Iraqi officials in Baghdad, Erbil, and elsewhere and their ability to stimulate the economy far exceeds that of the American embassy, no matter how many chicken wings the diplomats source locally.<sup>144</sup> By 2017 Iraq plans to produce 12 million bpd of oil, worth \$1,238 million at the NYMEX crude futures rate (as of April 5, 2012),<sup>145</sup> most of which will be drilled and refined by foreign companies. To put that figure into perspective, a 2006 article by Bilmes and Stiglitz concludes that the U.S. government spent \$720 million each day during the first three years of the Iraq War.<sup>146</sup>

Oil and gas firms will have more influence than American diplomats on Iraq’s future, its economy, and its governance. The U.S. should leverage American firms operating in Iraq to maintain influence and reinforce Iraq’s stability and territorial integrity. The rest of this chapter is broken down into three case studies. The first describes American independents with strong ties in Iraqi Kurdistan. The second details ExxonMobil’s

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<sup>142</sup> Ibid.

<sup>143</sup> Ibid.

<sup>144</sup> Ibid.

<sup>145</sup> “Energy and Oil Prices,” Bloomberg, <http://www.bloomberg.com/energy/> (accessed April 5, 2012).

<sup>146</sup> Linda Bilmes and Joseph E. Stiglitz, “The Economic Costs of the Iraq War: An Appraisal Three Years After the Beginning of Conflict,” *KSG Working Paper No. 06-002* (January 2006): 1, [http://papers.ssrn.com/sol3/papers.cfm?abstract\\_id=832646](http://papers.ssrn.com/sol3/papers.cfm?abstract_id=832646) (accessed April 6, 2012).

operations in Iraq and the overriding influence of the supermajors. The third, about Norway's DNO and Peter Galbraith, a former Bush administration official, serves as a warning that government meddling, either real or perceived, can backfire and prove detrimental to achieving policy goals.

### **Independents with Local Ties: Marathon, Hunt, and Hess**

Before ExxonMobil inked a deal with the KRG in October 2011, only smaller American independents operated in the region. Marathon Oil acquired four exploration tracts in October 2010. Two of their wells have struck oil thus far. Hunt Oil, which refers to Iraqi Kurdistan as simply "Kurdistan" under the "Countries" tab on its website, and Hess Corporation, which operates two exploration zones at Dinarta and Shakrok, have also signed contracts with the KRG.

The decision to operate within Iraqi Kurdistan was rather simple for the independents. They lack the economies of scale necessary to pump supergiants (fields with more than 5 billion barrels of proven reserves) at the prices offered by the GOI's servicing agreements. Losing out on the opportunity to bid on GOI contracts was not too concerning given the preferential terms offered by the KRG and the paucity of supermajors in Iraqi Kurdistan at the time.

While smaller than the supermajors, the independents operating in Iraqi Kurdistan are large firms. Marathon, the fourth-largest American oil company, set a \$5,267 million capital, investment, and exploration budget for 2011, a sizable portion of which was slated to be spent in Iraqi Kurdistan.<sup>147, 148</sup> And while independents operating in Iraqi

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<sup>147</sup> "Marathon Oil Announces Discovery in the Kurdistan Region of Iraq," Marathon Oil, [http://www.marathonoil.com/News/Press\\_Releases/Press\\_Release/?id=651814](http://www.marathonoil.com/News/Press_Releases/Press_Release/?id=651814) (accessed April 6, 2012).

Kurdistan do not have contacts in Baghdad they perform an important role by providing the infrastructure, equipment, and human capital requisite for the KRG to develop its own oil and gas industry. Had smaller independents not proven the profitability of Kurdistan's reserves, supermajors such as ExxonMobil and Total would not have risked big (but barely profitable) contracts with the GOI to follow in their footsteps.

Leveraging the power of independent firms would be a useful "pure play" on the KRG. Since Marathon, Hunt, and Hess do not operate in any fields controlled by the GOI, support for those firms' operations will directly benefit the KRG at the behest of the United States and provide the regional government with its own leverage to use in negotiations with Baghdad.

### **Enter the Supermajor: ExxonMobil**

Relations between the GOI and the KRG festered but did not worsen after the first independents signed on to explore for oil in Kurdistan in 2009. Baghdad seemed content to allow the KRG to sign its own contracts so long as the revenues flowed through the capital. The GOI also possessed few means to stop it.

That all changed when ExxonMobil became the first oil company operating in the south to sign an exploration agreement with the KRG. Prime Minister Nouri al-Maliki, Oil Minister Abdul-Kareem Luaibi, and Deputy Prime Minister for Energy Hussain al-Shahristani immediately blasted the deal. In November 2011 Shahristani stated:

ExxonMobil has written to the Iraqi government about [its contract with the KRG] and they have received the response from the ministry of oil and the prime minister's office that contracts will not be recognized unless they are approved by the Iraqi government...In this particular case, there is a breach of laws and the Iraqi

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<sup>148</sup> "Marathon Sets 2011 Capital, Investment and Exploration Budget," Marathon Oil, [http://www.marathonoil.com/News/Press\\_Releases/Press\\_Release/?id=651838](http://www.marathonoil.com/News/Press_Releases/Press_Release/?id=651838) (accessed April 6, 2012).

government is considering its actions...In the [West Qurna-1] contract there is a very clear article that the company has to respect all the Iraqi laws, rules and regulations.<sup>149</sup>

Shahristani suggested that Exxon's breach of Iraqi laws could lead to the cancellation of its servicing contract in the West Qurna-1 field, although it is uncertain which law, if any, Exxon actually broke. Iraqi energy and political analysts agree that Exxon and the KRG are operating in a legal grey area. The constitution gives the KRG the right to sign its own contracts but Baghdad argues it is illegal for the KRG to do so in the absence of a comprehensive hydrocarbons law. For now, the KRG and ExxonMobil continue to move ahead with the deal. Although Exxon has been barred from participating in the next round of TSA bidding, it has not yet had its West Qurna-1 TSA cancelled.

Supporting ExxonMobil is riskier politically but is also the best way to push the KRG and the GOI closer to agreement on a hydrocarbons law and the status of Kirkuk. ExxonMobil sought the advice of the State Department and, according to department spokeswoman Victoria Nuland, "We asked them to wait for national legislation. We told them we thought that was the best course of action."<sup>150</sup> It would likely be in the best interests of America's goals in Iraq, however, if ExxonMobil were to take the opposite approach.

Exxon's deal with the KRG will certainly provoke verbal conflict in the short-term, as it already has. Yet in the long-term it is more likely to force the KRG and the GOI to settle the two legislative issues that have plagued governance since 2007. Refraining

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<sup>149</sup> Grant Smith, "Iraq Has Told Exxon It's in Breach of Laws, Shahristani Says," *Bloomberg*, November 22, 2011. <http://www.bloomberg.com/news/2011-11-22/iraq-has-told-exxon-it-is-in-breach-of-laws-shahristani-says.html> (accessed April 6, 2012).

<sup>150</sup> U.S. Warned Exxon About Iraq, *UPI*, November 23, 2011. [http://www.upi.com/Business\\_News/Energy-Resources/2011/11/23/US-warned-Exxon-about-Iraq/UPI-92751322054875/](http://www.upi.com/Business_News/Energy-Resources/2011/11/23/US-warned-Exxon-about-Iraq/UPI-92751322054875/) (accessed April 6, 2012).

from developing Kurdistan's fields now would put the regional government at a serious disadvantage in future negotiations with Baghdad.

OPEC output limits include Iraq but the country itself is not restricted to a certain level of production, as all other OPEC members are except Angola.<sup>151</sup> Since 1991 the country has been permitted to produce as much oil as possible, but this will not be the case for much longer. Iraq's plan to produce 12 million bpd by 2017 is staggering, even by OPEC's standards. Although production quotas fluctuate as market conditions change, the entire OPEC target output level has never exceeded 30 million bpd.<sup>152</sup> OPEC would certainly not increase its target output to 42 million bpd as this would cause an undesirable (from OPEC's perspective) drop in the price of crude oil. Nor will OPEC push output from other countries down to 18 million bpd to accommodate increased Iraqi production. The most likely outcome is an intermediate option that provides for an increase in both Iraqi production and OPEC's target output level but to a total far less than 42 million bpd.

Iraqi Kurds worry their fields will be left unexplored and undrilled when OPEC limits are reinstated. From a purely economic perspective it makes sense for Iraq to pump all of its allowable output from preexisting wells in the south of the country. From a political perspective it makes sense for a Shi'a-led government in Baghdad to do the same thing to consolidate power in the capital. If Iraq increases production quickly enough it will be able to satisfy its entire output quota through its southern fields, effectively sealing the

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<sup>151</sup> "Member Countries' Crude Oil Production Allocations," Organization of Petroleum Exporting Countries, [http://www.opec.org/opec\\_web/static\\_files\\_project/media/downloads/data\\_graphs/ProductionLevels.pdf](http://www.opec.org/opec_web/static_files_project/media/downloads/data_graphs/ProductionLevels.pdf) (accessed April 7, 2012).

<sup>152</sup> Ibid.



KRG off from the country's massive oil wealth under the guise of OPEC limits. This could prove antithetical to American interests by allowing too much centralization in a country that must exist federally to exist peacefully.

### **A Cautionary Tale: DNO & Peter Galbraith**

Government influence through American multinationals can be a useful tool, but it can also be dangerous if it is too heavy-handed, controversial, or both. A particularly egregious example that did not even include the direct participation of a government official is Peter Galbraith, a former American diplomat, advisor to the KRG, and consultant to Norwegian oil firm DNO.

Galbraith has been an ardent supporter of Kurdish rights since he first uncovered Saddam Hussein's genocidal decimation of Kurdish towns in 1987. He was pivotal to the passage of the Prevention of Genocide Act of 1988, meant to sanction Hussein's regime, although the bill was vetoed by Ronald Reagan. He also served as a staff member on the Senate Committee on Foreign Relations and as the first U.S. Ambassador to Croatia.

Controversy arose when the ex-diplomat held potentially conflicting positions during the early post-invasion period. From 2003 to 2005 he served as an advisor to the KRG on negotiations with the GOI over drafting the TAL and a new constitution. An ardent federalist, Galbraith was instrumental in establishing the mindset that the Kurdish constitution should trump the Iraqi constitution in all conflicting statements.

Galbraith, however, consulted for the Norwegian oil firm DNO at the same time he consulted for the Kurdish government. He owned a 5% share (split with Yemeni investor Shahir Abd al-Haqq) of DNO's operations in the Tawke field from 2004 to 2008. His ownership stake was brought to light only in 2008 by the Norwegian newspaper *Dagens*

*Naeringsliv* after he was squeezed out of the agreement in a new contract signed between DNO and the KRG. He filed a lawsuit against DNO for \$500 million and eventually settled out of court for \$92 million.

Although Galbraith was not employed by the U.S. government at the time and maintains that he never had conflicting interests between his status as an ex-diplomat and his consulting arrangements with the KRG and DNO, the incident damaged America's ability to influence Iraqi business and policy without being seen as a meddling superpower. Government strategists should take note of that scenario when considering how to successfully leverage the power of American firms in Iraqi Kurdistan.

## HOW IT SHOULD BE DONE

The preceding chapters have detailed how American oil and gas firms can help the U.S. achieve its foreign policy goals in Iraq. This final chapter will discuss three specific policy tools the U.S. can use to leverage the power of private companies.

**Utilize the United States-Kurdistan Business Council (USKBC).** The USKBC was founded on April 3, 2012 during Massoud Barzani’s visit to Washington mentioned in the introduction to this paper. An American-based non-profit, its stated goal is to “work closely with the U.S. Government to ensure that it continues to support the development of the Kurdistan Region as a secure, stable and economically prosperous region in Iraq.”<sup>153</sup> It also “believes promoting stronger ties between the U.S. and Kurdistan is important to the stability of Iraq and the region.”<sup>154</sup> Marathon Oil and the Hunt Family of Companies (parent of Hunt Oil) are founding board members.

Although the USKBC does not have any specific initiatives planned yet, it hopes to hold events and discussions between businesses and the KRG, establish trade missions, and offer legal advice and counsel. Crucially, it will also “pursue policy initiatives in order to strengthen investment and business opportunities.”<sup>155</sup> The U.S. government should endorse USKBC policy initiatives it believes will lead to a resolution of the Kirkuk question or the passing of a hydrocarbons law.

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<sup>153</sup> “Our Goals,” United States-Kurdistan Business Council, <http://uskbc.org/our-goals> (accessed April 9, 2012).

<sup>154</sup> “About Us,” United States-Kurdistan Business Council. <http://uskbc.org/about-us> (accessed April 9, 2012).

<sup>155</sup> “Services,” United States-Kurdistan Business Council, <http://uskbc.org/services> (accessed April 9, 2012).

**Expand government-sponsored business initiatives.** A multitude of initiatives exist for promoting American firms abroad. Those specific to Iraq include the U.S. Business Council in Iraq, U.S. Chamber of Commerce Iraq Business Initiative, National U.S. Arab Chamber of Commerce, Bilateral U.S. Arab Chamber of Commerce, and U.S. Department of Commerce Iraq Task Force. The U.S. Department of Commerce Business Trade Mission in Erbil is a KRG-specific initiative.

Each of these initiatives performs functions devoted to helping American businesses succeed in Iraq. For example, the Department of Commerce's International Trade Administration has an office in Iraq that provides market intelligence, products and services promotion, Iraqi business contact development, and advocacy support from the U.S. government for American firms. According to the International Trade Administration's website, the U.S. government "advocates with the Iraqi government in support of U.S. firms to help win the deal"<sup>156</sup> after making "a national interest determination to identify whether the project qualifies for [U.S. government] support."<sup>157</sup> Projects that achieve the goals stated in this paper should qualify and be granted advocacy and financial support.

**Host another conference on doing business in Iraq.** Finally, the U.S. government should host another U.S.-Iraq Dialogue on Business and Investment Climate, a meeting it originally held in November 2008. The security situation in Iraq improved dramatically starting in 2009, making Iraq a much more attractive place for FDI. An event specifically for oil and gas firms could be used as a forum for the U.S., the KRG, and the GOI to

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<sup>156</sup> "USGC Advocacy Support," U.S. Commercial Service, [http://export.gov/iraq/usproducts/eg\\_iq\\_038633.asp](http://export.gov/iraq/usproducts/eg_iq_038633.asp) (accessed April 9, 2012).

<sup>157</sup> Ibid.

detail policy proposals and for companies to air their grievances with Iraq's investment climate.

Although none of the above policy options are guaranteed to work, they are the best choices for a government attempting to influence private sector actors to help it achieve its goals. By utilizing these and other commercial policies the United States can maintain influence in Iraq, domestic stability, regional stability, and territorial integrity.

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