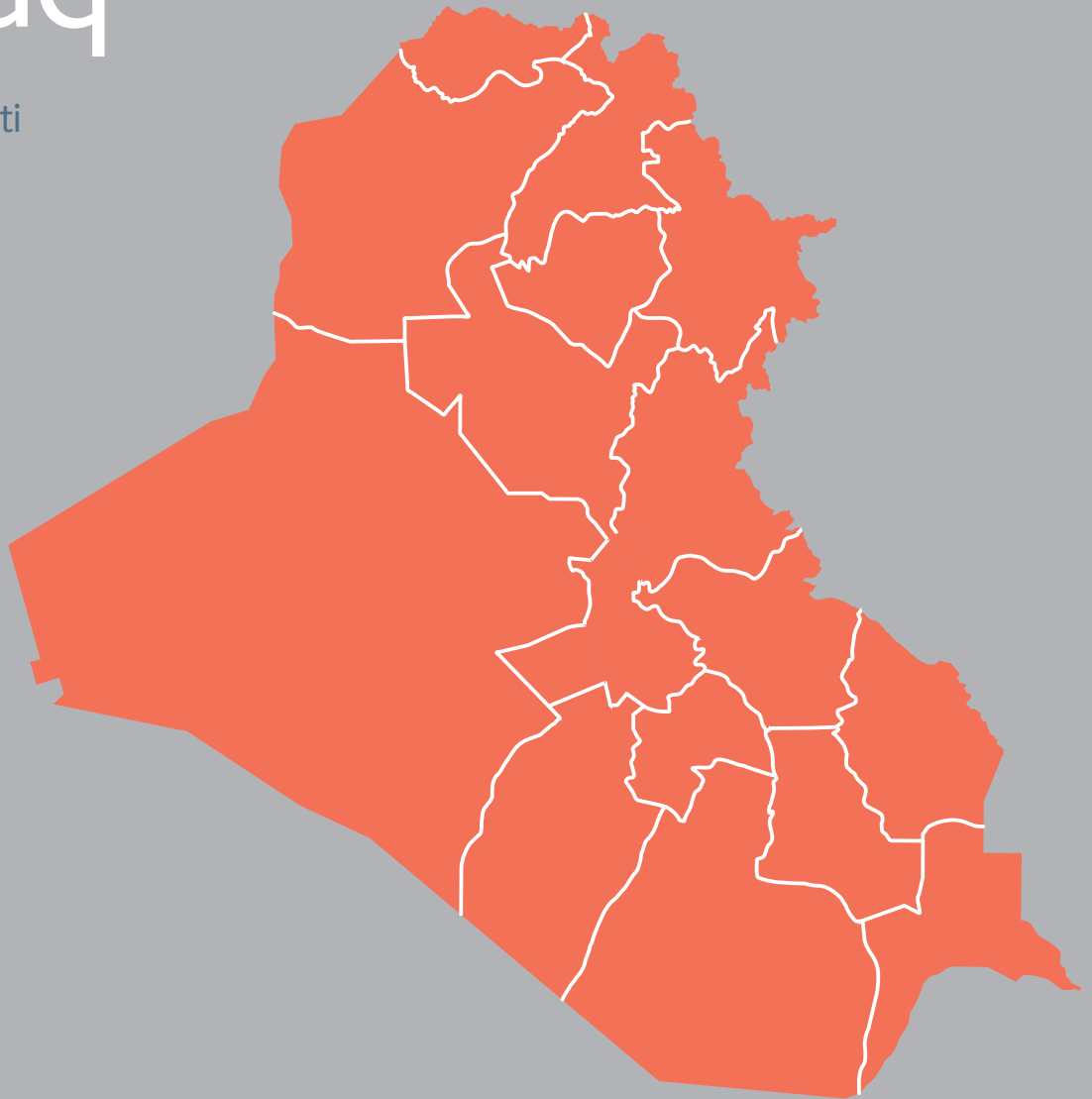


Oil and Gas Revenue Sharing in Iraq

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This case study is part of a series of country case studies describing how resource revenue are shared by national governments with subnational authorities.

Table of relevant Iraqi laws

| LEGISLATION NO. | NAME/DESCRIPTION | YEAR OF PUBLICATION |
|--------------------|--|---------------------|
| | Law of Administration for the State of Iraq for the Transitional Period | 2005 |
| | Constitution | 2005 |
| Law No. 22 of 2007 | Oil and Gas Law of the Kurdistan Region-Iraq | 2007 |
| Law No. 21 of 2008 | Law of Governorates Not Incorporated Into a Region | 2008 |
| Law No. 18 of 2010 | Law of Dissociation of the Ministry of Labor and Social Affairs' Local Departments | 2010 |
| | 2010 State Budget Law | 2010 |
| | 2013 State Budget Law | 2013 |
| | 2015 State Budget Law | 2015 |

Summary

This study provides an overview of Iraq's oil and gas revenue sharing, that is, the revenue that the Iraq national government earns from extraction and then redistributes to subnational—provincial and regional—governments. It outlines the country's attempts at fiscal decentralization and provides an overview of how resource revenues are collected and then shared with subnational governments. The study also provides information on any statutory earmarks on the revenue, and the level of transparency surrounding the revenue sharing system. It is primarily intended to inform policy debates on revenue sharing in Iraq and other countries, as well as to assist researchers interested in further exploring key issues related to this topic. It forms part of a broader set of country case studies on revenue sharing.

In 2015, Iraq had 144 billion barrels of proven oil reserves, the fifth largest in the world,¹ and almost 112 trillion cubic feet of proven natural gas reserves, the 12th largest in the world.² The country is highly dependent on oil production: in 2015, the Iraqi federal government (hereafter referred to as the IFG) estimated that USD 67.8 billion (or 84 percent) of its total budgeted revenue for that year would come from the oil and gas sector.³

Iraq is a federal country comprising 18 governorates. Fifteen governorates are administered by provincial governments and three are administered by the Kurdistan Regional Government (hereafter referred to as the KRG). The country's largest oil reserves are located in the governorate of Basrah⁴, the disputed governorate of Kirkuk⁵ and the autonomous region of Kurdistan.

The amount of revenue shared is determined annually through the country's state budget law (SBL) and thus subject to yearly modifications and approval by the parliament. Oil revenue is combined with other revenues in the budget, but distribution to subnational governments takes derivation⁶ into account through petrodollar allocation. Other than the country's budget law, which is drafted annually, there is no separate statutory system for sharing oil revenue with subnational government, although the KRG collects payments from the production sharing contracts (PSCs) it enters into.⁷

1 OPEC Iraq Country Profile (OPEC Annual Statistics Bulletin 2014), and Resource Governance Index, Iraq Country Profile (Natural Resource Governance Institute, 2012). The four largest oil reserves in the world are in Saudi Arabia, Venezuela, Canada and Iran.

2 U.S. Energy Information Administration, *Iraq Country Overview* (January 30, 2015), available at <http://www.eia.gov/countries/cab.cfm?fips=iz>.

3 Based on an estimated oil price of USD 56 per barrel and an export volume of 3.3 million barrels a day. Source: 2015 Iraq State Budget Law

4 Recently, Basrah has moved to partial autonomy by earmarking revenues from two oil fields for projects in the province. For details see http://www.iraqoilreport.com/news/basra-pushes-toward-financial-autonomy-18400/?utm_source=IOR+Subscribers&utm_campaign=c99ff94598-Email_Update&utm_medium=email&utm_term=0_f9870911e6-c99ff94598-192870637

5 Under Iraq's constitution of 2005, the political status of the disputed governorate of Kirkuk was scheduled to be formally resolved by the end of December 2007 by census and referendum "to determine the will of their citizens." This deadline has been postponed and the issue has never been resolved, although the constitutional obligation to resolve the issue remains in place. The key dispute is around whether Kirkuk should be part of an enlarged autonomous region or Kurdistan, which the KRG and Kurds support; Arabs fear this would de facto disintegrate the country and pave the way for an independent Kurdistan.

6 Applying a derivation mechanism to resource revenue sharing means that the amount of oil and gas revenue allocated to subnational governments is a function of their production levels.

7 KRG oil sales are made in defiance of Baghdad, which says that independent oil sales undermine the sovereignty of the country.

Overall, the main sources of revenue for the governorates are the Regional Development Program (RDP) transfers, petrodollar allocations and KRG transfers. The RDP, which has been part of the budget since 2010, is distributed among the 18 provincial governments (including those within the KRG).⁸ Allocations are based on governorates' population.⁹ The purpose of the RDP is to finance the reconstruction and development of projects in all the governorates of Iraq. Between 2011 and 2015, the RPD allocations have fluctuated substantially year-on-year.

The petrodollar allocation introduced in 2010 and implemented from 2011, was amended in June 2013 as part of the provincial law providing a USD 5 allocation per barrel for each producing region. This was translated in the most recent budget year of 2015 to an allocation of USD 2 to governorates for each barrel of oil produced, for each barrel refined, and for each 150 cubic meters of natural gas produced, of which the equivalent amount of the USD 1 will be transferred and the other half will be contingent of getting additional revenues.¹⁰ The 2015 SBL article stipulates that an accounting regularization will be made in 2016 to secure the remaining share of USD 3 for each producing governorates. Excluded from this allocation are the governorates of the KRG, who benefit from a separate share allocated to the region, as well as non-producing governorates of Diyala and Karbala.¹¹ Overall, since they were first introduced, petrodollars allocations have been relatively more stable year-on-year than RDP transfers, but they are uneven in per-capita terms and disproportionately reward oil and gas producing and refining areas such as the governorates of Basrah and Kirkuk. (See Table 1.)

Transfers to the KRG have been part of the budgeted expenditure since 2008 (with the exception of 2014, when the IFG halted payments to the region following disputes with the KRG government) and are supposed to be 17 percent of the total budget. This corresponds to the share of KRG population in Iraq at the time the KRG share was negotiated with the IFG.

Other than intergovernmental transfers, governorates do not levy direct taxes on oil and gas operations, with the exception of the KRG. Through PSCs, the KRG exports and commercializes part of its oil independently and collects receipts from oil sales as well as payments—such signature bonuses, corporate income tax and royalties—from operators active in the autonomous region.

Overall, excluding federal ministries, the KRG is the entity that benefits the most from the IFG's yearly budgeted expenditures.¹² But there are important gaps of information on the amount received by the region and methodology used to share with its provinces.

8 Since Halabja is not recognized as a separate governorate by the IFG, it does not receive an allocation as part of the RDP but is supposed to receive revenue indirectly through Sulaymaniyah.

9 2015 SBL, Article 2.D.

10 2015 SBL, Article 2.E.

11 Ahmed Mousa Jiyad (2015), 35

12 UN Iraq Joint Analysis Unit, *Low Oil Prices Put Iraq's Budget Under the Guillotine: A comparative Analysis of the 2013 Federal Budget and the Approved Budget for 2015* (Analysis Paper) 14-15.

Table 1. *De jure* Regional Development Program and petrodollar allocations in 2015¹³

| Governorate | Area in sq. km | 2011 population estimate* | RDP allocation (USD million) | Per capita RDP allocation (USD)* | Petrodollar allocation (USD million) | Per capita petrodollar allocation (USD) |
|---------------|----------------|---------------------------|------------------------------|----------------------------------|--------------------------------------|---|
| Ninewa | 37,323 | 3,270,422 | 307 | 93.87 | 13 | 4.0 |
| Kirkuk | 9,679 | 1,395,614 | 120 | 85.98 | 213 | 152.6 |
| Diyala | 17,685 | 1,443,173 | 130 | 90.08 | - | 0.0 |
| Anbar | 138,288 | 1,561,407 | 139 | 89.02 | 1 | 0.6 |
| Baghdad | 4,555 | 7,055,196 | 657 | 93.12 | 39 | 5.5 |
| Babil | 5,119 | 1,820,673 | 160 | 87.88 | 8 | 4.4 |
| Kerbela | 5,034 | 1,066,567 | 97 | 90.95 | - | 0.0 |
| Wasit | 17,153 | 1,210,591 | 108 | 89.21 | 82 | 67.7 |
| Salah al-Deen | 24,075 | 1,408,174 | 121 | 85.93 | 108 | 76.7 |
| Najaf | 28,824 | 1,285,484 | 119 | 92.57 | 7 | 5.4 |
| Qadisiya | 8,153 | 1,134,313 | 104 | 91.69 | 8 | 7.1 |
| Muthanna | 51,740 | 719,069 | 68 | 94.57 | 6 | 8.3 |
| Thi-Qar | 12,900 | 1,836,181 | 172 | 93.67 | 49 | 26.7 |
| Missan | 16,072 | 971,448 | 92 | 94.70 | 75 | 77.2 |
| Basrah | 19,070 | 2,531,997 | 231 | 91.23 | 896 | 353.9 |
| Dohuk | 6,553 | 1,128,745 | 92 | 81.51 | - | 0.0 |
| Erbil | 15,074 | 1,612,692 | 136 | 84.33 | - | 0.0 |
| Sulaymaniyah | 17,023 | 1,878,764 | 151 | 80.37 | - | 0.0 |
| Total | 435,052 | 33,330,510 | 3,004 | | 1,505 | |

*In 2015, the total amount budgeted for the petrodollar allocation was USD 3 billion. USD 1.5 billion of that amount was only to be transferred to governorates if the IFG received additional funds, i.e. contingency budget.¹³

There is very little transparency at the national, regional and governorate levels on amounts transferred and spent. At the national level, the only information publicly available is the annual state budget law, published at the beginning of each year. This discloses the formula for transfers, but the actual amounts to be transferred are unavailable at the national level. At the subnational level, provincial governments and KRG do not systematically disclose data on transfers received by the IFG and how the funds are spent.

This makes it difficult to ascertain receipt, use and impact of revenue at subnational levels.

There are earmarks on the use of RDP (i.e., for reconstruction and development projects) and petrodollar allocations (i.e., environmental management and meeting provincial economic and electricity import needs). There are also directives on some of KRG spending that is set in the IFG budget. (In 2015, these included apportioning funding for the newly created governorate of Halabja and prioritizing areas adversely affected by the production and refinement of oil, as well as to environmental protection and construction projects.) Yet, without information on amounts shared and spent, it is difficult to determine if earmarks are followed and to determine what impact they have.

¹³ Ahmed Mousa Jihad, *Iraq Extractive Industry: Legal, Fiscal, and Revenue Allocation and Management Issues* (2015), 35; <http://www.geohive.com/cntry/iraq.aspx>.

Introduction

As of January 2015, Iraq held about 18 percent of proven crude oil reserves in the Middle East and almost 9 percent of global crude oil reserves.¹⁴ Some of the foreign companies operating in the country are BP, China National Petroleum Corporation (CNPC), Shell, Petronas, Total, ExxonMobil, Petrochina, Lukoil, Eni, China National Offshore Oil Corporation and Japex.¹⁵ Iraq’s State Organization for Marketing of Oil (SOMO) is the country’s national oil company, in charge of collecting and exporting the country’s oil.

The most significant oil fields in Iraq are in the north (in the autonomous region of Kurdistan and in the Kirkuk governorate), and in the Basrah governorate, located in the southeast part of the country. Except for the governorates of Diyala and Karbala, all governorates produce oil or gas. (See Figure 1.)

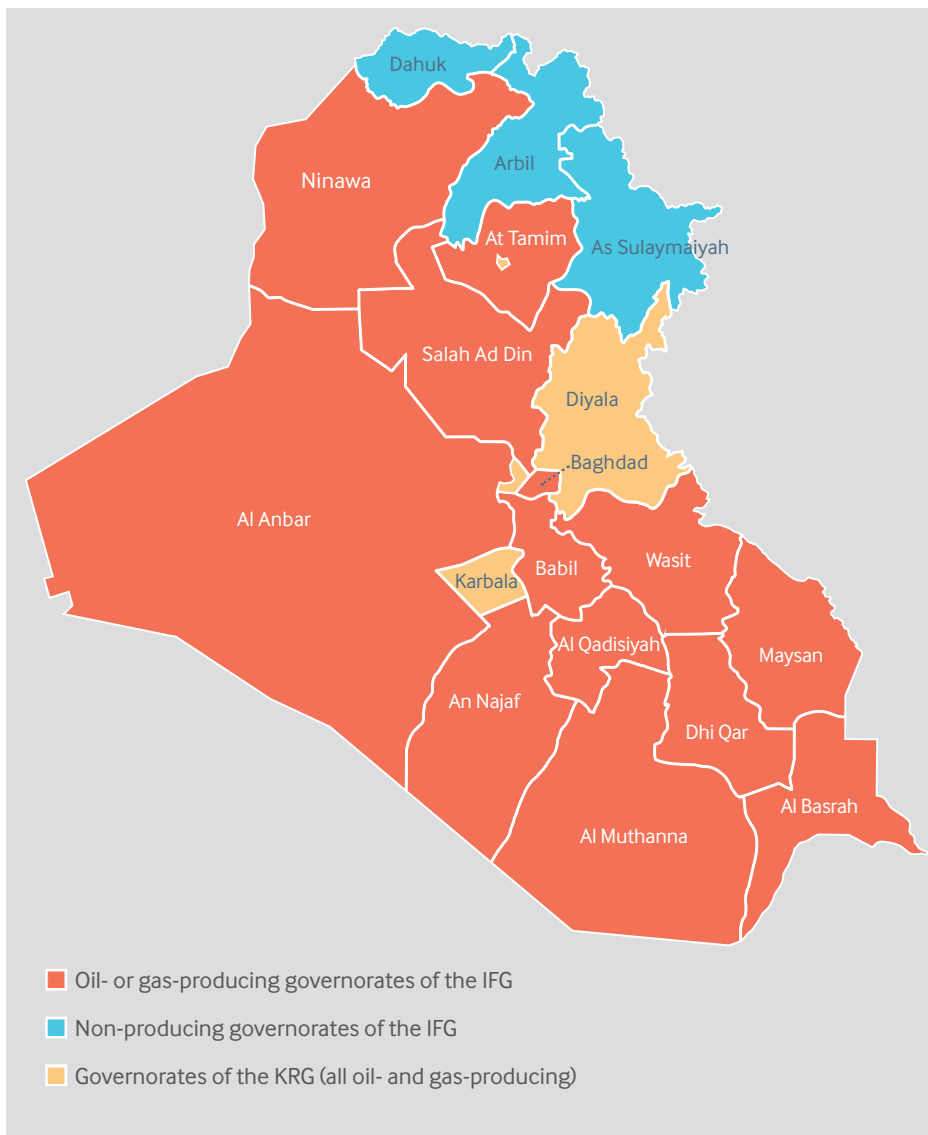


Figure 1. Governorates of Iraq and the KRG

14 U.S. Energy Information Administration, Iraq Country Overview (30 January, 2015), available at <http://www.eia.gov/countries/cab.cfm?fips=iz>
 15 A full list of companies operating in Iraq can be found at *Iraq Country Overview*

Management of oil fields and distribution of oil revenue are often the subject of debate between ethnic, religious and political groups in the country. Provincial governments do not have real authority or control over oil revenue and are highly dependent on federal government's revenue transfers. Even the Kurdistan Regional Government (KRG), with its semiautonomous status, continues to largely depend on the Iraq Federal Government (IFG) for its budget.

Oil and gas revenues constitute the majority of Iraq's fiscal receipts. In 2015, the Iraqi Federal Government (hereafter referred to as the IFG) estimated that USD 67.8 billion (or 84 percent) of its total budgeted revenue for that year would come from the oil and gas sector.¹⁶ The IFG shares revenues with governorates through the national budget, relying on three instruments: a petrodollar allocation distributed based on the oil and gas produced and refined in each governorate, except those in the KRG; the KRG share that is calculated on the basis of KRG's population; and Regional Development Program (RDP) transfers, which finance reconstruction and development projects. The KRG is the only subnational authority that directly collects revenues (such as royalty and tax payments and signature bonuses) from the production sharing contracts (PSCs) it signs.

Sections I and II briefly describe the process of decentralization and local governance and associated history of revenue sharing in the country. Section III maps the details of how oil and gas revenue is collected and shared in the country. Section IV investigates how this revenue is *supposed* to be spent and, when information is available, how it is *actually* spent. Section V looks into impact of the sharing. Finally, Section VI is a study of the level of transparency around the revenues shared with subnational governments.

16 Source: 2015 Iraq State Budget Law, based on an estimated oil price of USD 56 per barrel and an export volume of 3.3 million barrels a day.

1. Decentralization and local governance

The 2005 constitution established a parliamentary system of government with a two-tier federal system: a central government headed by the prime minister and his cabinet of appointed ministers and a subnational system of government with 18 provincial governments, three of which form the autonomous region of the KRG.¹⁷ Governorates comprise districts and sub-districts, but these are merely administrative units.

Law No. 21 of 2008 defined provincial councils as “the highest legislative and oversight authority within the administrative boundaries of the governorate” and gave them power to issue local legislation within the boundaries of their respective governorate.¹⁸ Article 3 in the law requires members of the provincial council to be elected directly by the citizens of the province.

Despite the de jure federal structure, in practice all provincial governments—including to a lesser extent the KRG’s provincial governments—depend significantly on the central government and serve as de facto administrative units of the federal government, working alongside the IFG local ministerial departments.¹⁹ Budget and expenditure decisions are made by the federal government and a large percentage of the staff delivering the main public services such as education and health at the governorate level are central government employees.²⁰

Law No. 18 of 2010 (Law of Dissociation of the Ministry of Labor and Social Affairs’ Local Departments) and Law No. 20 of 2010 (Law on the Dissociation of the Ministry of Municipality and Public Work’s Local Departments) both aimed to devolve from the IFG to governorates a number of directorates and related competences around social welfare, as well as water and sewage management. They were drafted by the national parliament in 2010. The Supreme Court, however, declared these laws unconstitutional on the basis that the national parliament can only propose laws, not draft them.²¹

THE KURDISTAN REGIONAL GOVERNMENT (KRG)

Article 117 of the constitution recognizes Kurdistan as a federal region having an autonomous government, the KRG. The KRG has its own parliament and ministries. The IFG and KRG share policymaking on health, education and water. Decisionmaking on all other public services is decentralized to the KRG.²²

Kurdistan is composed of three governorates: Erbil, Dohuk and Sulaymaniyah. In 2014, the KRG recognized Halabja as a fourth governorate, separate from Sulaymaniyah. However, the national parliament has not yet recognized Halabja as an official governorate.

Kirkuk is another territory with conflicting claims. Article 140 of the constitution sets a deadline of December 2007 (and later June 2008) for a referendum to be held for Kirkuk citizens to decide whether or not to join the KRG. The referendum has not taken place. In June 2014, taking advantage of the chaos following the spread of ISIS, the Peshmerga military forces of the KRG seized Kirkuk. The IFG does not recognize Kirkuk as part of KRG.

17 Richard Forster and Nick Michell, *Decentralization in Iraq. Challenges and Solutions for the Federal and Local Governments* (U.N. Habitat, 2011), 21.

18 Article 2 of Law No. 21 of 2008.

19 Forster and Michell (2011), 22.

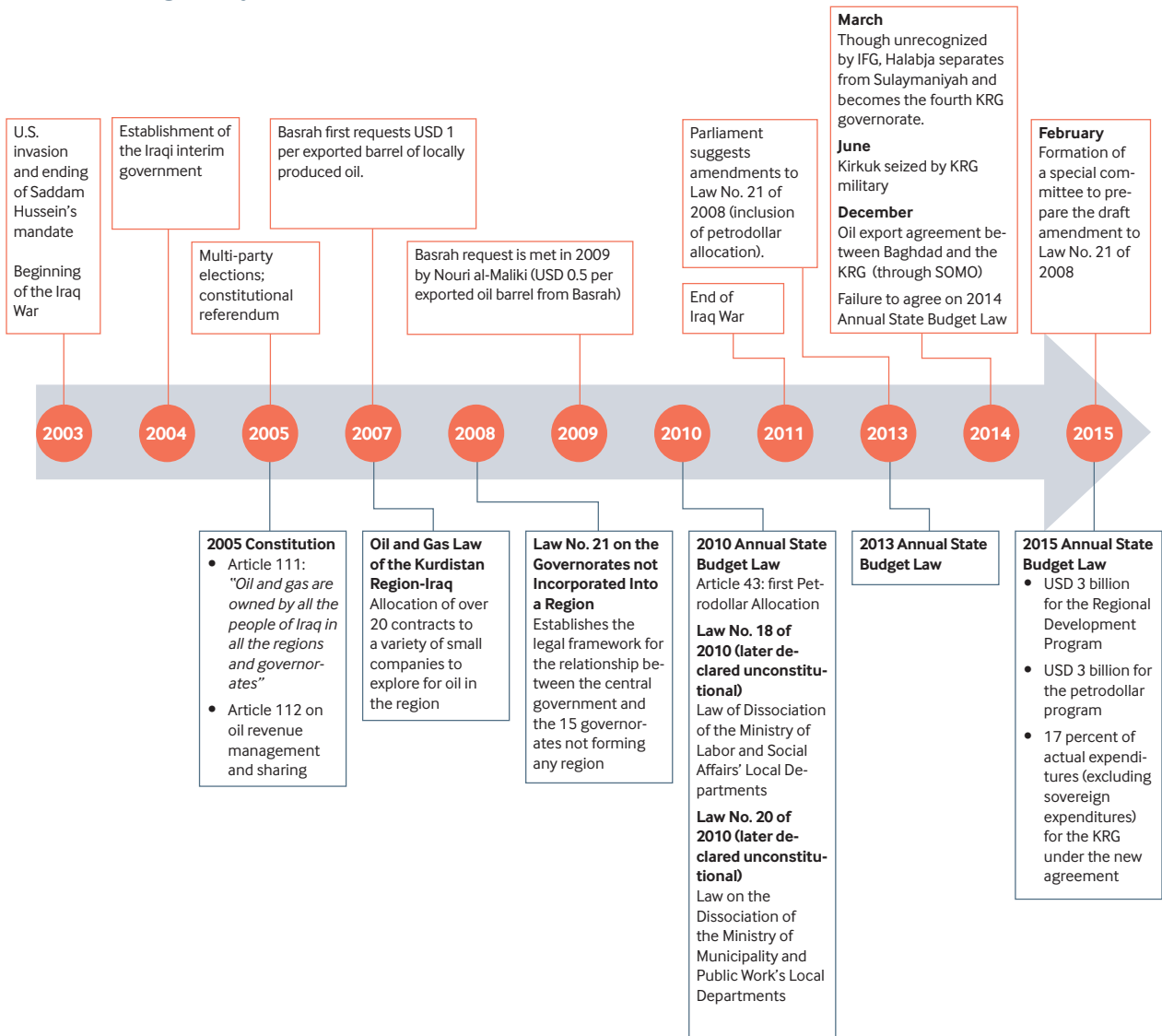
20 Ibid., 22.

21 Ibid., 23.

22 Ibid., 21.

2. Revenue sharing

Figure 2. Key events in Iraq's recent oil and gas revenue sharing history



Oil and gas revenue sharing with Iraq's 18 governorates has always been a contested issue in Iraq. Debates are mainly fueled by ambiguity in the provisions of the country's 2005 constitution.

Following the collapse of President Saddam Hussein's rule in March 2003 and the ensuing civil war, the United States and its coalition allies in June 2004 established an Iraqi Interim Government as a caretaker entity until the approval of the new constitution. Seven months later, in January 2005, countrywide elections were held to create the national assembly. A 55-member constitutional committee representing different parties and ethnicities drafted a new constitution, which was approved in 2005. The majority of the drafters—in particular the Kurds—wanted the new government to vest more power in the governorates and to allocate more resources to them. Federalism and the management of natural resources were among the most controversial elements discussed in the constitutional drafting process.²³

Oil ownership and management²⁴ are governed by Articles 111 and 112 of the 2005 constitution. The constitution's language is ambiguous in several key areas; its meaning is subject to interpretation, with no apparent means of clarification.²⁵ Article 111, for example, states that "oil and gas are owned by all the people in Iraq in all the regions and governorates."²⁶ This is interpreted by some to mean all Iraqis share equally in petroleum proceeds, regardless of where in Iraq oil and gas are extracted.²⁷ Yet, because of the lack of further clarifications and the contrast to the previous 1970 constitution, which stated that natural resources and basic means of production were owned by the people of Iraq, others—namely, KRG representatives—have interpreted the new constitution to imply that Iraqis in each region or governorate own the oil and gas within their region or governorate.²⁸

Another source of debate comes from Article 112, which covers petroleum management and resource revenue sharing. With respect to petroleum management, the first clause of Article 112 states that "The federal government, with the producing governorates and regional governments, shall undertake the management of oil and gas extracted from present fields, provided that it distributes its revenue 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 afterward, in a way that ensures balanced development in different areas of the country, and this shall be regulated by a law." The statement "the federal government, with the producing governorates and regional governments [...]" confers responsibilities on oil and gas management to both IFG and regions and governorates, without delineating how these responsibilities are shared.²⁹ This creates room for conflicting interpretations on the authority issuing licenses or in charge of petroleum sector management.³⁰ Additionally, the word "present fields" could restrict the applicability of this article to existing fields,

23 Nicholas Haysom and Sean Kane, *Negotiating natural resources for peace: Ownership, control, and wealth sharing* (Briefing Paper, Centre for Humanitarian Dialogue, 2009), 32.

24 For a more detailed discussion on oil ownership and management see Mishkat Al Moumin, *The legal framework for managing oil in post-conflict Iraq: A pattern of abuse and violence over natural resources* (High-Value Natural Resources and Peacebuilding, ed. P. Lujala and S. A. Rustad, 2012), 420-424.

25 Keith Myers, *Breaking Iraq's oil-law stalemate* (Petroleum-Economist, 2011), 12.

26 Even though Iraq currently has only one region (the KRG), the constitution mentions the word *regions* in plural as governorates have the right to form regions.

27 Myers (2011), 12.

28 Ibid.12; and Al Moumin (2012), 420.

29 Myers (2011), 12.

30 Ibid. 12.

creating more confusion over the entity that would manage future discoveries, fields and the revenues they generate.³¹

As a result of this confusion, several disputes between the IFG and the KRG—and between the IFG and the other governorates—have emerged over time around ownership and management.³² For example, from the IFG’s point of view, Article 111 ensures that ownership of oil and gas lies with the people of Iraq and not with any faction, sect or ethnicity. Thus, when the KRG unilaterally passed Law No. 28 of 2007 (entitled the Oil and Gas Law of the Kurdistan Region-Iraq),³³ awarding over 20 new contracts to petroleum companies, the IFG maintained that the KRG had breached its constitutional obligation to act jointly with the federal government in oil and gas matters.³⁴ The oil ministry ruled these contracts illegal and the IFG blacklisted companies that had been awarded contracts by the KRG prohibiting them from competing in future oil tenders.

Further disagreements on revenue sharing arise from the lack of definition on what constitutes “fair” redistribution or “damaged regions.” Lack of clarity has led to competing claims from different groups for a larger share of the petroleum revenue.³⁵

While confusion arising from language in the constitution persists, successive state budget laws (SBLs) and related negotiations advanced national practice in matters of resource revenue sharing. The IFG 2010 SBL³⁶ introduced a new provision whereby the IFG would deliver USD 1 to oil-producing governorates for each barrel of oil produced, each barrel of oil refined, and each 150 cubic meters of natural gas produced. This derivation provision finds its root in a request made in 2007 by the Basrah branch of the Al-Fadhila Party to the central government to put aside a USD 1 fee per locally produced barrel of oil and transfer it to a special fund. This request was not met until 2009, when former Prime Minister Nouri al-Maliki announced a special agreement with the provincial government of Basrah. The concession consisted of deducting USD 0.50 from every barrel of oil exported from Basrah, and setting aside these funds for special purposes such as financing the governorate’s economic and environmental costs of extraction.³⁷ This led the provincial government of Kirkuk—the second-largest producer—to ask for the same treatment. As a means to make the concession valid for all producing governorates, the 2010 SBL³⁸ for the first time included what is now known as the petrodollar allocation.

31 Baker, J. A. et al., *The Iraq Study Group report* (United States Institute of Peace, 2006), 22.

32 For some examples of these conflicts, see Al Moumin (2012), 421-423.

33 Law No. 28 of 2007 can be found here: http://cabinet.gov.krd/uploads/documents/Kurdistan%20Oil%20and%20Gas%20Law%20English__2007_09_06_h14m0s42.pdf.

34 Ben Holland, *Are Kurdistan’s oil contracts constitutional?* (Energy in the Middle East, Petroleum-Economist, 2012), 28.

35 Al Moumin, 424.

36 Article 43 of 2010 SBL.

37 The half-dollar difference between the 2007 proposal and the 2009 concession was largely attributed to the falling oil prices.

38 Article 43 of the 2010 SBL.

In 2007, when the KRG started to independently sign contracts with international oil companies (IOCs) in line with its own oil and gas Law No. 28 of the same year, the IFG demanded that the KRG manage its oil exports to the federal oil export system. In exchange, the federal government offered a 17 percent share of the total budget allocation to the KRG every year. After years of tense relations between the IFG and KRG, the IFG inserted punitive language into the 2013 and 2014 budgets withholding monthly budget transfers to the KRG if Iraq's State Organization for Marketing of Oil (SOMO) did not receive the prescribed volumes of oil from the autonomous region.³⁹ When the KRG failed to contribute, the IFG halted its monthly payment from the SBL to the KRG at the beginning of 2014. For most of 2014, the IFG and the KRG negotiated a revenue sharing arrangement.⁴⁰ In November 2014, Iraq Minister of Oil Adil Abdul Mahdi and KRG Premier Nechirvan Barzani firmed up an agreement whereby KRG would help export 150 thousand barrels per day through its pipeline system from Kirkuk oil fields in exchange for a one-time payment of USD 500 million to the KRG.⁴¹ Then, a second agreement was signed in December 2014, a diluted version of which was included in the 2015 SBL.⁴²

The December 2014 agreement established an oil export deal between the IFG and the KRG and became effective January 2015. The new agreement required the KRG to provide 250,000 barrels per day of the KRG's export blend to SOMO, which SOMO would then sell on using the same mechanisms used for selling oil from any other federally administered oil field. The agreement also required the KRG to facilitate SOMO's export of 300,000 barrels per day from the federally administered Kirkuk oil fields via KRG's secure internal pipeline network to Turkey.⁴³ The combined exported amount would therefore be 550,000 barrels per day. In return, the IFG would allocate 17 percent of the SBL to the KRG. It would also allocate a percentage of the budget for the federal ground forces of the Iraqi army to the Peshmerga to help in the fight against the Islamic State of Iraq and the Levant (ISIS).⁴⁴

39 Michael Knights (3 December 2014).

40 Ibid.

41 Ahmed Mousa Jiyad, *Midyear Review of the State Budget and Oil Export Revenues* (2015).

42 Ibid.

43 Michael Knights (3 December 2014). Such oil cannot reach export terminals via federal territory due to security risks and lack of good infrastructure between Kirkuk and Mosul.

44 Mousa Jiyad, *The Balance Sheet of the Recent IFG-KRG Oil Deal in Iraq* (2014).

Several Iraqi oil professionals, parliamentarians and politicians expressed their opposition to this deal, in part claiming that the share that the KRG would receive from the IFG was disproportionately high compared to its delivery obligations of 550,000 barrels per day. Others expected the deal to be mutually beneficial in that it allowed the IFG to retain its northern export route for Kirkuk crude and the Kurdish regional government to finance increasing expenses related to fighting ISIS. However, the KRG did not meet its delivery quotas to SOMO during the first quarter of the year, arguing that the budget commitment of 550,000 barrels per day was an annualized base and could be paid anytime during 2015.⁴⁵ There was significant increase of the KRG's deliveries to SOMO in April and May, but it still did not reach the budgetary commitment. (See Table 2.) In June, the KRG drastically reduced oil deliveries through SOMO to only 165,000 barrels per day, calling for a new deal.⁴⁶ At the same time, available data on the KRG's independent exports reveals a marked increase during the second quarter of 2015, from 28,000 barrels per day in April to 421,000 in June 2015.⁴⁷

| | |
|---|---|
| A. Yearly commitment for delivery to IFG through SOMO (2015) | 550,000 barrels per day |
| B. Cumulative actual delivery to SOMO (January-June 2015) | 53,742 million barrels |
| C. Deficit in cumulative actual delivery to SOMO | 46,358 million barrels |
| D. Daily actual delivery to SOMO (January-June 2015) | 296,000 barrels per day |
| E. Deficit in daily actual delivery to SOMO | 253,000 barrels per day (A-D) |
| F. Average export price of actual delivery to SOMO | USD 54.39 per barrel |
| G. Monetary value of actual delivery to SOMO | USD 2,923 billion (BxF) |
| H. Deficit in export revenues due to non-delivery to SOMO | USD 2,398 billion |
| I. Budget-equalising delivery requirement for July-December 2015 | around 800,000 barrels per day (A+E) |

Table 2. KRG's oil delivery commitment and implementation for the period January to June 2015⁴⁸

45 Mousa Jiyad, *Midyear Review of the State Budget and Oil Export Revenues* (2015).

46 Ibid..

47 Ibid. The monthly export reports can be accessed in the following links: <http://mnr.krg.org/images/monthlyreports/EXPORTS/April%202015%20-%20Export%20Report%20-%20Compressed%20Final.pdf> (April 2015), <http://mnr.krg.org/images/monthlyreports/May%202015%20Monthly%20Export%20Report.pdf> (May 2015), <http://mnr.krg.org/images/monthlyreports/2015.07.02%20June%20Monthly%20Export%20Report%20ENGLISH.pdf> (June 2015).

48 Mousa Jiyad, *Midyear Review of the State Budget and Oil Export Revenues* (2015), 7.

3. Revenue collection and sharing with subnational governments

Iraq has two types of contracts with IOCs: technical service contracts (TSC) usually used by the IFG and production sharing contracts (PSCs) usually used by the KRG. The most notable differences between the two types of contracts are in the cost and profit provisions.⁴⁹ Under the TSC model, the IOC operates as a contractor to a regional oil company.⁵⁰ The IOC bears all the costs and financial risk for undertaking upstream activities and in return obtains a fixed remuneration fee per barrel.⁵¹ The IOC is entitled to recover all its petroleum and supplementary costs, up to a maximum of 50 percent of petroleum revenue. The PSC model used in the KRG implies that IOCs share revenue and operating costs with the KRG's Ministry of Natural Resources (MoNR).⁵² IOCs enter into a contract directly with ministry. They finance and carry out all exploration and production operations and receive a certain amount of oil or gas for the recovery of costs, along with a share of the profits. The duration of TSCs in Iraq is 20 years extendable to 25 years. PSCs in the KRG last 25 years and are extendable to 30 years.⁵³

The major components of the IFG and the KRG fiscal regimes for oil and gas activities can be seen in Table 3.⁵⁴ The IFG's Ministry of Oil (MoO) collects most of the revenue from oil and gas (except revenue from general taxes) and then transfers it to the IFG's General Taxation Commission (GTC). The KRG's MoNR collects the revenue accruing to KRG and transfers it to the KRG Ministry of Finance.

49 Ernst & Young, *2015 Global Oil and Gas Tax Guide, Iraq* (2015), 260-268.

50 Regional oil companies in Iraq are the North Oil Company (NOC), the South Oil Company (SOC), the Midland Oil Company (MDOC), and the Missan Oil Company (MOC).

51 Ernst & Young, *2015 Global Oil and Gas Tax Guide, Iraq* (2015), 260-268.

52 The Ministry of Natural Resources is the sole entity that is authorised to sign production-sharing agreements with companies willing to invest in the exploration of hydrocarbons and mineral resources in the autonomous region of Kurdistan. The ministry is also the authority that awards licences for transportation and storage infrastructure, hydrocarbons and minerals production operations as well as refining, petrochemicals and retail operations. (Ministry of Natural Resources, available at: <http://mnr.krg.org/index.php/en/the-ministry/about-the-ministry2>).

53 Ernst & Young, *2015 Global Oil and Gas Tax Guide, Iraq* (2015), 260-268.

54 For a comprehensive overview of the IFG and the KRG fiscal regimes and a full list of their components, see Ernst & Young, *2015 Global Oil and Gas Tax Guide, Iraq* (2015), 260-268.

| Revenue stream | Jurisdiction of application | Base of calculation | Rate | Authority collecting it |
|----------------------|-----------------------------|--|------------------------------------|-------------------------|
| Signature bonus | IFG and KRG | fixed for IFG; variable for KRG | | MoO (IFG) ; MoNR (KRG) |
| Corporate income tax | IFG and KRG | Taxable income | 35 percent; 15 percent for the KRG | MoO (IFG) ; MoNR (KRG) |
| Withholding tax | IFG only | Taxes from payments made to subcontractors | 7 percent | GTC (IFG) ; MoNR (KRG) |
| Capital gains | IFG and KRG | Gains derived from the sale of fixed assets | 35 percent; 15 percent for the KRG | MoO (IFG) ; MoNR (KRG) |
| Royalty | PSCs in KRG only | Oil and non-associated gas produced and saved from the contract area | 10 percent | MoNR (KRG) |

Table 3. Revenue streams in the oil and gas industry in Iraq⁵⁵

OIL AND GAS REVENUE SHARING

Revenue sharing can occur by granting subnational authorities direct taxation powers on extractive projects or through intergovernmental transfers of resource revenues.

The KRG is the only subnational entity in Iraq that collects revenues directly from PSCs with oil and gas operators. In addition to exporting through SOMO, the KRG obtains revenue by selling its oil directly to IOCs. The KRG's oil sales are carried out through the MoNR, which is also responsible for sharing oil and gas revenue with the KRG's provincial governments. However, no information is available on how oil and gas revenue is shared within the KRG. Provincial governments outside the KRG obtain revenue from oil and gas operations only through the transfers from the IFG and do not levy or collect taxes from the oil and gas sector.

The vast majority of revenues flowing to provinces and the KRG are through intergovernmental transfers of oil and gas revenue, which are determined yearly through ad hoc allocations in the SBL. Since 2010 SBL, the main mechanisms for sharing revenue with provincial governments and the KRG are the petrodollar allocation, the KRG share and the RDP.

55 Ernst & Young, *2015 Global Oil and Gas Tax Guide, Iraq* (2015), 260-268. In 2010, the Iraqi parliament ratified a tax law for foreign oil and gas companies. As per this 2010 oil and gas income tax law, the income tax rate applicable to income earned in Iraq from contracts undertaken by foreign oil and gas companies and by contractors working in the fields of production and extraction of oil and gas and related industries is 35 percent. Companies, branches or offices of oil and gas companies and service companies, and subcontractors working in fields of production and extraction of oil and gas and related industries are all subject to the law. In late December 2011, the Ministry of Finance finalized instructions aimed at clarifying the applicability of this law. The Iraqi tax authority will deem a minimum taxable income percentage; a taxable income percentage of 20 percent was deemed upon the oil and gas sector, which will be subject to the tax rate of 35 percent, resulting in a deemed income tax liability of 7 percent of revenues (Ernst & Young, 2013).

The petrodollar allocation is derivation based and the amount transferred is directly proportional to the oil produced or refined in each governorate. In general, petrodollar allocations have been relatively stable across years since they were first introduced in 2011. (See Table 3.) As per the 2015 SBL, the first tranche of petrodollar transfer amounted to USD 1.5 billion and was shared with the oil-producing governorate of Basrah, which received 60 percent of the total allocation (USD 354 per capita), and to a lesser extent Kirkuk, which was allocated 14 percent of the total petrodollar transfer amount (USD 153 per capita). (See Table 4.) Other producing governorates such as Salah Al-Din, Missan and Wassit benefitted from the petrodollar allocation to a smaller extent. The only governorates that were not allocated petrodollars were the two non-oil- and gas- producing governorates (Diyala and Karbala) and the governorates of the autonomous region of Kurdistan (Erbil, Dohuk, and Sulaymaniyah). An additional petrodollar tranche of USD 1.5 billion was conditional on additional revenues from increased oil prices or international funding. (At the time of writing, it is unclear if this second tranche was paid.)

A second mechanism through which the federal government shares oil revenues is the special arrangement with KRG. Since 2008, as a result of a political agreement between then-Prime Minister Eyad Alawwy and KRG Premier Nechirvan Barzani, the KRG has a separate revenue sharing arrangement with the IFG.⁵⁶ Based on a United Nations estimate that Kurds made up 17 percent of Iraq's population, the revenue share for the KRG was set at 17 percent of the 2008 Iraqi state budget.⁵⁷ Every budget law contains a provision for this share to be recalculated based on the region's population census. This is to ensure that any new census count is considered in the calculation.⁵⁸

It is important to note that the 2015 SBL—unlike the 2013 budget⁵⁹—required the KRG payment to be calculated on actual expenditures and not budgeted expenditures.⁶⁰ This meant that the share will be subject to a decrease proportional to any reduction in the country's actual expenditure with respect to the budgeted expenditure.⁶¹ In addition, the 2015 SBL required the KRG to be paid once the IFG's sovereign and governing expenditures were paid, contrary to what the Kurdish politicians and the minister of finance had publically stated their preference for.⁶² This resulted in the share for the region in the 2015 SBL to be lower and is in the around 12.2 percent of the budgeted expenditure.

56 The statement by Barzani can be found on the website of the KRG, in the following link: <http://cabinet.gov.krd/a/d.aspx?s=010000&l=12&a=19508>

57 Michael Knights, *Making the Iraqi Revenue-Generating Deal Work* (PolicyWatch 2341, The Washington Institute, 3 December 2014), available at: <http://www.washingtoninstitute.org/policy-analysis/view/making-the-baghdad-krq-revenue-generating-deal-work>

58 Mousa Jiyad (2015), 35.

59 In 2014, parliament failed to agree on the federal budget bill. Mousa Jiyad, *Iraqi State Budget 2015-It Deserves Careful Reading But Needs Serious Revision* (30 December 2014).

60 Mousa Jiyad, *Iraqi State Budget 2015* (2014).

61 Mousa Jiyad, *Iraqi State Budget 2015* (2014).

62 Mousa Jiyad, *Iraqi State Budget 2015* (2014).

The final mechanism to share resource revenues is the RDP program. (See Table 4 for 2015 figures.) The purpose of the RDP is to finance the reconstruction and development of projects in all the governorates of Iraq, including those within the KRG. Allocations are based on governorates' population (the largest RPD transfer is for the highly populous province of Baghdad).⁶³ RPD amounts have fluctuated more noticeably than petrodollar allocations since 2010. (See Table 5.)

Ongoing debates on petrodollar allocation

In 2013, parliament voted on amendments to Law No. 21 of 2008. A new provision would have allowed producing governorates to be allocated USD 5 for each barrel of oil produced, for each barrel of oil refined and for each 150 cubic meters of processed natural gas. The amendment, however, was not enforced because former Prime Minister Maliki filed a case at the Supreme Court to block it. Newly appointed Prime Minister Haider al-Abadi recently withdrew the case from the Supreme Court in order to "re-examine" the amendments.⁶⁴ The council of ministers decided on 3 February 2015, to form a special committee chaired by Abadi to prepare a "draft amendment to Law No. 21." The draft was still under preparation at the time of writing.

If provisions similar to those voted on in 2013 were introduced at the end of the drafting process, a fixed petrodollar allocation could be enshrined in the country's legal framework and replace the current system of hoc allocation decided by the Ministry of Finance through the SBL. While this move would recognize that governorates are entitled to receiving a fixed share of their oil and gas production, it would reduce the flexibility enjoyed by the IFG in adjusting allocations to changing commodity price and budget circumstances. A fixed petrodollar provision may adversely impact the IFG budget in an environment of persistently low oil prices and oil and gas revenues.⁶⁵

Table 4. *De Jure* RDP and petrodollars (in USD billion),* 2010-2016

| | Budget proposal 2016 | | Budget Law 2015 | | Budget Law 2013 | | Budget Law 2012 | | Budget Law 2011 | | Budget Law 2010 | |
|------------------------|----------------------|------------------------------------|-----------------|------------------------------------|-----------------|------------------------------------|-----------------|------------------------------------|-----------------|------------------------------------|--|------------------------------------|
| | USD billion | Percentage of budgeted expenditure | USD billion | Percentage of budgeted expenditure | USD billion | Percentage of budgeted expenditure | USD billion | Percentage of budgeted expenditure | USD billion | Percentage of budgeted expenditure | USD billion | Percentage of budgeted expenditure |
| RDP allocation** | 1.5 | 1.5 | 3.0 | 2.9 | 6.2 | 5.2 | 5.3 | 5.3 | 2.3 | 2.8 | 2.3 | 3.1 |
| Petrodollar allocation | 1.5 | 1.5 | 1.5 | 1.5 | 1.1 | 1.0 | 1.4 | 1.4 | 1.4 | 1.7 | No specific amount is stated in the budget | NA |

Source: Iraq Budget laws 2010,2011,2013,2015 and Budget proposal 2016

*Note: Budget law 2014 is missing because no budget law was passed in 2014

** Includes KRG share of RDP. In 2015, KRG share of RDP amounted to USD 379 million

63 2015 SBL, Article 2.D.

64 Mousa Jiyad (2015), 34.

65 Mousa Jiyad (2015), 34.

Table 5. *De jure* Regional Development Program and petrodollar allocations in 2015⁶⁶

| Governorate | Area in sq. km | 2011 population estimate* | RDP allocation (USD million) | Per capita RDP Allocation (USD)* | Petrodollar allocation (USD million) | Per capita petrodollar allocation (USD) |
|---------------|----------------|---------------------------|------------------------------|----------------------------------|--------------------------------------|---|
| Ninewa | 37,323 | 3,270,422 | 307 | 93.87 | 13 | 4.0 |
| Kirkuk | 9,679 | 1,395,614 | 120 | 85.98 | 213 | 152.6 |
| Diyala | 17,685 | 1,443,173 | 130 | 90.08 | - | 0.0 |
| Anbar | 138,288 | 1,561,407 | 139 | 89.02 | 1 | 0.6 |
| Baghdad | 4,555 | 7,055,196 | 657 | 93.12 | 39 | 5.5 |
| Babil | 5,119 | 1,820,673 | 160 | 87.88 | 8 | 4.4 |
| Kerbela | 5,034 | 1,066,567 | 97 | 90.95 | - | 0.0 |
| Wasit | 17,153 | 1,210,591 | 108 | 89.21 | 82 | 67.7 |
| Salah al-Deen | 24,075 | 1,408,174 | 121 | 85.93 | 108 | 76.7 |
| Najaf | 28,824 | 1,285,484 | 119 | 92.57 | 7 | 5.4 |
| Qadisiya | 8,153 | 1,134,313 | 104 | 91.69 | 8 | 7.1 |
| Muthanna | 51,740 | 719,069 | 68 | 94.57 | 6 | 8.3 |
| Thi-Qar | 12,900 | 1,836,181 | 172 | 93.67 | 49 | 26.7 |
| Missan | 16,072 | 971,448 | 92 | 94.70 | 75 | 77.2 |
| Basrah | 19,070 | 2,531,997 | 231 | 91.23 | 896 | 353.9 |
| Dohuk | 6,553 | 1,128,745 | 92 | 81.51 | - | 0.0 |
| Erbil | 15,074 | 1,612,692 | 136 | 84.33 | - | 0.0 |
| Sulaymaniyah | 17,023 | 1,878,764 | 151 | 80.37 | - | 0.0 |
| Total | 435,052 | 33,330,510 | 3,004 | | 1,505 | |

*In 2015 the total amount budgeted for the petrodollar allocation was USD 3 billion, out of which USD 1.5 billion was only to be transferred to governorates if the IFG receives additional funds, i.e. a contingency budget.

66 Sources: Ahmed Mousa Jihad, *Iraq Extractive Industry: Legal, Fiscal, and Revenue Allocation and Management Issues* (2015), 35; <http://www.geohive.com/cntry/iraq.aspx>

4. Earmarks and use of revenue by subnational governments

There are guidelines and earmarks for all three revenue allocations to regions and governorates. These are normally specified in SBLs.

For the 2015 SBL, the directives on use of RDP and the petrodollar allocations are specified in Article 2⁶⁷ and are as follows⁶⁸:

- RDP USD 3 billion should be used for reconstruction and development projects in all governorates, including those of the KRG.
- The governor in each governorate must first submit a development plan for the governorate to the Ministry of Planning (including its districts and sub-districts. This plan has been ratified by the provincial council.
- Once the Ministry of Planning approves the plan, it shares the RDP with the governorate. The internal allocation by the governorates is based on districts and sub-districts' relative population size. The governor implements the development plan while the provincial council monitors implementation.

Provincial governments are mandated to use the petrodollar allocation to manage economic and environmental costs related to oil and gas extraction. Article 2 of the 2015 SBL states “the governments must use no more than 50 percent of the petrodollar allocation to import electricity or provide services to the governorate, and must take care of the environment and the current expenditures based on the governorate needs.”

In terms of KRG allocation, the 2015 SBL required the KRG to allocate a portion of its received payments to the newly created (yet still unrecognized) governorate of Halabja based on its population.⁶⁹ The 2015 SBL also required that priority be given to the KRG's areas most affected by the production and refinement of oil, as well as to environmental protection and construction projects.⁷⁰

67 First clause; paragraph D for the RDP, and paragraph E for the petrodollar allocation.

68 U.N. Iraq Joint Analysis Unit, *Low Oil Prices Put Iraq's Budget Under the Guillotine: A Comparative Analysis of the 2013 Federal Budget and the Approved Budget for 2015* (2015), 18.

69 Article 51 of the 2015 SBL.

70 Ibid..

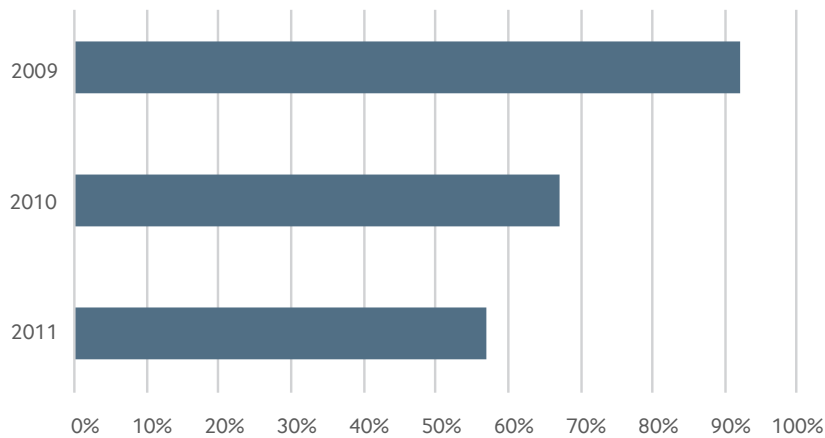


Figure 3. Implementation rates of the RDP across governorates and region, 2009-2011 (in percentage implemented)⁷¹

There isn't comprehensive information on receipt and spending of resource allocations. While there is no information available on KRG spending, information on implementation rate of the RDP funds reveals it was quite high in 2009 at 92 percent, and subsequently went down to 67 percent and 56.6 percent in 2010 and 2011, respectively.⁷² While data on petrodollar utilization at the provincial government level is unavailable, there is evidence of low absorptive capacity: the Supreme Auditing Board, a government entity, raised concerns in 2015 about provincial governments' capacity to "even spend the USD 1-petrodollar."⁷³

71 Ministry of Planning, *National Development Plan 2013-2017*.
 72 Mousa Jiyad (2015), 35.
 73 Ibid..

5. Impact of revenue sharing

In January 2013, about 60 percent of all Iraq households were suffering from lack of access to at least one of these: improved drinking water source, sanitation, regular electricity and food.⁷⁴ Researchers cite two reasons why Iraq's government budget cannot translate fully into development. First, funds allocated are insufficient to meet to development needs. Second, execution of the investment budget by governorates remains low: it amounted to only 50 percent in 2011 for the mentioned sectors.⁷⁵

Also the type of revenue sharing itself—derivation-based sharing through petrodollar allocation and special shares to KRG—is bound to create inequalities across provinces and region. Beyond these observations, it is difficult to ascertain the impact of revenue allocations to subnational governments in absence of data on actual transfers.

74 JAU Iraq, *Iraq budget 2013, Background Paper*, 2013.

75 JAU Iraq, *Iraq budget 2013, Background Paper*, 2013.

6. Disclosure of revenue sharing

Revenue transparency is a crucial requirement for governorates and regions to know what they are owed, to resolve conflicts and to ascertain impact. There is little disclosure of revenue transfers either at the national or subnational levels of governments.

Although the constitution mandates the establishment by law of a “public commission” to “verify the ideal use and division of the federal financial resources,” to “guarantee transparency and justice in appropriating funds to the governments of the regions and governorates [. . .] in accordance with the established percentages,” and even to “verify the fair distribution of grants, aid and international loans pursuant to the entitlement of the regions and governorates that are not organized in a region,”⁷⁶ the establishment of such a commission was delayed by the IFG. In 2011, the government approved a draft law for the “Public Commission to Audit and Appropriate Federal Revenues.” However, as of 2015, the draft law had not been discussed in parliament.⁷⁷

Disclosure of transfers by the national government

The Ministry of Finance publishes the annual SBLs on its site.⁷⁸ Although they contain all the yearly provisions for intergovernmental transfers, they do not contain information on the actual amounts to be transferred and the amounts transferred.

Disclosure of transfers by subnational governments

Within the KRG, the MoNR publishes monthly reports that contain information on the volume of oil and gas exported; however, these do not contain information on total export revenue or the export price for the independently exported oil.⁷⁹ This makes it difficult to assess the importance of KRG oil exports in the region’s or the country’s economy.⁸⁰ Moreover, the text of the December 2014 deal between the IFG and the KRG has not been published, and according to Minister of Finance Hoshyar Zebari will not be published. The minister has not provided an explanation on why the document won’t be publicly available.⁸¹

Provincial governments and the KRG do not publish data on revenue received from the IFG. Also the KRG does not disclose any information on how it shares revenue with its governorates.

76 Article 106

77 Mousa Jiyad (2015), 33-34.

78 These are available at the following link: <http://www.mof.gov.iq/pages/ar/FederalBudgetLaw.aspx>

79 These are called monthly export reports and are available here: <http://mnr.krg.org/index.php/en/press-releases>.

80 *Midyear Review of the State Budget and Oil Export Revenues* (2015).

81 Mousa Jiyad, *The Balance Sheet of the Recent IFG-KRG Oil Deal in Iraq* (2014).

Final remarks

Iraq's oil and gas revenue sharing arrangement is embedded in the country's SBLs, and is therefore subject to yearly modifications and approval by the parliament. The process of determining shares, especially for the KRG, is highly contentious and linked to ongoing national debates on decentralization and autonomy. Insufficient guidance on interpreting the constitution or even the budget laws creates a large degree of contention.

RDP revenue is allocated to all governorates based on their population, while petrodollar allocation provides additional revenue to oil- and gas-producing governorates (except the governorates of the KRG). Baghdad receives the largest share of the RDP, while Basrah and Kirkuk receive the highest petrodollar allocation.

KRG has received payments every year since 2008 except for 2014, when the IFG halted payments to the region. The December 2014, an agreement between the KRG and the IFG reactivated the 17 percent transfer in favor of the KRG, conditional on the region contributing roughly 550,000 barrels to the country's oil export system per day.

Based on the allocation formulas used—derivation-based sharing through petrodollar allocation and the large KRG share, with no equalization to compensate less well-off provinces—the revenue sharing mechanism seems to reinforce inequalities across provinces.

The SBLs are usually disclosed. However, there is very little transparency both at the federal and governorate levels (including in the KRG) on revenue shared and received. Piecemeal information on utilization of RDP and petrodollars suggest low capacity of governorates to absorb the funds.

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