RECONSTRUCTION IN IRAQ'S OIL SECTOR: RUNNING ON EMPTY?

JOINT HEARING

BEFORE THE

SUBCOMMITTEE ON
THE MIDDLE EAST AND SOUTH ASIA

AND THE

SUBCOMMITTEE ON INTERNATIONAL
ORGANIZATIONS, HUMAN RIGHTS, AND OVERSIGHT

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RECONSTRUCTION IN IRAQ'S OIL SECTOR: RUNNING ON EMPTY?

WEDNESDAY, JULY 18, 2007

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON THE MIDDLE EAST AND SOUTH ASIA, AND
SUBCOMMITTEE ON INTERNATIONAL ORGANIZATIONS, HUMAN RIGHTS, AND OVERSIGHT,
COMMITTEE ON FOREIGN AFFAIRS,
Washington, DC.

The subcommittees met, pursuant to notice, at 2:04 p.m. in room 2172, Rayburn House Office Building, Hon. Gary Ackerman (chairman of the subcommittee) presiding.

Mr. ACKERMAN. The subcommittees will come to order.

Last March, our two subcommittees held a hearing on reconstruction in Iraq where it became painfully obvious that none of the major goals of United States reconstruction efforts had been met. In particular, the oil sector, the engine of Iraq's economy, and the source of 90 percent of its revenue continued to produce at well below pre-war levels.

Three years ago the Coalition Provisional Authority set oil production targets at 3 million barrels per day. Last year, according to GAO, Iraq produced an average of 2.1 million barrels a day, and this year Iraq is averaging only 1.9 million barrels a day.

In terms of oil specifically for export, Iraq produces 1.4 billion barrels a day, 800,000 barrels per day below the goal, and 100,000 barrels per day less than last year. So 3 years after the CPA set the initial target not only is Iraq not producing anywhere near the goal, they are actually going backwards. At $50 a barrel, that is a $40 million per day in lost revenue, $14.6 billion per year, or almost $45 billion less than expected since the targets were first established 3 years ago. Where I come from $45 billion would buy a lot of reconstruction, but the story gets worse.

Apparently between 100,000 and 300,000 barrels of oil per day go unaccounted for. It is just gone. The Government Accountability Office reported in May that over the last 4 years Iraqi oil worth somewhere between $5 million and $15 million a day may have been stolen, siphoned or maybe not even produced. It is surprising the Iraqi people are not demanding that we bring the old crooks back.

What GAO has uncovered here is that neither the Iraqis nor we know even precisely how much oil is being produced. Unfortunately, it is not just crude oil production where the targets are being missed. The CPA also set production targets for natural gas and liquefied petroleum gas as well as stockpile targets for gasoline, diesel, kerosene and LPG to ensure that domestic demand could be met. In all these area, Iraq efforts, as well as our own, have fallen short. Natural gas production was 70 million standard cubic feet per day short of the goal. LPG production was 1.291 tons per day short of the goals, and instead of 15 days each worth of fuel stockpiled for domestic use, there is only 3½ day's worth of diesel, only 4 days of kerosene, only 2 days of gasoline, and only 1 day of LPG.

After having spent more than $2 billion of American taxpayer money on rebuilding Iraq's oil infrastructure, you would think that we would at least know how much oil was being produced. Since oil production is one of the milestones we are using to measure reconstruction progress, it seems to me that precision in this regard would be something of a priority.

You would also think, having spent all that money, that Iraq would at least be showing progress toward achieving the production goals but not only is there not progress, production levels have actually declined.

We are not exacting getting a lot of bang for our buck here, but perhaps it is just as well that the Iraqi Government didn't have that revenue anyway. Last year the ministry of oil budgeted $3.5 billion for capital projects in the oil sector, but only succeeded in spending 3 percent of that money, $35 million—not an impressive track record for a government that will need billions of dollars to sustain the oil sector long after the United States has withdrawn.

Beyond simply trying to get the stuff out of the ground, Iraqis need to establish the legal regulatory framework which would make clear who decides how to exploit Iraq's oil and who benefits. Unfortunately, only the legal framework has been sent to the Parliament for consideration. Legislation on revenue sharing, restructuring of the oil ministry and establishing the National Oil Company all remain in some political limbo.

This debate inside of Iraq has become a metaphor for who will rule Iraq and how. It defines the struggle between those who want a strong central government and those who want the regions to have more autonomy, and it lays bare the sectarian division over Iraq's wealth. Shias want the central government to control decisions about currently producing oil fields, and exploration of new ones. Kurds want to interpret the constitution and the proposed oil law so that they have the right to determine how new oil fields are exploited in their areas. Sunnis simply think that no matter what the Shia and Kurd decide, it will leave them out in the cold.

Political breakthrough here could galvanize ordinary Iraqis into believing that their leaders actually can make decisions for the greater good of the nation. Political stalemate will only reinforce the downward spiral of an already raging civil war.

Like everything else in Iraq, the stakes are high and the costs of failure are great, but in the end it is the Iraqi people who will have to solve this problem no matter how much we wish they would make the decisions that seem obvious to us. We will ultimately have to let them decide on their own.

I would like to turn now to Mr. Wilson, member of the Middle East and South Asia Subcommittee.

Mr. WILSON. Thank you, Mr. Chairman. I have no question or opening statement.

Mr. ACKERMAN. Then we will turn to the co-chairman of today's hearing, the chairman of the Subcommittee on International Oversight, Mr. Delahunt.

Mr. DELAHUNT. Thank you, Mr. Chairman, and let me thank you on behalf of myself and Mr. Rohrabacher, the Subcommittee on Oversight's ranking member, for arranging this hearing. We are pleased to work with you once more on this particular issue, and look forward to other joint hearings where our interests and jurisdiction coincide.

As you indicated, this hearing will address, among a number of critical issues, the draft hydrocarbon law pending before the Iraqi Parliament. This draft law, a framework draft as I will refer to it, creates an obtuse and arcane legal structure for reorganizing the Iraqi oil industry. It is important to emphasize that it does not address—it does not address the fair and equitable distribution of oil revenue among the various Iraqi communities, so it should not be confused with the benchmark in the recent supplemental appropriation identified by Congress to be a sign of progress.

In fact, legislation to ensure such an equitable distribution of hydrocarbon revenue has not even been adopted by the Iraqi cabinet, which is a prerequisite for consideration by the Iraqi Parliament.

Now, this framework draft was originally crafted by three Iraqi oil experts, including Mr. Tariq Shafiq, one of our witnesses today. That draft, however, has been substantially altered. The current version allows foreign oil companies to secure ownership of Iraqi oil, and it would also permit foreign oil executives to sit on a so-called independent expert panel and provide advice to a newly-created Federal gas and oil council, which would be the key decision-making authority under this proposed regime, and yet there appears to be no prohibition on these same international oil company executives from advising and reviewing contracts involving their companies.

To state that the framework draft is controversial is an understatement. The Iraqi oil unions vigorously object to the current version, and in an open letter dated March 19, 2007, to the Iraqi Parliament, a number of respected Iraqi oil experts have articulated their reservations. Numerous other stakeholders have also weighed in to express their concern and opposition.

From our perspective, it is important to examine the role of the administration in the evolution of this framework draft and how it may influence resulting perceptions. Over to my right there is a time line created by the Congressional Research Service. Obviously, we can't see it from here, but I know it is in the packages provided by staff to members and those who have an interest can later view it up close. But it is full of instances where the United States appeared to be encouraging substantial foreign equity participation in the Iraqi oil industry.

In April 2003, a month after the invasion, the Department of State had issued a report on the future of Iraqi oil, calling for the privatization of the oil sector, and in that same year, in March, after the Coalition Provisional Authority was established, the administration retained former oil company executives to assist Iraqi oil officials. They, of course, were supportive of privatization. There are numerous other examples listed on the CRS time line.

Now, when we add this framework draft to the equation, it appears to some that the administration had less than a noble agenda, and according to a University of Michigan poll, 76 percent of Iraqis said that one of the primary reasons the United States invaded Iraq initially was to control Iraqi oil. As a result of this framework draft, I have no doubt that today that percentage would be even higher.

For example, knowledgeable Iraqis have questioned why unexplored areas should be auctioned off while existing wells currently producing in discovered but not yet producing fields, which can meet Iraqis economic needs for many years. There is a growing belief that this framework draft would benefit international oil companies to the long-term detriment of Iraq and the Iraqi people. As one of our witnesses notes, this is a very divisive issue within Iraq, and appears to have been planned under pressure from both within and without. There is a real danger that a perception will take hold that we, the United States, the administration pressed passage of this framework draft to benefit ourselves.

As a Kurdish lawmaker recently noted, "This has always been the case. Washington has been pushing the Iraqis to fit their agenda." Those are his words.

And we should remind ourselves that this sentiment is not limited to Iraq. Again, recent polling reveals that 79 percent of respondents in four Muslim countries—Morocco, Indonesia, Pakistan and Egypt—felt that the United States' aim was to maintain control over Middle East oil, and a framework draft perceived to be favorable to international oil companies will support that belief.

If this passage, or rather, if the passage of this framework draft is interpreted to be an exploitation of Iraq's most coveted natural resource, then our reputation and prestige could very well suffer even further, and a claim that we fought to free Iraq will be rejected out of hand by the Iraqi people and by others as well, and our national interest will suffer in the long term.

So it is my belief that it is of critical importance that Congress be clear to the people of Iraq that we respect their sovereignty in whatever decisions they make regarding their natural resources.

With that, Mr. Chairman, I yield back, and look forward to hearing from our witnesses.

Mr. ACKERMAN. Thank you, Chairman Delahunt.

We are expecting our ranking member, Mr. Pence, and he will make a statement, I would anticipate, at an appropriate time, but now we will turn to our first witness.

Mr. Joseph Christoff is director of the Government Accountability Office's International Affairs Trade Team. Mr. Christoff directs GAO's work at U.S. agencies responsible for nonproliferation, export control, and international security issues. He also leads GAO's efforts reviewing reconstruction and security issues in Iraq.

Mr. Christoff joined GAO in 1980, and has a master's degree in public administration from American University and a B.A. in public policy from Miami University-Ohio.

Welcome, Mr. Christoff. Without objection, your written remarks will be made a part of the official permanent record, and you may summarize them and proceed as you wish.

STATEMENT OF MR. JOSEPH A. CHRISTOFF, DIRECTOR, INTERNATIONAL AFFAIRS AND TRADE, GENERAL ACCOUNTABILITY OFFICE

Mr. CHRISTOFF. Thank you, Mr. Chairman. Just wait 1 second for some of my props to be put up, but let me begin by, of course, thanking you all for inviting GAO to this important hearing.

My statement today is based on GAO's May 2007 report on Iraq's energy sector, and additional research that we completed for this hearing, and I will discuss three issues: First, United States progress toward achieving Iraq's oil production; second, challenges in restoring Iraq's oil infrastructure; and third, Iraqi efforts to enact hydrocarbon legislation.

First, after 4 years of effort and $2.7 billion in United States funds, Iraqi oil output has consistently fallen below United States' goals. In 2006, Iraq's oil production averaged 2.1 million barrels per day as reported by the State Department, and as displayed in the first chart to your left, this level was short of the United States' goal of 3 million barrels per day. Iraqi exports averaged 1.5 million barrels per day in 2006 compared to the United States' goal of 2.2 million barrels per day.

Moreover, State Department data may actually overestimate Iraq's oil production. As displayed in the middle chart, the Department of Energy, its data shows lower production levels between 100,000 and 300,000 barrels less per day. This equates to $1.8–5.5 billion per year. This discrepancy may result from inadequate metering and reporting, corruption, theft, and sabotage. Comprehensive metering of Iraq's oil production has been a longstanding problem and is a continuing need.

The United States faces many challenges in helping Iraq restore its oil sector. These challenges include poor security, corruption, and funding constraints.

First, violence in Iraq continues unabated, placing workers and infrastructure at risk. The U.S. reconstruction program assumed a permissive security environment that has never materialized. In June 2007, the number of enemy attacks against the Coalition and its Iraqi partners averaged 180 per day. This is 50 percent higher than in June 2006.

The second challenge, widespread corruption and smuggling continue to reduce oil revenues. A variety of criminal, insurgent and militia groups fund their activities through oil theft and illicit sales. Last month DoD reported that as much as 70 percent of the fuel processed at Iraq's key refinery was sold on the black market, possibly as much as $2 billion each year. As a result, the Iraqi army assumed control of the refinery and is trying to install equipment to prevent siphoning.

The third challenge, Iraq's needs are significant but future funding is uncertain. For the oil sector, the United States has spent nearly all of its reconstruction funds, international donors have provided no grants, and Iraq has invested little. For example, in

2006, Iraq spent less than 3 percent of the $3.5 billion it budgeted for oil projects.

To address these many problems, we recommended that the Secretary of State work with Iraqi ministries to do five things: (1) develop an integrated energy strategy; (2) establish an oil metering system; (3) develop financial management systems; (4) secure greater donor funding; and (5) implement hydrocarbon legislation.

I will only provide a few comments on the hydrocarbon legislation, noting that your experts will follow me on this panel.

Iraq has yet to enact legislation that defines the distribution of oil revenues and the rights of foreign investors. As shown in the last chart on your far right, the government must enact four separate but interrelated pieces of legislation, not just one. Iraq's cabinet has submitted only one of these to its Parliament. A framework to establish the oil sector is management and oversight. The cabinet has not approved a draft revenue-sharing law. This law would provide for the ownership of oil resources and the distribution of revenues.

Two other laws are being drafted. One would restructure the ministry of oil and the other would establish the Iraq National Oil Company. Until all legislation is enacted, Iraq may have difficult attracting the foreign investment it needs to modernize the oil sector. Passage of hydrocarbon legislation is one of 18 benchmarks the United States expects Iraq to achieve, and as required by law, GAO will provide Congress an independent assessment of Iraq's progress in achieving these 18 benchmarks. We will issue our report on September 1.

Thank you, Mr. Chairman. That concludes my statement.

[The prepared statement of Mr. Christoff follows:]

United States Government Accountability Office

GAO

Testimony

Before the Subcommittee on the Middle East and South Asia and the Subcommittee on International Organizations, Human Rights, and Oversight, Committee on Foreign Affairs, House of Representatives

For Release on Delivery Expected at 2:00 p.m. EDT Wednesday, July 18, 2007

REBUILDING IRAQ

Serious Challenges Impair Efforts to Restore Iraq's Oil Sector and Enact Hydrocarbon Legislation

Statement of Joseph A. Christoff, Director
International Affairs and Trade

GAO-07-1107T

Mr. Chairmen and Members of the Subcommittees:

I am pleased to be here today to discuss U.S. efforts to rebuild Iraq's oil sector and Iraq's efforts to enact hydrocarbon legislation.

The oil sector is critical to Iraq's economy, accounting for over half of Iraq's gross domestic product and over 90 percent of its revenues. The timely and equitable distribution of these revenues is essential to Iraq's ability to provide for its needs, including the reconstruction of a unified Iraq.

The Iraqi government inherited oil infrastructure that was greatly deteriorated due to the previous regime's neglect; international sanctions; and years of conflict, looting, and vandalism. For fiscal years 2003 through 2006, the U.S. government made available about $2.7 billion in reconstruction funds to help restore Iraq's crude oil production and exports. The United States spent an additional $2.8 billion in Iraqi funds on the oil sector through the end of 2005; however, these funds were used primarily to purchase petroleum products because Iraq does not have adequate domestic refining capability.

My testimony discusses (1) U.S. goals for Iraq's oil sector and progress in achieving these goals, (2) key challenges the U.S. government faces in helping Iraq restore its oil sector, and (3) efforts to enact and implement hydrocarbon legislation.

This statement is based on our May 2007 report[1] and updated data, where appropriate. To accomplish our report objectives, we reviewed and analyzed U.S., Iraqi, donor government, United Nations (UN), International Monetary Fund (IMF), and World Bank reports and data. During two trips to Iraq and Jordan, we met with Iraqi, UN, IMF, World Bank, donor country (Japan and European Union), private sector, and U.S. officials. We also analyzed data on Iraqi oil production from the Department of State and the Department of Energy's Energy Information Administration (EIA). This work was conducted in accordance with generally accepted government auditing standards.

Summary

Despite 4 years of effort and $2.7 billion in U.S. reconstruction funds, Iraqi oil output has consistently fallen below the U.S. goals of producing 3 million barrels per day (mbpd) and exporting 2.2 mbpd. For 2006, State Department data show that crude oil production and exports averaged 2.1 mbpd and 1.5 mbpd,

[1]GAO, *Rebuilding Iraq: Integrated Strategic Plan Needed to Help Restore Iraq's Oil and Electricity Sectors*, GAO-07-677 (Washington, D.C.: May 15, 2007).

respectively. However, the State Department's data on Iraq's oil production may be overstated since data from the U.S. Department of Energy show lower production levels—between 100,000 and 300,000 barrels fewer each day. Inadequate metering, reinjection, corruption, theft, and sabotage account for the discrepancy, which amounts to $5 million to $15 million daily, or about S1.8 billion to $5.5 billion per year. Comprehensive metering of Iraq's oil production has been a long-standing problem and continuing need.

Poor security, corruption, and funding constraints continue to impede reconstruction of Iraq's oil sector. The U.S. reconstruction effort was predicated on the assumption that a permissive security environment would exist. However, a deteriorating security environment continues to place workers and infrastructure at risk while protection efforts have been insufficient. Widespread corruption and smuggling continue to reduce oil revenues. According to State Department officials and reports, about 10 percent to 30 percent of refined fuels is diverted to the black market or smuggled out of Iraq and sold for a profit. Moreover, Iraq's needs are significant and future funding for the oil sector is uncertain as nearly 80 percent of the U.S. funds for the oil sector have been spent. Iraq's contribution to improving its infrastructure has been minimal with the government spending less than 3 percent of the $3.5 billion it approved for oil reconstruction projects in 2006. Further, the international community has not provided any grants to develop the oil sector, and Iraq has not accessed nearly $500 million in loans from international contributions to the oil sector. U.S. and international officials stated that international donors have not provided funds for the oil sector because they expected that Iraq and the private sector would provide the needed resources.

Iraq has yet to enact and implement comprehensive hydrocarbon legislation that defines the distribution of future oil revenues and the rights of foreign investors. Until this legislation is enacted and implemented, it will be difficult for Iraq to attract the billions of dollars in foreign investment it needs to modernize the oil sector. According to the State Department, as of July 13, 2007, Iraq's cabinet had approved only one of four separate but interrelated pieces of legislation—hydrocarbon framework legislation that establishes structure, management, and oversight for the sector. This draft legislation is currently being considered by Iraq's parliament (Council of Representatives). A second piece of legislation, the revenue-sharing legislation, has been drafted but not approved by Iraq's cabinet (Council of Ministers). Two other pieces of legislation that would restructure the Ministry of Oil and establish an Iraq National Oil Company have not been drafted. According to a State Department and a Kurdistan Regional Government (KRG) official, the passage and implementation of all four laws is essential to achieve increased transparency, accountability, and revenue management.

However, poor security, corruption, and lack of unity and trust will likely impede the implementation of the legislation.

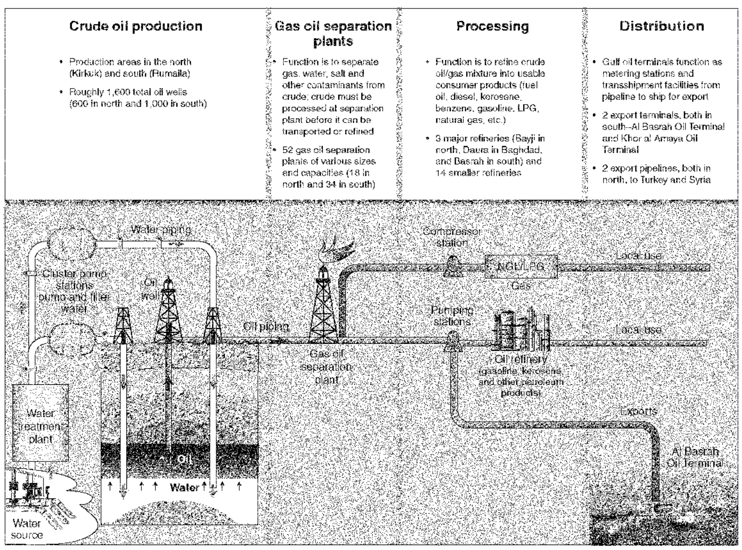
In our May 2007 report, we recommended that the Secretary of State work with the Iraqi government and particularly with the Ministries of Oil and Electricity to (1) develop an integrated energy strategy for the oil and electricity sectors; (2) expedite efforts to establish an effective metering system for the oil sector; (3) develop fair and equitable hydrocarbon legislation, regulations, and implementing guidelines; (4) expedite efforts to develop adequate budgeting, procurement, and financial management systems; and (5) implement a viable donor mechanism to secure funding for Iraq's future oil and electricity rebuilding needs.

In commenting on our prior report, State agreed that all the steps we included in our recommendations are necessary to improve Iraq's energy sector but stated that these actions are the direct responsibility of the Government of Iraq, not the Department of State, any U.S. agency, or the international donor community. We recognize that these actions are ultimately the responsibility of the Iraqi government. However, the U.S. government wields considerable influence in overseeing Iraq stabilization and rebuilding efforts.

Background

Iraq's oil infrastructure is an integrated network that includes crude oil fields and wells, pipelines, pump stations, refineries, gas oil separation plants, gas processing plants, export terminals, and ports (see fig. 1). This infrastructure has deteriorated significantly over several decades due to war damage; inadequate maintenance; and the limited availability of spare parts, equipment, new technology, and financing. Considerable looting after Operation Iraqi Freedom and continued attacks on crude and refined product pipelines have contributed to Iraq's reduced crude oil production and export capacities.

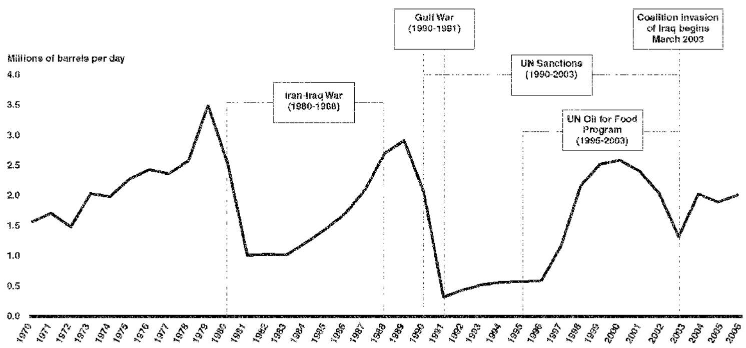
Figure 1: Overview of Iraq's Oil Network



Sources: GAO analysis; photo (U.S. Army Corps of Engineers).

Iraq's crude oil reserves, estimated at a total of 115 billion barrels, are the third largest in the world. However, Iraq's ability to extract these reserves has varied widely over time and has been significantly affected by war. Figure 2 shows Iraq's daily average crude oil production levels annually from 1970 through 2006.

Figure 2: Crude Oil Production Levels in Iraq, 1970 through 2006



Source: GAO analysis of data from the U.S. Department of Energy, Energy Information Administration.

Iraq's crude oil production reached 3.5 mbpd, its highest annual average, in 1979. In September 1980, Iraq invaded Iran and production levels plummeted. Although the Iran-Iraq War continued until 1988, production levels grew steadily after 1983, peaking at 2.9 million barrels per day in 1989. The Gulf War began the following year when Iraq invaded Kuwait. In January 1991, the United States and coalition partners began a counter-offensive (Operation Desert Storm). Crude oil production once again dropped precipitously and remained relatively low from 1990 to 1996, while Iraq was under UN sanctions. Under the UN Oil for Food program, Iraqi crude oil production began to rebound, peaking at an annual average of 2.6 mbpd in 2000. In the 5 years preceding the 2003 U.S. invasion of Iraq, crude oil production averaged 2.3 mbpd. In 2003, crude oil production dropped again to a low of about 1.3 million barrels per day (annual average) but then rebounded.

Iraq's Oil Production Goals Have Not Been Met and Oil Production Figures May Be Overstated

Despite U.S. and Iraqi government efforts to reconstruct Iraq's key economic sector, oil production has consistently fallen below U.S. program goals. In addition, production levels may be overstated and measuring them precisely is challenging due to limited metering and poor security. Comprehensive metering has been an outstanding goal of the United States, the international community, and the Iraqi government.

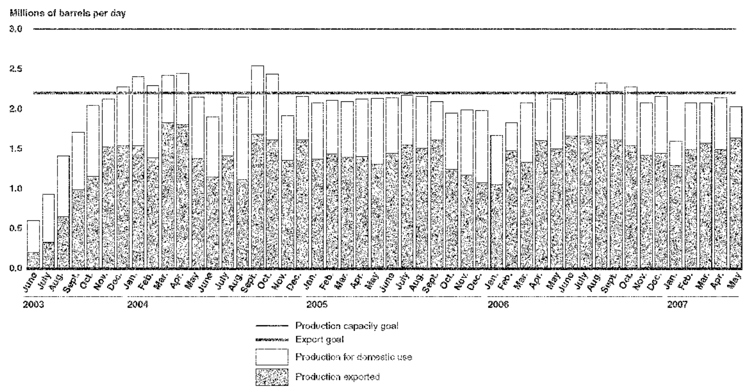
U.S. Oil Goals Have Not Been Met

Key reconstruction goals for Iraq's oil sector, including those for crude oil production and exports, and refined fuel production capacity and stock levels, have not been met. U.S. goals for the oil sector include reaching an average crude oil production capacity of 3 million barrels per day (mbpd) and crude oil export levels of 2.2 mbpd.[2] However, in 2006, actual crude oil production and exports averaged, respectively, about 2.1 mbpd and 1.5 mbpd. Figure 3 compares Iraq's oil production and exports with U.S. goals (the data for this figure are presented in appendix I). As the figure shows, production and exports for the first five months of 2007 were still below U.S. goals. In August 2003, the CPA established a U.S. program goal to increase crude oil production to about 1.3 mbpd. The CPA increased this goal every 2 to 3 months until July 2004, when the goal became to increase crude oil production capacity to 3.0 mbpd.[3]

[2]U.S. goals differ from the government of Iraq and IMF targets. According to the State Department, as of January 2007, Iraq's production goal is 2.1 mbpd and its export goal is 1.7 mbpd.

[3]Production *capacity* differs from actual production. Production capacity is the maximum amount of production a country can maintain over a period of time. For example, EIA has defined production capacity as the maximum amount of production that (1) could be brought online within 30 days and (2) sustained for at least 90 days. Since Iraq has been trying to increase its production of crude oil, we use actual production as an indicator of Iraq's production capacity in this report.

Figure 3: Iraqi Reported Crude Oil Production and Exports and U.S. Goals, June 2003 through May 2007



Source: GAO analysis of Iraq Ministry of Oil data collected by State Department.

Besides production and export of crude oil, the CPA also established goals for the production of natural gas and liquefied petroleum gas (LPG), as well as the national stocks of refined petroleum products (such as gasoline) that are used to generate energy by consumers and businesses. These CPA goals were to increase production capacity of natural gas to 800 million standard cubic feet per day (mscfd); increase production capacity of LPG to 3,000 tons per day (tpd); and meet demand for benzene (gasoline), diesel, kerosene, and LPG by building and maintaining their stock levels at a 15-day supply.

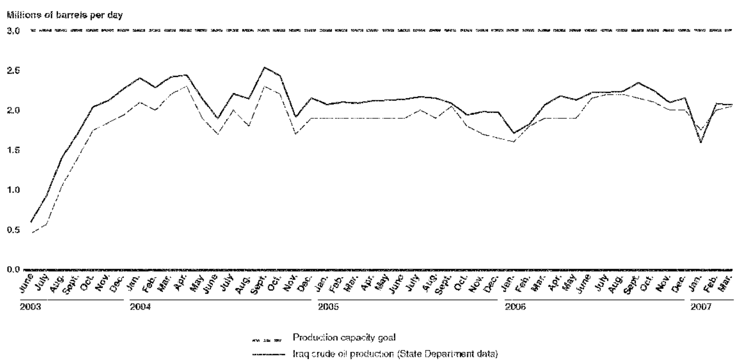
However, the 2006 averages did not meet these goals. To increase the stocks of petroleum products and their availability to consumers, Iraq legalized the importation of petroleum products by private companies to supplement its own production and state-owned company imports. For 2006, the IMF estimated that Iraq's state-owned companies imported about $2.6 billion of petroleum products. At the recommendation of the IMF, the Iraqi government has been reducing subsidies for refined oil products, which raises the prices consumers pay. In the past, refined oil products in Iraq had been highly subsidized, which led to increased demand. Reduction in domestic demand for refined oil products would allow additional crude oil to be exported for revenue rather than refined in Iraq.

Iraq's Crude Oil Production May Be Overstated

Iraq's crude oil production statistics may be overstated. We compared the State Department's statistics to those published by the EIA, which are based on alternate sources.[4] Part of EIA's mission is to produce and disseminate statistics on worldwide energy production and use. While these two data sets follow similar trend lines, EIA reports that Iraqi oil production was about 100,000 to 300,000 barrels per day lower than the amounts the State Department reported. At an average price of \$50 per barrel, this is a discrepancy of \$5 million to \$15 million per day, or \$1.8 billion to \$5.5 billion per year. Figure 4 shows these two data sets over the time period (June 2003 to March 2007) for which data from both State and EIA were available. The data for this figure are presented in appendix I.

[4]EIA uses its own analysis and a variety of sources, including Dow Jones, the *Middle East Economic Survey*, the *Petroleum Intelligence Weekly*, the International Energy Agency (IEA), the *Monthly Oil Market Report* from OPEC, the *Oil & Gas Journal*, Platts, and Reuters.

Figure 4: Comparison of State Department and EIA Data on Iraq's Crude Oil Production



Source: GAO analysis of Iraq Ministry of Oil data collected by the State Department and U.S. Energy Information Administration data.

According to EIA, several factors may account for the discrepancy. One factor is the lack of storage facilities for crude oil in Iraq. Crude oil that cannot be processed by refineries or exported is reinjected into the ground.[5] Another factor affecting the discrepancy may be differences in the frequency and timing of the data. The State Department's data are reported daily in real time, while EIA produces monthly data that have been reviewed and corroborated from several sources. This lag in reporting and longer time period may allow analysts to address inconsistencies such a double counting and reinjection. In addition, the State Department regularly reports on sabotage and interdictions to crude oil pipelines and other disruptions in the crude oil production process. Also, under Saddam Hussein, Iraq had a history of diverting crude oil production to circumvent UN sanctions. Therefore, it is possible that corruption, theft, and sabotage may also be factors in the discrepancy.

[5] Reinjecting crude oil and, more commonly heavy fuel oil (residual oil) into wells is one way to maintain pressure in the wells for extraction. However, this practice can also damage the wells and reduce the value of the remaining reserves.

Metering of Oil Production and Distribution Network Has Been a Long-standing but Unmet Goal

Reliable information on Iraqi's oil production is further complicated by the lack of metering. According to a State Department oil advisor, meters are in place at many locations but are not usable in many instances due to the difficulties in obtaining needed replacements and spare parts. Without comprehensive metering, crude oil production must be estimated using less precise means, such as estimating the flow through pipelines and relying on reports from onsite personnel rather than an automated system that could be verified.

An improved metering system has been a U.S. and international donor priority since early 2004, but implementation has been delayed. In 1996, the UN first cited the lack of oil metering when Iraq was under UN sanctions. In 2004, the International Advisory and Monitoring Board (IAMB) for the Development Fund for Iraq recommended the expeditious installation of metering equipment. According to IAMB, in June 2004, the CPA had approved a budget to replace, repair, and calibrate the metering system on Iraq's oil pipeline network. However, the oil metering contract was not completed due to security and technical issues. In June 2006, IAMB reported that the Iraqi government had entered into an agreement with Shell Oil Company to serve as a consultant for the Ministry of Oil. Shell would advise the ministry on the establishment of a system to measure the flow of oil, gas, and related products within Iraq and in export and import operations. The U.S. government is assisting in this effort by rebuilding one component of the metering system in the Al-Basrah oil port—Iraq's major export terminal—and expects the project to be complete in July 2007.

Security, Corruption, and Funding Challenges Hinder Reconstruction Efforts

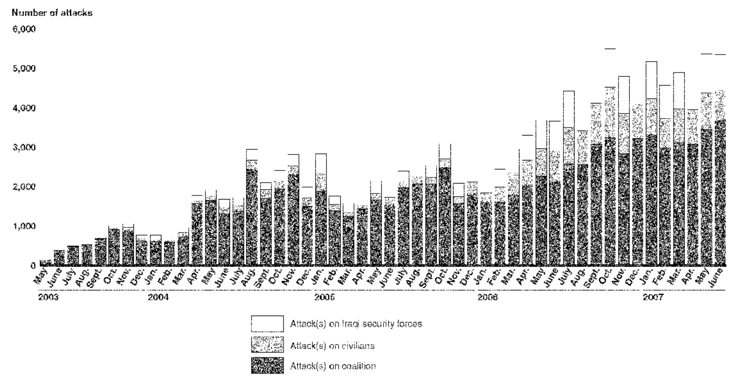
The U.S. government and Iraq face several key challenges in improving Iraq's oil sector. First, the U.S. reconstruction program assumed a permissive security environment that never materialized; the ensuing lack of security resulted in project delays and increased costs. Second, corruption and smuggling have diverted government revenues potentially available for rebuilding efforts. Third, future funding needs for reconstruction of Iraq's oil sector are significant, but the source of these funds is uncertain.

Poor Security Conditions Have Slowed Reconstruction and Increased Costs

The U.S. reconstruction effort was predicated on the assumption that a permissive security environment would exist. However, since May 2003, overall security conditions in Iraq have deteriorated and grown more complex, as evidenced by the increased numbers of attacks (see fig. 5). The average number of daily attacks in June 2007 was about the same level as the prior high of about 180 attacks per day that occurred in October 2006 around the time of Ramadan.

Overall, the average number of daily attacks was about 50 percent higher in June 2007 than in June 2006.[6]

Figure 5: Enemy-Initiated Attacks against the Coalition, Iraqi Security Forces, and Civilians (May 2003 through June 2007)



Source: GAO analysis of DIA-reported Multi-National Force-Iraq data, June 2007.

Note: Attacks against infrastructure account for less than 1 percent of enemy-initiated attacks.

The deteriorating security environment has led to project delays and increased costs. Insurgents have destroyed key oil infrastructure, threatened workers, compromised the transport of materials, and hindered project completion and repairs by preventing access to work sites. Moreover, looting and vandalism have continued since 2003. U.S. officials reported that major oil pipelines in the north continue to be sabotaged, shutting down oil exports and resulting in lost revenues. For example, according to the Army Corps of Engineers, although eight gas oil separation plants in northern Iraq have been refurbished, many are

[6]While the data on attacks provide a reasonably sound depiction of security trends, DOD documents and officials acknowledge that these data provide only a partial picture of violence in Iraq because not all attacks against civilians and Iraqi security forces are observed by or reported to coalition forces.

not running due to interdictions on the Iraq-Turkey pipeline and new stabilization plant. The Corps noted that if the lines and plant were in operation today, an additional 500,000 barrels per day could be produced in northern Iraq.

The U.S. government has developed a number of initiatives to protect the oil infrastructure and transfer this responsibility to the Iraqi government.[7] Such efforts include fortifying the infrastructure and improving the capabilities of rapid repair teams and protection security forces such as the Oil Protection Force and the Strategic Infrastructure Battalions (SIB). The U.S. government has paired these security forces with coalition partners and has trained and equipped the SIBs. However, U.S. officials stated that the capability and loyalty of some of these units are questionable. According to Department of Defense (DOD) and Center for Strategic and International Studies reports,[8] these security forces have been underpaid, underequipped, and poorly led, and are sometimes suspected of being complicit in interdiction and smuggling. Additional information on the nature and status of these efforts and the SIBs is classified.

Corruption and Smuggling Reduce Oil Revenues

U.S. and international officials have noted that corruption in Iraq's oil sector is pervasive. In 2006, the World Bank and the Ministry of Oil's Inspector General estimated that millions of dollars of government revenue are lost each year to oil smuggling or diversion of refined products. According to State Department officials and reports, about 10 percent to 30 percent of refined fuels are diverted to the black market or are smuggled out of Iraq and sold for a profit. According to State Department reporting, Iraqi government officials may have profited from these activities. The insurgency has been partly funded by corrupt activities within Iraq and by skimming profits from black marketers, according to U.S. embassy documents. According to a June 2007 DOD report, a variety of criminal, insurgent, and militia groups engage in the theft and illicit sale of oil to fund their activities. For example, DOD reported that as much as 70 percent of the fuel processed at Bayji was lost to the black market—possibly as much as S2 billion a year. As a result, the Iraqi Army assumed control of the entire Bayji refinery, and equipment is being installed to prevent siphoning.

[7] The Special Inspector General for Iraq Reconstruction (SIGIR), *Unclassified Summary of SIGIR's Review of Effort to Increase Iraq's Capability to Protect Its Energy Infrastructure*, SIGIR-06-038 (Washington, D.C.. Sept. 27. 2006).

[8] Anthony Cordesman, Center for Strategic and International Studies, *Iraqi Force Development and the Challenge of Civil War: The Critical Problems and Failures the U.S. Must Address If Iraqi Forces Are to Eventually Do the Job* (Washington. D.C.: Nov. 30. 2006). Department of Defense, *Measuring Stability and Security in Iraq* (Washington. D.C.: June 7, 2007).

One factor that had stimulated black market activities and fuel smuggling to neighboring countries was Iraq's low domestic fuel prices, which were subsidized by the government. However, under the IMF's Stand-by Arrangement with Iraq, the government has already increased domestic fuel prices several times, significantly reducing the subsidy for many fuel products. The Iraqi government intends to continue the price increases during 2007 and encourage private importation of fuels, which was liberalized in 2006. The purpose is to decrease the incentive for black market smuggling and to increase the availability of fuel products.

Future Funding Needs Are Significant but Funding Sources Are Uncertain

While billions have been provided to rebuild Iraq's oil sector, Iraq's future needs are significant and sources of funding are uncertain. For fiscal years 2003 through 2006, the United States made available about $2.7 billion, obligated about $2.6 billion, and spent about $2.1 billion to rebuild Iraq's oil sector. According to various estimates and officials, Iraq will need billions of additional dollars to rebuild, maintain, and secure its oil sector. Since the majority of U.S. funds have been spent, the Iraqi government and international community represent important sources of potential future funding.

However, the Iraqi government has not fully spent the capital project funds already allocated to the oil sector in Iraq's 2006 budget. In 2006, Iraq planned to spend more than $3.5 billion for capital projects in the oil sector. This amount accounted for about 98 percent of the Ministry of Oil's total budget ($3.6 billion) that year. As of December 2006, the end of Iraq's fiscal year, only 3 percent of oil sector capital project funds had been spent.[9] While Iraq's inability to spend its capital budget may not directly affect U.S.-funded projects, U.S. investment alone is not adequate for the full reconstruction and expansion of the oil sector. Therefore, Iraq's continued difficulties in spending its capital budget could hamper efforts to attain its current reconstruction goals.

According to U.S. officials, Iraq lacks the clearly defined and consistently applied budget and procurement rules needed to effectively implement capital projects. For example, the Iraqi ministries are guided by complex laws and regulations, including those implemented under Saddam Hussein, the CPA, and the current government. According to State Department officials, the lack of

[9]Although U.S. advisors are aware of various Iraqi ministries' limited spending in areas such as capital projects, we cannot verify the precision of these numbers. For the purpose of this testimony, we only use these data, in conjunction with U.S. advisors' reports, to identify limited spending as a potential challenge for Iraq should it rely on its ministries' own budgets to fund future reconstruction projects.

agreed-upon procurement and budgeting rules causes confusion among ministry officials and creates opportunities for corruption and mismanagement. Additionally, according to the State Department and DOD, personnel turnover within the ministries, fear of corruption charges, and an onerous contract approval process[10] have caused delays in contract approval and capital improvement expenditures.

Furthermore, the Iraqi government has not made full use of potential international loans, and future donor funding for the oil sector remains uncertain. Donors other than the United States have not provided any grants to develop the oil sector, and the Iraqi government had not taken advantage of $467 million in loans from Japan to develop a crude oil export facility and upgrade a refinery. According to U.S. and international officials, donor funding has been limited because of an expectation that sufficient funds would be provided through Iraq's oil revenues and private investors.

Moreover, it is unclear to what extent the International Compact with Iraq will serve as a viable mechanism to obtain additional donor support for Iraq, particularly for the oil sector. Launched in May 2007, the compact was intended to secure additional funding for Iraq's oil, electricity, and other sectors. However, the extent to which the compact will stimulate international assistance for the oil sector remains uncertain.

Challenges Impede Efforts to Enact and Implement Comprehensive Hydrocarbon Legislation

The World Bank reports that additional incentives are needed to stimulate oil production and investment, including a clear legal and regulatory framework; clearly assigned roles for Iraq's ministries, state agencies, and the private sector; and a predictable negotiating environment for contracts. Iraq has yet to enact and implement comprehensive hydrocarbon legislation that would define the distribution of future oil revenues and the rights of foreign investors. According to U.S. officials, until such legislation is passed and implemented, it will be difficult for Iraq to attract the billions of dollars in foreign investment it needs to modernize the oil sector.

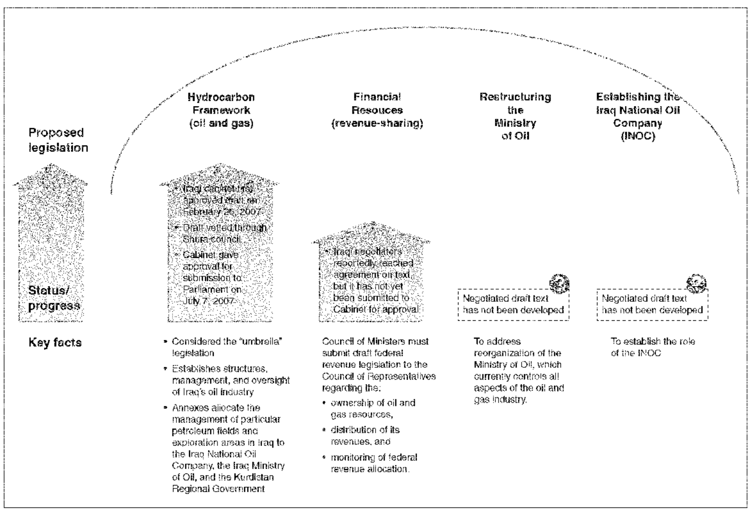
As of July 13, 2007, the Iraqi government was in various stages of drafting and enacting four separate, yet interrelated, pieces of legislation: hydrocarbon framework legislation that establishes the structure, management, and oversight

[10] According to the State Department, the Contracting Committee requirement for about a dozen signatures to approve electricity and oil contracts exceeding $10 million further slows a bureaucratic process.

for the sector; revenue-sharing legislation (the draft "Law of Financial Resources"); legislation restructuring the Ministry of Oil; and legislation establishing the Iraq National Oil Company (INOC). According to the State Department, to be enacted as law, the four pieces of legislation must be approved by Iraq's cabinet (Council of Ministers), vetted through the Shura council,[11] and then submitted by the cabinet to a vote by Iraq's parliament (Council of Representatives). If the laws are passed, they are then made publicly available in the Iraqi government's official publication, known as the *Official Gazette*. Figure 6 shows the status of the four proposed pieces of legislation as of July 1, 2007.

[11]According to a State Department official responsible for monitoring the hydrocarbon legislation, the Shura Council is the committee to ensure constitutionality and avoid contradictions with the Iraqi legal system (including Islamic law).

Figure 6: Status of Iraq's Hydrocarbon Legislation, July 1, 2007



Source: GAO based on information from the State Department and Kurdistan Regional Government.

Note: According to a State Department official, as of July 13, 2007, the annexes may have been dropped from the hydrocarbon framework legislation because agreement could not be reached on the allocation of petroleum fields and exploration areas. It remains uncertain how this reportedly contentious issue will be resolved.

The draft hydrocarbon framework is the furthest along in the legislative process and is currently before Iraq's parliament, according to a State Department and a KRG official. According to these officials, it provides an overall framework but lacks key details that will be addressed in the financial resources and other legislation. The UN reported in early June 2007 that there had been no decision on whether the hydrocarbon framework legislation would be voted on as a part of a larger energy package with annexes and supporting legislation or voted on separately. The KRG has published the negotiated "agreed-to" text for the revenue-sharing legislation, which has not yet been approved by the cabinet. Negotiated text of the draft laws for restructuring the Ministry of Oil and establishing INOC have yet to developed and published. According to a State Department and KRG officials, the passage and implementation of all four laws is essential to achieve increased transparency, accountability, and revenue management.

Moreover, enacting and implementing hydrocarbon legislation and subsequent regulations and procedures will likely be impeded by some of the same challenges, such as poor security and corruption, that affect achieving program goals and reconstruction of the oil sector. According to U.S. officials, sectarian attacks and the lack of national unity and trust have resulted in competing sectarian interests and wariness of foreign investment. Also, according to U.S. officials, opportunities to profit from corruption and smuggling reduce the incentive for greater transparency and accountability in oil resource management. U.S. officials recognize that significant implementation challenges will remain once the draft legislation is enacted into law.

Conclusion

As we recently reported, the United States has spent billions of dollars to rebuild Iraq's oil sector, but billions more will be needed to surmount the challenges facing Iraq's oil sector. Iraq's oil sector lacks an effective metering system to measure output, determine revenue trends, and identify illicit diversions. Opaque laws governing investment have also limited foreign investment in this critical sector. The passage of comprehensive Iraqi hydrocarbon legislation could serve as an important impetus for stimulating additional investment if and when security conditions improve. The development of the sector is also hindered by weak government budgeting, procurement, and financial management systems and limited donor spending. The absence of an integrated strategic plan that coordinates efforts across the oil and electricity sectors is essential given their highly interdependent nature. Such a plan would help identify the most pressing needs for the entire energy sector and help overcome the daunting challenges affecting future development prospects.

Recommendations for Executive Action

In our May 2007 report, we recommended that the Secretary of State, in conjunction with relevant U.S. agencies and in coordination with the donor community, work with the Iraqi government and particularly the Ministry of Oil to:

1. Develop an integrated energy strategy for the oil and electricity sectors that identifies and integrates key short-term and long-term goals and priorities for

rebuilding, maintaining, and securing the infrastructure; funding needs and sources; stakeholder roles and responsibilities, including steps to ensure coordination of ministerial and donor efforts; environmental risks and threats; and performance measures and milestones to monitor and gauge progress.

2. Set milestones and assign resources to expedite efforts to establish an effective metering system for the oil sector that will enable the Ministry of Oil to more effectively manage its network and finance improvements through improved measures of production, consumption, revenues, and costs.

3. Improve the existing legal and regulatory framework, for example, by setting milestones and assigning resources to expedite development of viable and equitable hydrocarbon legislation, regulations, and implementing guidelines that will enable effective management and development of the oil sector and result in increased revenues to fund future development and essential services.

4. Set milestones and assign resources to expedite efforts to develop adequate ministry budgeting, procurement, and financial management systems.

5. Implement a viable donor mechanism to secure funding for Iraq's future oil and electricity rebuilding needs and for sustaining current energy sector infrastructure improvement initiatives once an integrated energy strategic plan has been developed.

Agency Comments

In commenting on a draft of our May 2007 report, State agreed that all the steps we included in our recommendations are necessary to improve Iraq's energy sector but stated that these actions are the direct responsibility of the Government of Iraq, not of the Department of State, any U.S. agency, or the international donor community. State also commented that U.S. agencies are already taking several actions consistent with our recommendations. We recognize that these actions are ultimately the responsibility of the Iraqi government. However, it remains clear that the U.S. government wields considerable influence in overseeing Iraq stabilization and rebuilding efforts. We also believe additional actions are warranted given the lack of progress that has been made over the last 4 years in achieving Iraq reconstruction goals.

Mr. Chairmen, this concludes my statement. I would be pleased to answer any questions that you or other Members may have at this time.

GAO Contacts and Acknowledgments

For questions regarding this testimony, please call Joseph A. Christoff at (202) 512-8979 or christoffj@gao.gov. Other key contributors to this statement were Stephen Lord, Assistant Director; Lynn Cothern; Kathleen Monahan; and Timothy Wedding.

Appendix I: Data on Iraq's Crude Oil Production and Exports

Table 1 provides the data used in figures 3 and 4 of this testimony. Department of State data on Iraq's crude oil production and exports are collected by State Department officials in Iraq through Iraq's Ministry of Oil. We calculated Iraq's production for domestic consumption (the amount of oil produced that remains in the country) as the remainder of Iraq's production of crude oil after exports, based on State Department's data. Data from the Department of Energy's Energy Information Administration (EIA) are based on EIA's own analysis and a variety of sources, including Dow Jones, the *Middle East Economic Survey*, the *Petroleum Intelligence Weekly*, the International Energy Agency, OPEC's *Monthly Oil Market Report*, the *Oil & Gas Journal*, Platts, and Reuters.

Table 1: Iraq's Oil Production, Exports, Production for Domestic Consumption (millions of barrels per day)

	State Department Data			EIA Data
Month/Year	Production	Exports	Production for Domestic Consumption	Production
Jun-03	0.596	0.200	0.396	0.452
Jul-03	0.927	0.322	0.605	0.572
Aug-03	1.408	0.646	0.762	1.050
Sep-03	1.705	0.983	0.722	1.399
Oct-03	2.046	1.149	0.897	1.749
Nov-03	2.124	1.524	0.600	1.848
Dec-03	2.278	1.541	0.737	1.948
Jan-04	2.406	1.537	0.869	2.103
Feb-04	2.289	1.382	0.907	2.003
Mar-04	2.421	1.825	0.596	2.203
Apr-04	2.445	1.804	0.641	2.303
May-04	2.149	1.380	0.769	1.903
Jun-04	1.899	1.148	0.751	1.703
Jul-04	2.210	1.406	0.804	2.003
Aug-04	2.148	1.114	1.034	1.803
Sep-04	2.539	1.679	0.860	2.303
Oct-04	2.435	1.607	0.828	2.203
Nov-04	1.916	1.351	0.565	1.703
Dec-04	2.156	1.607	0.549	1.903
Jan-05	2.076	1.367	0.709	1.903
Feb-05	2.103	1.431	0.672	1.903

	State Department Data			EIA Data
Month/Year	Production	Exports	Production for Domestic Consumption	Production
Mar-05	2.091	1.394	0.697	1.903
Apr-05	2.121	1.398	0.723	1.903
May-05	2.127	1.308	0.819	1.903
Jun-05	2.140	1.440	0.700	1.903
Jul-05	2.172	1.550	0.622	2.003
Aug-05	2.153	1.504	0.649	1.903
Sep-05	2.089	1.609	0.480	2.053
Oct-05	1.944	1.239	0.705	1.803
Nov-05	1.981	1.168	0.813	1.703
Dec-05	1.978	1.071	0.907	1.653
Jan-06	1.713	1.094	0.619	1.603
Feb-06	1.829	1.473	0.356	1.803
Mar-06	2.072	1.325	0.747	1.903
Apr-06	2.183	1.596	0.587	1.903
May-06	2.131	1.507	0.624	1.903
Jun-06	2.221	1.702	0.519	2.153
Jul-06	2.226	1.685	0.540	2.203
Aug-06	2.238	1.582	0.656	2.203
Sep-06	2.348	1.740	0.608	2.153
Oct-06	2.247	1.511	0.737	2.103
Nov-06	2.097	1.436	0.660	2.003
Dec-06	2.156	1.450	0.706	2.003
Jan-07	1.597	1.292	0.305	1.753
Feb-07	2.084	1.494	0.590	2.003
Mar-07	2.073	1.571	0.502	2.053
Apr-07	2.141	1.491	0.650	
May-07	2.024	1.631	0.393	

Source: State Department and U.S. Energy information.

Note: EIA data on Iraq's crude oil production are available only through March 2007.

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Mr. ACKERMAN. This thing seems to be a total screw up.

Mr. CHRISTOFF. A lot of problems.

Mr. ACKERMAN. Have you ever seen anything like this?

Mr. CHRISTOFF. Well, not in the 25 years I have worked for GAO.

Mr. ACKERMAN. Is it getting better over there?

Mr. CHRISTOFF. There are a few things that I think are getting better. I can give you one example.

Mr. ACKERMAN. Please.

Mr. CHRISTOFF. I think Iraq has done well in trying to raise the price of gasoline and diesel as required by the IMF. September 2005, it was about five cents a gallon. It is now $1.20 a gallon. That helps reduce smuggling because people are paying fair market prices at this point. But in terms of producing oil, it hasn't gotten any better.

Mr. ACKERMAN. If $1.20 a gallon is a fair market price, I was just robbed this morning.

Mr. CHRISTOFF. Well, compared to its neighbors, it is about in the ballpark.

Mr. ACKERMAN. This thing is a total mess. I mean, we are spending $2 billion of American taxpayer money every week, and for the last how many years, and people are siphoning off billions of dollars of oil in addition to that that is supposed to be helping the Iraqi people.

Mr. CHRISTOFF. Right.

Mr. ACKERMAN. It sounds like an unconscionable criminal enterprise in which we have all conspired. Do we have any idea who is benefiting from all of this?

Mr. CHRISTOFF. I think it is pretty clear from both the published reports that I have read and the classified reports that I read that corruption in the oil sector is pretty pervasive at all levels of the industry.

Mr. ACKERMAN. Explain to me, as I understand, there are 15, no less than 15, that is more than a dozen, a dozen and a quarter paid American consultants overseeing this enterprise. Who do these consultants work for? What agencies?

Mr. CHRISTOFF. Well, if you are referring to the advisors.

Mr. ACKERMAN. Yes.

Mr. CHRISTOFF. The U.S. has about 20 advisors working with the minister of oil.

Mr. ACKERMAN. And what is their job again?

Mr. CHRISTOFF. What do they do? Well, one of the problems that all the ministries have is that they don't know how to execute budgets. They don't know how to spend their budget. They don't have good contracting and procurement rules, and all of the——

Mr. ACKERMAN. They couldn't even figure out how to execute the dictator.

Mr. CHRISTOFF. Pardon?

Mr. ACKERMAN. It was a quip. You don't have to address that. Tell me again what they are supposed to do.

Mr. CHRISTOFF. One of the key things that all the advisors, and of course I am speaking from my observations as part of the legislative branch, not from the administration's perspective, is that they are trying to help them execute their budgets.

As you noted in your opening statement, minister of oil only spend $90 million out of the $3.5 billion they set aside for oil projects.

Mr. ACKERMAN. Any advisors to tell them how to do this the way they are doing it?

Mr. CHRISTOFF. Well, they don't know how. According to the advisors, they don't have good skills and good technical skills in terms of letting contracts, issuing contracts. They don't know what fair and competitive bidding is. The World Bank has even commented on the difficulties they have in trying to explain true competitive bidding procedures with Iraqi officials.

Mr. ACKERMAN. Somebody better call the cops. There is something bad going on here. I just don't understand this. How are we letting them get away with this? How are they getting away with this? How are the Iraqi people allowing them to get away with this? What are these advisors doing? Are they following the advice the advisors are advising?

Mr. CHRISTOFF. One thing that we are actually going to be issuing a report in about 6 weeks looking at all of what the advisors are doing, and I think one of the challenges the advisors have found is that oftentimes the Iraqis don't take their advice, because they have their own agendas in terms of what they want to achieve.

Mr. ACKERMAN. Wow. This is beyond criticism. It is hard to get a handle on even what end to approach this problem with it seems to huge and immense. How did it get so out of hand? Do we suspect that this system was that bad under Saddam Hussein?

Mr. CHRISTOFF. Oh, absolutely. In fact, Mr. Delahunt, you recall the hearings we had on the Oil for Food Program. GAO at the time estimated that up to 480,000 barrels of oil was smuggled out of Iraq.

Mr. ACKERMAN. Yes, but we know who got the money then.

Mr. CHRISTOFF. A variety of companies as well as the Iraqi Government.

Mr. ACKERMAN. And who is getting it now?

Mr. CHRISTOFF. Unclear.

Mr. ACKERMAN. How do we get it clearer?

Mr. CHRISTOFF. You can get clearer with some additional classified information certainly.

Mr. ACKERMAN. The classified information would indicate to us who is getting rich?

Mr. CHRISTOFF. It indicates——

Mr. ACKERMAN. How this is getting done and how to stop it?

Mr. CHRISTOFF. It would indicate the pervasiveness of the problem, yes.

Mr. ACKERMAN. I think we have got a flavor of the pervasiveness of the problem.

Mr. CHRISTOFF. One of the——

Mr. ACKERMAN. I mean, this is world class racketeering that we are in charge of advising. Yes, this is an international RICO kind of deal. I mean, this is absolutely mind boggling.

I think I have used my 5 minutes in amazement. We are pleased to yield the time to Mr. Pence, the ranking member on the Subcommittee on the Middle East and South Asia.

Mr. PENCE. Thank you, Chairman, and I thank the chairman of both subcommittees for calling an important hearing, and I thank our witness for your service to the country at GAO.

The topic before us today seems to me of enormous significance. Oil experts provide 95 percent of Iraq's foreign exchange earnings, nearly all its food and medicine imports, virtually all of its government revenue. Oil is Iraq.

Mr. CHRISTOFF. Right.

Mr. PENCE. But it seems to me it is also a sector that is subject to immense complexity, and how to assist the Iraqi Government in writing laws dealing with managing its economy in the midst of sectarian violence is, I think, as important as it is difficult, and your testimony reflects that.

As I said at our full committee hearing yesterday, Mr. Chairman, I believe we do have a stake in success. If our generals reports and recommends some different tactic and strategy on the ground, as I said before the full committee yesterday, I am more than willing to adjust strategy, tactics, but not the objective, which I believe must be an American success and an Iraqi success, and it seems to me that the energy laws are central to that success given their centrality of oil to this economy.

I also am very concerned that we not inadvertently send a message that will result in rushing hydrocarbon laws which could ultimately result in increased violence and jeopardize the entire constitutional order in its fledgling moments.

With that, a couple quick questions for our witness because I know, Mr. Chairman, that votes might be imminent here.

Mr. Christoff, give me a little context here. This is an area of foreign affairs that you have great expertise in. I think we can know somewhere less than 4 years Iraq has been negotiating this hydrocarbon law. How long has it taken other countries to draft legislation of this nature? Is there a comparison? And the process that we are witnessing, is it taking longer than expected or is it reflective of what we have seen in other jurisdictions?

Mr. CHRISTOFF. Yes, I don't think I have a good comparison to other countries, but when you made the point 4 years, I think it is important to keep in mind that there were three governments. We had an interim government, a provisional government, and now the permanent government. So one of the things that I hear from our advisors is just being able to have some consistency in the ministries that they are working with.

So we started working with the current government for all practical purposes in May 2006, when it was finally formed.

Mr. PENCE. You were nodding when I was talking about the centrality of oil revenues to this economy.

Mr. CHRISTOFF. Yes.

Mr. PENCE. Can you speak to that a bit? How closely connected do you see—because when many of us talk about or have visited Iraq, and one of my five trips, it seems like we talk about a variety of reforms, including de-Baathification, provincial elections, and of course the oil revenue sharing law, but it isn't just one of the reforms, in my judgment, after making a deeper study of this. It seems to me, and this is a benefit of this hearing, this is really—this is at a level of, it seems to me implied in your testimony, that this interrelates to the success of a constitutional order in Iraq. Is that a fair——

Mr. CHRISTOFF. That is a correct statement.

Mr. PENCE. Could you expand on that?

Mr. CHRISTOFF. Yes. For example, I think some of the provisions, the constitutional, you could call it a constitutional Congress or the committee that still has yet to be formed and to report out on changes to the constitution. You know, one of the important changes that would have to be debated is the role of regions, and the extent to which new regions are going to be allowed to be formed, like a Shia region in the south.

Well, that bears into what would be the percentages in oil revenue that would go to the regions versus the central government. So if you don't have decisions in the constitution about clearly defined roles of federalism, that is going to bear on how do you determine whether the central government gets what percentage or the regions get what percentage, so it is very interrelated.

Mr. DELAHUNT. Would my friend yield?

Mr. PENCE. I would be pleased to yield, Mr. Chairman.

Mr. DELAHUNT. If I understand you, Mr. Christoff, it makes little sense to pass a hydrocarbon law in all of its aspects without having the work of the constitutional committees accomplished as a prerequisite. In other words, how can the Iraqi Government pass a law dealing with the management of its hydrocarbon resources and implicated in that is an allocation among the regions when the constitutional provisions that would order those or that would define those regions are not in existence?

Mr. CHRISTOFF. Yes, an uncertified——

Mr. DELAHUNT. I mean, are we putting the cart before the horse, to put it in the colloquial.

Mr. CHRISTOFF. I actually see lots of carts and lots of horses, and it is not just——

Mr. DELAHUNT. What about this horse and this cart?

Mr. CHRISTOFF. That is one. That is one, but you also have to what extent do you resolve the disposition of Kirkuk? To what extent do you have a census that would clearly define the populations that would result in the percentage of revenue that those regions are going to get?

So you have a whole host of issues, both constitutional and others.

Mr. DELAHUNT. But the constitution that would create those regions and hopefully resolve those issues, no action has been taken by the Iraqi Parliament or the Iraqi cabinet on those issues, and yet we are pressing the Iraqi Government to pass a hydrocarbon act in a vacuum. That is my point. The more I examine this issue, I just can't understand the logic in terms of the sequence here. I don't know whether you agree with me, Joe, and I thank the gentleman for yielding.

Mr. PENCE. I am reclaiming my time. I would like the gentleman to respond. I will pose this one question.

Mr. CHRISTOFF. I don't know what the sequence should be. I just know that there are a variety of different laws and decisions that either have to be made by the Iraqi Government or through the constitutional process that all bear on the sharing of revenues, that all bear on the status of key oil-producing areas in Iraq.

Mr. PENCE. Well, by way of conclusion, and, Mr. Chairman, let me make it clear that I only yield to the gentleman from Massachusetts on his birthday, and birthday wishes.

Mr. CHRISTOFF. Happy birthday.

Mr. DELAHUNT. It is tough being 40, I guess.

Mr. PENCE. Let me allow you to amplify a point. It does seem to me that adding to the complexity of this, and in fairness to Mr. Delahunt's point, that while benchmarks contemplated by the Congress suggests the passage of a hydrocarbon law, it is actually four hydrocarbon laws.

Mr. CHRISTOFF. Correct.

Mr. PENCE. We have four moving legislative vehicles here. We have an evolving constitutional order that has not had provincial elections to date, and I just find your testimony very compelling to the point that these are—there are many moving parts toward a success, however it would be defined in Iraq, but these are the two, the constitutional order and the hydrocarbon laws are two of the bigger cogs, but you speak to that of being four laws, the point you made in your testimony.

Mr. CHRISTOFF. Absolutely, and those four laws that are part of this umbrella, they are at different stages, so the hydrocarbon framework law has been approved by the cabinet. The revenue sharing is still being debated by the cabinet, and two other laws haven't even been drafted, and that is establishing the ministry of oil and also an Iraq National Oil Company.

Mr. PENCE. Very illuminating. Chairman, thank you for calling the hearing.

Mr. ACKERMAN. Thank you.

Chairman Delahunt.

Mr. DELAHUNT. Yes. Thank you, Mr. Ackerman.

I want to be really clear and see if I can clarify for the record what the benchmark that was established by Congress in the last supplemental addressed. I am going to read that language to you, Mr. Christoff.

One of the benchmarks of the 18 was, "Enacting and implementing legislation to ensure the equitable distribution of hydrocarbon resources to the people of Iraq without regard to the sector ethnicity of recipients in an equitable manner."

The legislation that I describe as the framework draft has nothing whatsoever to do with the equitable and fair distribution of oil revenue.

Mr. CHRISTOFF. Well, not really. The hydrocarbon framework might have two annexes attached to it, and those annexes list every single oil field in Iraq, both those producing and those that have been discovered, and they assign them either to the central government or the regions, so that does affect revenue sharing legislation as to who gets what oil wells.

Mr. DELAHUNT. But we don't even know what those annexes are, do we?

Mr. CHRISTOFF. I have seen drafts of them that have been on the KRG site, the Kurdistan Regional Government site.

Mr. DELAHUNT. I inquired——

Mr. CHRISTOFF. But those require a debate.

Mr. DELAHUNT. Let me inform you I inquired of the Department of State, and they don't have access other than what they discover on the Web site of the KRG.

Mr. CHRISTOFF. Right.

Mr. DELAHUNT. The Kurdistan Regional Government.

Mr. CHRISTOFF. Right.

Mr. DELAHUNT. So what we have here is a non-transparent, and it is my understanding from a variety of sources and reports that the Iraqi Parliament has had no access to either model contracts, so-called, or these annexes, and it appears to be dealing in a blind, if you will. Well, let me forego that, and——

Mr. ACKERMAN. Would the gentleman yield for just a moment before he goes on?

Mr. DELAHUNT. Yes.

Mr. ACKERMAN. I wanted to just clear something up to get a better understanding so that there is either a sense of hope or an understanding that what was being offered is not necessarily a sense of hope.

When the legal questions are resolved as far as the oil law and its implementation and everything, is the suggestion is that these problems will be cleared up and resolved because one might note that since the U.S. Constitution was ratified, as I am advised it was in 1789, there has been absolutely no theft of anything in America?

What makes us think that posting the Iraqi constitution in front of the pipelines will prevent the kind of thing that is going on now with these billions of dollars benefiting everybody except the people for whom it is intended to benefit, the people who own those resources? Why would this stop with the passage of a law if the implementation is going to be what it is now?

Mr. CHRISTOFF. I am gong to give you two comments.

First, the benchmark says enact, so you can enact. Even if you enact all four, you still have to develop implementing regulations that put details behind those laws. That is going to take awhile.

The second question is in terms of the corruption, I think one thing that the framework——

Mr. ACKERMAN. Is the problem the details behind the laws or the criminals that are not behind the bars?

Mr. CHRISTOFF. Well, I want to relate those too because the corruption that we see now is being addressed in the hydrocarbon framework because there is a great deal of accountability and transparency procedures. Iraq has to provide details and all the contracts it lets, the royalties, the revenues, so there is an accountability provisions in the framework itself.

Mr. ACKERMAN. And people won't violate the law in that instance? I mean, why aren't the American advisors telling the Iraqis what to do to eliminate this as if there were a constitutional resolution, as if there were——

Mr. CHRISTOFF. Well, I am trying to give you some hope.

Mr. ACKERMAN. I would like some plans better than some—I mean, I like hope. I like prayer, but I would like better on plans, and I don't see them. I don't see anybody figuring out how to get the bad guys, and I don't see anybody attempting, and I don't see anybody trying to identify them, and is it a big secret, we have to go into secret session in some dark chamber in the Capitol to find out who is stealing the oil, that is a problem. Bounce a check in my supermarket, they post your name of the register.

Mr. CHRISTOFF. One thing that I would offer you that I offered Mr. Delahunt last month is that we are completing a report looking at the—a classified report looking at the question, Who are we fighting?, and that details the different factions in Iraq and their sources of revenue.

Mr. ACKERMAN. I just have a dreadful feeling that the people who are stealing these billions of dollars are putting some of it in the pockets of the people that are shooting us in the ass.

Mr. CHRISTOFF. Well, I think the State Department's 2207 report already said that, and that is a public document.

Mr. ACKERMAN. Mr. Delahunt.

Mr. DELAHUNT. Mr. Christoff, it is my understanding that the annexes that you suggested were part of the framework laws actually have been dropped because of objections of the Kurdistan Regional Government, and they have been deferred to the Federal and Oil Gas Council which doesn't exist yet.

Could you check that with your staff and see whether you are right or whether my staff is right?

Mr. CHRISTOFF. Well, just following the papers every day something different and new happens with the hydrocarbon legislation, so I have read that, that now the annexes may be pulled because they want to decide who gets which oil wells.

Mr. DELAHUNT. Okay. Well, then I am trying to make the case, because I want to be very sure of my facts, that even if the proposed framework law is ratified by this Parliament, and who knows, but that will not meet the criteria as established by the benchmark that was part of the Iraqi supplemental approved by both Houses.

Mr. CHRISTOFF. Yes, I agree with that.

Mr. DELAHUNT. Okay. I think it is important to understand that if we see a headline that says the Iraqi Parliament approves of the hydrocarbon act, that it does not satisfy the benchmark because there are three other separate and distinct pieces of legislation that are required before the requirement that the Congress established is met.

Could I have another question?

Mr. ACKERMAN. Yes, only if you would ask what is the projected time frame in all that happening. [Laughter.]

Mr. CHRISTOFF. I don't know.

Mr. DELAHUNT. He doesn't know. [Laughter.]

And with that I will yield my time to the gentleman from South Carolina.

He doesn't know.

Mr. WILSON. Thank you, Mr. Chairman, and indeed, Chairman Delahunt, happy birthday.

Mr. DELAHUNT. Thank you, Joe. I haven't got the gift yet. [Laughter.]

Mr. WILSON. It is in the mail, I am sure.

But Mr. Christoff, thank you for your presentation and the information you have provided. In my visits to the region, I have visited

Qatar, Bahrain, Kuwait. I have seen countries of fabulous development. I represent Hilton Head Island. When I visit these countries, I feel like I am visiting Hilton Head Island on steroids. There should be such opportunity to wisely use the oil resources of the Middle East to benefit the people who live in the country, and indeed I have seen it, and I hadn't been to UAE, I haven't been to Saudi Arabia, but obviously we know that all of these nations are very modern, I think progressing.

So it is really frustrating to me the report that you have given although I put it in the context, as you indicated, that the government that we are dealing with came about a year ago, May 2006, and our chairman just correctly referenced that our constitution was adopted in 1789. It took the United States 13 years to ultimately evolve the form of government that we so much appreciate today. But here we are in just a little bit over a year in Iraq.

I am very pleased that, and I noted with interest that there was a GAO report of May 2007, and you have five points and you have reiterated those today, but I would like for you to further explain the first one because I think that is the basis of what we are looking for, and that is that the ministries of oil and electricity would develop an integrated energy strategy for the oil and energy sectors.

Can you explain what you mean by that?

Mr. CHRISTOFF. Yes, absolutely. Those two sectors are without a doubt interrelated. The electricity plants need to have fuel that comes from the ministry of oil. Similarly, the ministry of oil needs to have electricity to produce the oil throughout the country, run the pipelines.

What we found in our research, as well as talking to the advisors for those two ministries, is that those two ministries, number one, they don't get along very well, and number two, there really isn't an integrated plan. The ministry of electricity does have a long-term plan, about a 10-year plan in which that minister specified the kinds of projects that he needs in order to achieve greater electrical output. The minister of oil doesn't have a comparable plan.

So right now they are at different levels, but more importantly, they had to have an integrated approach in order to help the country produce more oil and more electricity.

Mr. WILSON. And as we look at the different sectors, are we talking about public ownership, private ownership, public/private? What is the potential of recruiting foreign oil companies to invest, to develop the expertise, and the infrastructure? What is the planning for that, if any?

Mr. CHRISTOFF. Well, I think that is the debate in terms of the different drafts of hydrocarbon legislation for the oil sector: What is the appropriate role of an Iraqi National Oil Company? Do you want a nationalized approach or do you want to invite in foreign investors? And that is still part of the contentious debate about what should be in the hydrocarbon legislation.

Mr. WILSON. And in looking at the countries identified—Kuwait, Qatar, Bahrain—what types models did they use? Are those state or are they——

Mr. CHRISTOFF. Saudi Arabia is state. I don't know of the other ones. But I think for Iraq, when you look at where they need to get the money to invest in their oil sector, I think for practical purposes you have got to think toward foreign investors as well. When you look at the fact that we have already obligated all the money that we are going to spend on the oil sector, the international community has provided nothing in the way of grants, and Iraq isn't spending its budget. You have to look somewhere, and you have to look to foreign investors.

Now, whether or not they are willing to come into Iraq given the violence, the corruption, that is a different question.

Mr. WILSON. And not only the investment, but the technological innovation certainly would be advantageous, and can't contracts and agreements be drafted by way of royalties to indeed provide for benefit of Iraq but at the same time have the benefit of investments and infrastructure?

Mr. CHRISTOFF. Sure, and I think that is part of the debate that is occurring right now: What would be the royalties if a foreign company would invest in Iraq; what future royalties would they get in the production of that oil. But again, that is all part of this very contentious debate that is occurring right now.

Mr. WILSON. Again, thank you very much for your service. I yield back my time.

Mr. ACKERMAN. Thank you very much.

We go next to Mr. Carnahan, but I do want to ask the indulgence of Mr. Carnahan and the committee that the next panel begin at three because one of our panelists is by satellite in London, and that is when we bought the time, and we are going to be breaking for a series of nine votes, two of which are 15 minutes and the rest are 2 minutes whenever they ring those bells. We will stay on with that until we can, so without further time going by. Mr. Carnahan.

Mr. CARNAHAN. Thank you, Mr. Chairman, and I will try to zip through these questions.

First, describe to me the magnitude of Iraqi's oil wealth if you would, please.

Mr. CHRISTOFF. Of their oil wealth you said?

Mr. CARNAHAN. Wealth, their oil wealth.

Mr. CHRISTOFF. Sure. Last year Iraq's oil revenues generated about $31 billion in revenues. This year it is projected to be about $36–37 billion. That is 90 percent of their budget, so they are dependent on oil as the basis for what they need to do for their budget, for their ministries, for everything.

Mr. CARNAHAN. And compared to other countries, they are second, third in the world in terms of oil reserves?

Mr. CHRISTOFF. They have the third largest proven reserves, 115 million barrels—115 billion barrels, and they have the potential of 240 billion barrels of oil.

Mr. CARNAHAN. Because there are a lot of promises and talk going into the Iraq conflict, that that oil wealth was going to be used, in fact, to rebuild and pay for much of what was going on there, and what we have seen is not that, and rather a raid on the U.S. Treasury and a rash of corruption.

Mr. CHRISTOFF. Yes, that was one of the key assumptions that the CPA made back in 2003. Not only would there be a secure environment to rebuild, but the Iraqis would make major contributions to their own rebuilding.

Mr. CARNAHAN. Well, I guess to wrap this up, I guess I would like to ask you to give me some points given that wealth, given that raid on the U.S. Treasury, and this rash of corruption, how do we get from there to utilizing that wealth in a way to help them help themselves and not use the U.S. Treasury and troops as a crutch any longer?

Mr. CHRISTOFF. Well, I think it first begins with a secure and stable environment upon which the Iraqis can engage in useful negotiations and reconciliation. That is difficult to achieve when you have reached nearly an all-time high in the number of attacks. In June alone, 180 per day. So as was espoused by the administration that the purpose of the surge you need breathing room, but you need to have that breathing room in order for the Iraqis to engage in the critical negotiations over 115 billion barrels of oil underneath their country.

Mr. CARNAHAN. And I guess lastly so we can get on to the next witness, I guess you were before our committee last year, and you stated that Iraq spent only 20 percent of the $6.2 billion they had budgeted for capital improvement projects.

Mr. CHRISTOFF. Right.

Mr. CARNAHAN. I would be interested to hear whether you found a similar problem in the oil sector? I understand there has been, you know, very much spending our dollars instead of theirs, and how do we change that?

Mr. CHRISTOFF. Yes. Just at the end of 2006, Iraq ended its year, spending about 23 percent of the $6 billion it set aside for capital projects. It is only 3 percent for the oil sector. They only spent 3 percent of the $3.5 billion. So we have a lot of advisors over there trying to help the Iraqis spend their budget. In fact, that has been the passion of the U.S. Embassy for over a year. Tim Carney was sent over there last fall to focus on budget execution, to get them to spend the budget.

I have got some preliminary data that we got from Treasury, at least through February, they haven't spent any of the capital budget they have set aside of the $10 billion yet. So it is not promising for 2007 either.

Mr. CARNAHAN. Thank you, Mr. Chairman. I yield back.

Mr. ACKERMAN. We will begin dialing up in a minute.

Mr. DELAHUNT. Mr. Chairman, while we are dialing up, I just want to follow up with—I have some follow-up questions on the line of questions that were posed to you by Mr. Wilson from South Carolina.

It is true that if there was a stable and secure environment, that the expertise that he refers to can be purchased, which is the practice in Kuwait, Bahrain and Saudi Arabia and elsewhere, where the nation has created a state oil company that retains the ownership of the asset. So while foreign investment, and I am not going to reach any conclusions as to whether that is the preferable course for Iraqis to take, it is a decision for them to take, not for us to influences is the point that I am making, and that there are other models—service contracts, many of which are contracted with American companies and other companies to provide the expertise and the services that would allow the continued ownership of the oil by the Iraqis to spend as they see fit. Is that an accurate statement?

Mr. CHRISTOFF. Sure, I would agree with that, and I would just add to that, that in a stable environment you might also bring back the educated class that are the technocrats that you would need to help with the development of the regulations and the rules for a hydrocarbon law.

Mr. DELAHUNT. Along those lines, I think it is fair to state that there is significant expertise, human capital if you will——

Mr. CHRISTOFF. Right.

Mr. DELAHUNT [continuing]. Among the Iraqi population in terms of their abilities as far as exploration and the management of their oil resources. The problems have been Saddam Hussein, instability, war, et cetera. Is that a fair statement?

Mr. CHRISTOFF. Yes, I agree.

Mr. DELAHUNT. Thank you.

Mr. ACKERMAN. Thank you. Mr. Christoff, thank you very, very much for your testimony. We would go another round with you but that is technology.

Mr. CHRISTOFF. Thank you very much.

Mr. ACKERMAN. Thank you very much. You have been very helpful. Thank you for your service.

We are going to turn now to our second panel. It may be a little noisy while we are doing the dial-up. We will proceed none the less.

Mr. Tariq Shafiq is the Managing Director of Petrolog & Associates, a petroleum consulting group, and the chair of Fertile Crescent Oil Fields Development Company. Mr. Shafiq has worked worldwide in the oil and gas industry for the last 50 years, and as an independent consultant for the last 35. He is currently the coordinator of a three-man consulting team entrusted with the drafting of the petroleum law for the Iraqi Ministry of Oil.

In Iraq, he was one of the founders and directors of Iraq National Oil Company, INOC, in which he also served as vice chairman and executive director from 1964 to 1967. Prior to this, he served for 10 years with the Iraq Petroleum Company, IPC, in various technological capacities in Iraq and London, including as head of petroleum engineering from 1963 to 1964. He also worked with the Kellogg Corporation on the construction of Dura Refinery in Iraq from 1953 to 1954.

Mr. Shafiq holds a Bachelor of Science Degree in petroleum engineering from the University of California, Berkeley, and was granted an honorary master's degree from Oxford University.

Mr. Issam Michael Saliba is a Senior Foreign Law Specialist from the Law Library of Congress, advising on the laws of the Middle Eastern and North African Arab states as well as on Islamic law. Mr. Saliba is a member of the Beirut, Lebanon, Bar, an associate of the DC Bar, and has more than 25 years experience in the legal profession as a practicing attorney, corporate counsel and international legal consultant in the United States, and in several countries across the Middle East.

Before joining the Library of Congress, Mr. Saliba served as a legal advisor to the Government of Yemen on oil and gas matters, a senior national attorney for Hunt Oil Company and legal manager for Getty Oil Company.

Mr. Saliba is a graduate of the Lebanese University, School of Law.

We welcome each of you. Without objection, both of your written testimonies will be entered into the record, and we appreciate it if you would summarize your statement.

Mr. Shafiq, welcome. Can you hear us?

Mr. SHAFIQ. I can hear you but I cannot see you yet.

Mr. ACKERMAN. It is fortunate for you. [Laughter.]

Mr. SHAFIQ. Oh, that is great now.

Mr. ACKERMAN. You may begin and hopefully the video will magically appear soon. You may proceed.

STATEMENT OF MR. TARIQ SHAFIQ, CONSULTANT, PETROLOG & ASSOCIATES

Mr. SHAFIQ. Thank you very much, sir.

The Honorable Mr. Chairman, Members of the House, Ladies and Gentlemen, indeed it is an honor to address a gathering of your status. Allow me to summarize the salient points of interest to you and permit me, if you may, a few extra minutes to cope with the many diversified issues.

One, who drafted the law?

Three Iraqis, Thamir Ghadhban, Farouk al-Kasim, and I, our combined oil industry experience amounts to some 120 years.

Two, what are the principal criteria of the petroleum law which we drafted?

One, reconciliation and production capacity growth are a priority;

Two, prevent struggle over control of the resource management between the Federal and regional governments to preserve the unity of the country and nation;

Three, a strong National Oil Company seeking management and technology services from the international oil companies and the gradual introduction of the IOC's on one or two other areas;

Four, the principal policy choice should be unified plans, policy and management running from the center in order to achieve efficiently the production of maximum return which is a condition made by the constitution;

Five, reconcile Federal versus regional conflict through a compromise where policy and management by the Federal Government run from the center not only in cooperation with the regions or provinces as required by the constitution, but also in participation on both aspects of the management of the resource, that is to say the development as well as the exploration.

How was this done?

The holding company, Iraq National Oil Company, would operate through operating oil companies whose shares are open to be acquired up to 50 percent by the region or provinces where they operate, and thus their directors would become elected directors, elected members of the board of the National Oil Company. This should ensure sharing of management decision in development and the production operation of the country. But this share option was dropped out in the negotiated draft and replaced by tasking the provinces, and the hours, a separate withdrawal in the management of the resource.

Two, the ministry was tasked with the regulatory and supervisory roles and preparational plans and policy in cooperation or participation with the regional and provincial authorities, and creating an oil and gas commission or council chaired by the prime minister with the secretariat of the minister of oil. Its members are experienced independent managers skilled at decision making.

To carry out their task, they were given two units. One is a special negotiating unit charged with the bidding process to grant exploration and development rights. This was dropped out by the Ministerial Negotiation Committee in view of assigning this role directly and separately to the region's minister of oil and INOC.

The other unit is a think tank charged with review, examination and advice to the decision-making council for all matters under their jurisdiction.

Four, the other main and desirable changes to our draft, the most important changes concern the above council and the think tank. The role of the independent advisory think tank, the bureau, has been weakened and lacked transparency. The formal scope to examine all issues has been reduced to only those issues selected by the council. The requirement to publish their annual report has been removed. The appointment of its members is reduced to 1 year, and the appointment requires unanimity of all members of the council, a most strange rule indeed.

The oil and gas council has been enlarged to some 15 to 20 members. Its tasks increased, overlapping those of the ministry of oil. The role and ability to make decisions have been considerably weakened as a regulator. The regulated parties—the regions, provinces and INOC—have been members where they would decide on projects of their suggestion as exploration and development operators.

Furthermore, it has been politicized by including additional ministers and appointment of its members made subject to conforming to the country's sectarian and ethnic divide.

The next objectional matter is the programming of exploration. The first draft prioritized the rehabilitation of infrastructure and building capacity, to monetize the reserves. The present approval results of 115 billion can raise today's production of 2 million barrels per day to 10 million barrels and maintain it for a decade. That is to say "the capability of Saudi Arabia."

The latest draft called for the immediate grant of rights to IOCs for the exploration and development of some 65 blocks with billions of potential reserves. The new oil is indeed not needed for over a decade. Its investment and discovery would lead to unhealthy consequences.

However, a last minute change was made where the four attachment allocating the oil fields between INOC and the regions were dropped out, leaving it to the council to decide instead of the Parliament as a concessionary move to the Kurdistan Regional Government, which is indeed not such a better choice.

Before I close, I would like to mention that the Shoura Council examined the latest petroleum draft and made corrections, mainly linguistic, and suggesting to include the deferment of decisions already draft or the draft petroleum law until a decision over an earlier revised draft constitution is finalized.

However, the Kurdistan Regional Government contains a subjection considering this latest revision by the Shoura Council as having "unauthorized changes" made to the draft. KRG formal policy considers unacceptable any changes made post the stage of approval at the Ministerial Negotiating Committee. This is how things stand today. I am afraid it is a stalemate with some movement within a week.

I see myself. How about you folks?

[The prepared statement of Mr. Shafiq follows:]

PREPARED STATEMENT OF MR. TARIQ SHAFIQ, CONSULTANT, PETROLOG & ASSOCIATES

IRAQ'S PETROLEUM LAW REVISITED

1.0 Introduction

Iraq may prove to have one of the greatest endowed petroleum resource bases in the world, with oil potential reserves in excess of 215 billion (bn) barrels, and proven reserves in the region of 115bn barrels housed in 80 oil fields.

Moreover, its finding and development costs are low—amongst the lowest in the Middle East. However, its historical maximum production rate in any one year has not exceeded 3.5mn barrels per day (mbpd), although its exploration and development history has stretched over seven decades.

Iraq's oil production level, historically, has lagged behind its oil reserve production capability and its low extraction costs. This has been due to a number of factors, the access of the Major oil companies to huge reserves throughout the Middle East pre-1970s, Iraq's confrontational policy since the 1960s, the wars and sanctions of the 1990s, and the instability created post March 2003.

The present era is characterised by the lack of institutions, law and order, sectarian and ethnic divisions, and a dis-unified government under the influence of armed militias, and ongoing warfare, leaving the Iraqi people in desperation without security and basic life support systems.

Iraq's proven reserves can comfortably support a production plateau of 10 million barrels per day (mbpd) and maintain it for a decade. Iraq requires nearly two decades to export such a volume to the world's markets. Priority should, therefore, be given to the rehabilitation of infrastructure and the building of production capacity.

Russia produces today nearly 10 mbpd from its reserves of some 74 bn barrels.

Besides, there is no reason for new discovery while there are already huge oil reserves in some 60 discovered but undeveloped or produced fields, ready for immediate production capacity expansion or development.

Iraq's finding and lost opportunity costs are prohibitive enough without piling on additional wasted wealth.

Planning oil field development and production capacity growth is carried out on a composite master plan which examines the capacity of all 80 discovered and producing fields distributed unevenly throughout the country (including each and every multiple producing formations within each field), from the technical and economic feasibility aspects and on local and regional scales.

In the meantime, oil development should take into consideration Iraq's social and economic development plans. This clearly requires unified plans, policy management and execution, avoiding un-coordinated competing projects of each of Iraq's 18 provinces.

Iraq's oil economics today is such that, finding cost per barrel (pb) of oil is in the region of US Cent 1.0 (not $1 or its multiples, common cost elsewhere in the world). Development investment cost per produced barrel is estimated at US $1.0-1.5, which is equivalent to some US$6,000-9,000 per bpd (a rate of 1 barrel per day, bpd) or $6-9 billion per 1 mbpd. Operating cost is US$1.5-2 per barrel. These figures make Iraq one of the least expensive in the Middle East

Today, Iraq's production facilities are dilapidated, looted, sabotaged or war-torn, to the extent that in September 2003, its production rate sank to around 1mbpd from the pre-war level March 2003 level of some 2.8 mbpd. Thus far, by the beginning 2007, Iraq produces around 2 mbpd and exports around 1.5 mbpd and declining.

A draft petroleum law has been written almost a year ago by three Iraqi oil technocrats, including myself. Since then, negotiations amongst the Government Ministerial Committee but mainly between the Kurdistan Regional Government (KRG) and the Federal government, has been going. The KRG's initial position was tantamount to a confederate state and, in effect, is a status in itself and by its implications that could encourage fast, unplanned, uncontrolled devolution into federation based on sectarian and ethnic basis. This will exacerbate damaging trends by inducing similar provincial moves among the 'haves', and potential border disputes, with the 'have-nots' watching in envy.

The KRG had already published their own draft petroleum law, based on a radically different interpretation of the constitutional articles governing the oil and gas resources from that adopted in the draft of the federal Ministry of Oil (MoO). The divergence in positions was somewhat narrowed by December 2006, when the KRG declared that it was prepared to "voluntarily" come to an interpretation which was more or less close to the federal perspective, but not without two major concessions secured in a January 2007 draft and again in the latest March 2007 draft in favour of the KRG and the regions and at the expense of the country's interests.

It must be emphasised here that the initial MoO draft was strictly envisaged as a professional document without margins for negotiation.

However, like the January 2007 draft before it, the March 2007 draft was soon thereafter denounced by the KRG on the basis that their government had not been party to examining the four attachments, three of which allocate the discovered fields between Iraq National Oil Company (INOC), the MoO and the regions, while the fourth defines 65 exploration blocks. Even today, 12 July 2007, there is no sign of a successful outcome.

The Council of Ministers approved the latest draft and passed it to the Parliament around 10 June 2007, after it had been checked and linguistically corrected by the Shoura Council. This is a legal unit whose function it is to ensure that laws are properly formatted and in legal language consistent with the constitution.

The draft was passed to Parliament, however, without the four attachments, in a conciliatory move to the KRG. The KRG, however, maintained its objections, considering this latest revision as having "unauthorized changes" made to it. This is how things stand today.

Iraq today is enduring a number of damaging trends of what may be termed 'Tsunami' dimensions. There is widespread lack of security and law and order. Public assassinations are common place, motivated by ethnic and sectarian divides, or criminal intent. There is widespread corruption, lack of efficiency in government organizations and a near absence of institutional performance or sound management at the centre, and especially in the provinces.

Action to reverse these damaging trends ought to be all-embracing in nature, coordinated and united in approach, having the welfare of the country and nation at heart above all considerations.

Iraq clearly requires a petroleum law but not at any cost, especially if it could become another divisive element, in the same way as the constitution itself, which revision is already overdue.

In fact a parliamentary committee has already agreed on a new draft constitution. It has successfully amended the oil and gas governing articles whereby the management of future exploration falls in line with the management of the producing fields under the umbrella of the federal government, in co-operation and jointly with the regional and provincial governments. Placing the management of exploration under the auspices of the Regions Governorates, not the Federal Government, posed serious problems to efficient and unified plans and policy in the management of the oil and gas resource as a whole.

The question to ask now is, if good will exists: Shouldn't the revised constitution be approved ahead of any petroleum law, in order to avoid falling into the complications of having to be taken to Arbitration for nullifying contracts which have resulted from the grants of rights for exploration and development contracts on long-term basis (25-35 Years), based on a petroleum law which then becomes invalid?

2.0 The Draft Petroleum Law

The first draft law, written by Farouk al-Kasim, Thamir Ghadhban and myself, aims at uniformity of plans and policy throughout the country. It provides prior consultation with the provinces (regions and governorates). Decisions taken at the centre involve provincial participation. Supervision of oil and gas operations is shared between the Provinces and the Ministry. The decision-making process has checks and balances to enhance transparency and anticorruption practices. The overall objective is to optimize the oil and gas exploitation, maximize the return and unite the country. It has been based on the legal interpretation given above.

The draft law has defined the tasks, principles and roles of each authority as outlined below.

2.1 The Ministry of Oil

The Ministry is the competent authority for proposing Federal policy and legislation, as well as issuing regulations and guidelines and undertaking the necessary monitoring, supervisory, regulatory and administrative actions required to ensure the proper implementation thereof at all times in consultation with the Regions and Governorates. It is tasked with pre-qualifying candidate International Oil Companies (IOCs) for bidding to compete over acquiring oil and gas explor

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- The Ministry's functions to suggest plans and policy have been duplicated by the Federal Oil and Gas Council, at its own initiative.
- Regions are authorised to pre-qualify IOCs for bids in their regions, approve IOCs development plans and appoint the oil and gas company Operator, and to negotiate and initial finalised contracts.

2.2 The Iraq National Oil Company (INOC)

INOC is an independent, financially and administratively, upstream holding company, fully owned by the government. It is ear marked all discovered fields and operates through operating companies. INOC's operational activities in the provinces shall be carried out by affiliated companies where the Provincial authorities have an option to participate up to 50% through ownership in the respective affiliates. INOC is permitted to team with IOCs on service contracts to acquire management and technology.

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- Government officials and others from the Regions are designated to hold board directorships in conflict with its true independence.
- INOC is appointed as member of the Federal Oil and Gas Council thereby playing both roles of a regulator and "regulated" body deciding on its own projects in the Council.
- While the producing fields have been allocated to INOC only 2/3 of the discovered but partially developed fields are allocated to it in contradiction to the terms of the constitution.
- Furthermore 65 exploration blocks, housing the bulk of Iraq's potential reserves, are assigned for urgent exploration. Exploration calls for tendering to IOCs to explore and develop while there is no need for new oil for many years to come. Furthermore, developed oil by the IOC's would undergo fast track production to pay back a return and profit to the investing company, competing with Iraq's own INOC oil over limited markets and destabilising markets and prices.

This is a very divisive issue which appears to have been planned under pressure from within and without.

2.3 The Provincial Authorities

Provincial authorities should propose to the Federal authorities activities and plans for the Province to be included in the country's plan for Petroleum Operations. They shall further assist and participate with the Federal authorities in discussions leading to the finalisation of the Federal plan as required.

Provincial authorities should participate as part of the Commission's (changed to Federal Oil and Gas Council, the Council) negotiation team in licensing preparations, evaluations and negotiations regarding areas within the Province.

Provincial authorities should be represented in the activities carried out by the Petroleum Commission (the Council) and Petroleum Council (a think tank renamed Independent Consulting Bureau, the Bureau).

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- Regions are authorised to pre-qualify IOCs for bids in their regions, approve IOCs development plans and appoint the oil and gas company Operator, and to negotiate and initial finalised contracts.
- The provincial authorities are appointed as members to the Federal Oil and Gas Council, thereby would play both roles of a regulator and "regulated" body deciding on their own projects.

2.4 The Federal Petroleum Commission (changed to the Federal Oil and Gas Council)

It carries out and examines on behalf of the Council of Ministers matters related to the approval of Petroleum plans and policy which are prepared by the Ministry, and in granting Exploration and Production rights.

It is chaired by the Prime Minister with the secretariat of the Minister of Oil.

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- The Federal Petroleum Commission's role has been changed from a sole decision-making Council to include proposing its own plans and policy, which is the Ministry of Oil task.
- Its membership has been unreasonably increased to some 15-20 or even more in the future.
- It has been politicised by the addition of ministers and making its membership appointments subject to conforming to the sectarian and ethnic division of the nation, and not necessarily based on the qualifications and experience of managers who are skilled decision-makers.
- The inclusion of INOC, the Regions and the producing Provinces conflicts with the basic task of the Council as a decision-making body. On the one hand, they propose plans and on the other, decide on them as members of the Council.
- Decisions requires a 2/3 majority instead of simple 1/2, which can be blocked by an influential Regional member managing 1/3 opposition.
- There is duplication of authority between the Council, the Ministry, Regions and Provinces, such as in pre-qualifying companies to bid or approval of development plans, amongst other matters.
- The checks and balances system is weakened leading to potential malpractice.

2.5 The Petroleum Advisory Council (changed to the Independent Consulting Bureau)

This examines and provides comments and recommendations on overall Petroleum plans and strategic policy, licensing contracts, overall Development policy, as well as key projects and any other relevant matters referred to it by the Federal Petroleum Commission or the Ministry. Members are appointed to 5 a year membership, tasked with all matters referred to the Council and required to publish their annual report.

It consists of nine professionals, three of whom are from the regions and governorates.

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- Members are appointed to a one-year term and their appointment by the Council requires unanimity of all members.
- They will be limited to advise only on matters passed to them by the Council and not to all matters referred to the Council.
- They will not be allowed to publish their annual report.
- The checks and balances system is weakened leading to potential malpractices and transparency obstructed.

2.6 The Negotiation Committee

This is an entity for planning and executing the process leading to the allocation of Exploration and Production rights.

It consists of specially trained members of the Ministry, INOC and related entities with appropriate skills and experience. For specific negotiations, the Committee shall be supplemented by representatives from the Region or the Governorate where the particular acreage is located.

Undesirable changes in the latest negotiated draft by the Ministerial Committee:

- The committee is removed. Each of the Regions, INOC and the Ministry negotiate their own contracts based on model contracts, in accordance with Council set rules.
- There is the risk of disparity and possibly inferior results due to lack of experience at a time when the Regions suffer from poor institutional capacity.

2.7 The Licensing Code

The licensing process shall be carried out by a specially trained Licensing Unit (where the province concerned shall be represented) and based on transparent and accountable tendering in accordance with model contracts.

All model contract shall be developed based on the following criteria:

- National control
- Ownership of the resources
- Optimum economic rent to the country
- Appropriate return on investment to the investor

- Reasonable incentives to the investor for ensuring solutions which are optimal to the country in the long-term related to.

Undesirable changes in the latest negotiated draft by the Ministerial Committee: It would have been desirable to have had the model contracts decided on and attached to the draft law for approval by the Parliament. Neither the model contracts or the allocated fields and exploration blocks to their respective authority have been included.

3.0 The Negotiations

As highlighted above the negotiations have resulted in a number of significant changes to the original draft. The most vital concern the administrative units, the process of decision-making and the expediting of a large exploration programme.

3.1 The role of the independent advisory professional think tank, named in the first original draft as the Oil and Gas Independent Council renamed as the Bureau, has been weakened and lacked transparency. Its former scope to examine all issues has been reduced to only those issues selected by the Council. The requirement to publish its annual report has been removed. The appointment of its members is reduced to one year from five and the appointment requires unanimity of all the members of the Council, a most strange rule, indeed. The appointments to the Council and the Bureau have been made to conform to Iraq's sectarian and ethnic groups, an alarming indication of the politicizing of the most vital economic commodity that concerns the nation when, instead, sound independent professional management is badly needed.

The Council has been enlarged from nine to some 15 or ultimately 20 members, depending on future development, which makes it more fit as a debating society than trusties tasked with a vital decision-making role on optimizing the proper resource development of the nation. Moreover, while its size has been inflated and its tasks increased, overlapping those of the MoO, its role and ability to make decisions have been considerably weakened as a regulator. "Regulated" parties, the regions and INOC, have become members where they would decide on projects of their suggestions as exploration and development operators. Furthermore it has been politicized by including additional ministers and the appointment of its members made subject to conforming to the country's sectarian and ethnic divide.

In fact, the negotiating task with regards to oil and gas contracts and other vital decisions have been passed to the Regions. At the present time there is only one region, the KRG, but this is an invitation to the other 15 Provinces to form Regions to follow suit at a time of when their institutions lack capacity and risking disharmony of practices. This would make the haves richer and the have-nots envious, in addition to the border disputes it would create as a result of oil fields crossing under geographical borders, contributing further to disunity.

The critical items that have been removed in the latest petroleum draft are fundamental to professionalism, transparency and accountability. The principles are still there but the mechanisms for enforcing them, in a process of checks and balances within Iraq's current turbulent situation, have been removed or circumvented in away that could produce damaging effects.

The resultant checks and balances in the draft are now insufficient to cope with Iraq's internal political complications, and are more of a façade, leaving the competence of authorities and the processes of the grant of rights open to manipulation by the political forces that prevail in today's circumstances in Iraq.

3.2 The first draft law prioritised the rehabilitation of the infrastructure and building production capacity to monetize the reserves and make the most of the country's bulk of idle proven reserves of 115 bn barrels. At today's production of 2 mbpd Iraq needs no more than 17Bb, calculated on the generally accepted Reserve to Production ratio of 20. In line with this rule, Russia, for example, produces some 10 mbpd from its reserve of 74 bn barrels. In effect, Iraq is wasting the finding cost and the earning capacity of 98 bn barrels of undeveloped stored reserves.

The latest draft called for the immediate grant of rights to IOCs for the exploration and development of 65 blocks with billions of potential oil reserves. The discovered reserves shall be developed and produced to unrestricted capacity without delay or a cap to earn investment capital and provide a healthy return. They will, therefore compete with INOC's oil large production capacity over a limited share of markets open to Iraq, cause oversupply, destabilize the crude oil price structure and contravene Iraq's obligation towards OPEC, among other undesirable consequences.

The latest Shoura Council examined petroleum draft and passed by the Cabinet to the Parliament omitted reference to these exploration blocks, in a conciliatory move by the Cabinet to the KRG, and left the matter to the Federal Oil and Gas Council to decide. KRG, however, maintained its objections, considering this latest revision by the Shoura Council as having "unauthorized changes" made to it. KRG formal policy considers unacceptable any changes made post the stage of approval at the Ministerial Negotiation Committee. This is how things stand today.

4.0 Concluding Remarks

4.1 Without a central unified policy there will be disharmony and competition between INOC (operating on production and marketing its export oil to provide the state's income) and the Regions & Governorates (prioritising exploration for additional reserves that will not be required for many years to come), and among the various Regions and Governorates. This will lead to disharmony and envy between the haves and have-nots.

Such development would cause instability which is discouraging to investment, as well as a multitude of damaging consequences contributing to fragmentation, instead of promoting the uniformity of oil and gas practices and the unity of the nation and the country.

The Constitution has tasked the Federal Government with the job of oil and gas resource management, not any one village, governorate or region. The initial draft law was drawn up to unify plans, policy and decision-making through participation (beyond cooperation or consultation) of the regions, governorates and the federal government at the centre, without ignoring participation at the operating and supervisory processes.

4.2 Instability, especially when associated with insecurity, would lead to an unhealthy oil industry and would discourage the serious IOCs, who have the required knowledge, capital and markets. Iraq would then find itself accepting speculators with more promises than they can deliver, and the minor companies which do not have the capability to develop Iraq's giant oil fields.

4.3 IOCs, in my view, are advised to aim for urgently needed rehabilitation of the infrastructure, expansion of production capacity of the producing and partially developed fields, improving damaged reservoir performance, and to develop the many discovered but not yet delineated oil fields, in partnerships with INOC, rather than going for extensive exploration for unnecessary new oil. A rush for exploration and development contracts at this particular juncture of Iraq's political and economic development would be viewed as mortgaging the reserves of future generations. It would provide fuel to the view that the war was for oil.

4.4 There are today a number of damaging trends of 'Tsunami' dimensions, engulfing Iraq. There is a widespread lack of security and law and order, widespread killing for reasons of identity, ethnicity, sect, or for no reason other than criminal ends.

There is widespread lack of efficiency in government organisations and a near absence of institutional performance or sound management at the centre and especially in the Provinces, in addition to a lack of investment and extremely high unemployment.

Action to reverse these damaging trends ought to be all embracing in nature, coordinated and united in approach, and having the welfare of country and the nation at heart above all considerations. A healthy and robust oil industry would provide the revenue necessary for social and economic reform and the right environment for easing much of the above trends.

4.5 Unless the draft petroleum law is revised to conform to professional practices rather than politicised concessions among the political parties, the petroleum law could further fragment the country. To pass the petroleum law by simple majority ignoring the rest of parliamentary representatives would further fragment the country and nation.

And, to enact the petroleum law ahead of the revision of the constitution would appear as an act of folly. Clearly, a path of action to defer enacting the petroleum law and advance the revised constitution, which is logical, requires sufficient will to abandon much of prevailing political attitude by the major political parties that has brought the country to the calamity it is in today. Indeed it is a challenging path worthy of mentioning by an oil technocrat.

Mr. ACKERMAN. You are double blessed.

Thank you very much. Please standby.

Mr. Saliba.

STATEMENT OF MR. ISSAM MICHAEL SALIBA, SENIOR FOREIGN LAW SPECIALIST, MIDDLE EAST AND NORTH AFRICA, LAW LIBRARY OF CONGRESS

Mr. SALIBA. Thank you, Chairman Ackerman, Chairman Delahunt, Ranking Members, and all members of the two subcommittees.

I am honored to be here today to testify about the legal implication of the Iraqi oil and gas draft legislation, better know as the framework hydrocarbon law. This legislation can be summarized as intending to: (1) create an independent body to make final decision on all matters related to oil and gas activities in Iraq; (2) open the Iraqi oil and gas sector to private investors; (3) expand the role of the Iraqi Government in the management of present and future oil discoveries.

The draft law provides for the creation of a Federal oil and gas council vested with the authority to approve contracts, including what is known in the industry as production sharing agreement, or PSA.

A PSA gives the contractor an equity ownership in the oil reserve and is used in exploration and production contracts where the contractor is at risk of losing all his investment money if no commercially exploitable quantities of oil or gas are found within the contract area. It is uncommon to use a PSA type contract for discovered but not yet developed oil.

The proposed law divides the oil resources in Iraq into three categories: (1) the presently producing fields identified in Annex 1; (2) discovered but not yet developed fields identified in Annex 2 and 3; (3) prospective exploration areas identified in Annex 4.

The draft law locates the fields in Annex 1 and 2 to the Iraq National Oil Company, INOC, and the fields in Annex 3 to the regional authorities. The ministry of oil, INOC, and each of the regions, each within its respective jurisdiction, may initiate negotiations and sign initial contracts related to oil and gas activities in accordance with instructions and model contracts as may be approved by the Federal created council.

The initial contract shall be submitted to the Federal council for review. If the Federal council expresses no objections or if it fails to act within a prescribed period of time, the contract will become binding by default. If there is fault with the initial contract, the Federal council may object to it only by a two-third majority vote of the members present.

The role of the Federal Government in managing future and undeveloped oil discoveries raises a potential constitutional issue. Article 111 of the Iraq constitution stipulates that oil and gas existing in all of Iraq are the property of the Iraqi people. This implies that the Federal Government should have the power to regulate and manage all oil and gas activities. However, Article 110, 112 and 115 of the constitution suggests otherwise.

Article 110 enumerates the power exclusively reserved to the Federal Government, but none is related to oil and gas. Article 112 allows the Federal Government to manage only the presently oil-producing fields, and distribute the revenue equitably among all geographic areas of Iraq.

The constitution is silent as to who has the power to manage future discoveries or discoveries that has not been developed. This seems to suggest that the power of this manual has to go to the regions and the local governments, and Article 115, which stipulates that all powers, not exclusively reserved to the Federal Government, belong to the regions and governments.

Finally, I shall conclude by pointing out: (1) the annexes that must be a part of the draft legislation have not been finalized; (2) the Kurdistan Region is moving ahead with the enactment of its own oil and gas law that may be in conflict with the proposed Federal legislation; (3) that the proposed legislation does not by itself address the issue of how the oil revenue should be equitable distributed.

Thank you for your attention listening to this abridged version of my written statement, and I will be happy to answer any questions you may have.

[The prepared statement of Mr. Saliba follows:]

PREPARED STATEMENT OF MR. ISSAM MICHAEL SALIBA, SENIOR FOREIGN LAW SPECIALIST, MIDDLE EAST AND NORTH AFRICA, LAW LIBRARY OF CONGRESS

Chairmen Ackerman and Delahunt, Ranking Members Pence and Rohrabacher, and Distinguished Members of both House Subcommittees,

I am Issam Michael Saliba, Senior Foreign Law Specialist for the Middle Eastern and North African Arab States, at the Law Library of Congress. I have also practiced extensively, both as an attorney and general counsel, in the oil and gas industry in several countries in the Middle East. I am honored to appear before you today to testify about the legal implications of the oil and gas draft legislation approved by the Iraqi Cabinet, but not yet enacted into law by the Iraqi Council of Representatives or Parliament. This proposed legislation is known as the "framework Hydrocarbon law," as referred to in Paragraph (iii) of the Initial Benchmark Assessment Report to Congress, dated July 12, 2007. I have relied in my analysis on a copy of the draft law posted on the official web site of the Regional Government of Kurdistan.[1] The intent of the proposed legislation may be summarized as follows:

1. to create an independent federal body with the power to make all final decisions on oil and gas activities in Iraq;
2. to open the Iraqi oil and gas sector to private investment by Iraqi and non-Iraqi investors; and
3. to expand the role of the Federal Government in matters related to the management and development of Iraqi oil and gas resources.

The draft law provides for the creation of a council called the Federal Oil and Gas Council (FOGC) or, simply, the Federal Council. This Council is composed of the Prime Minister, or his designee, as chairman and includes in its membership:

1. the Iraqi Government Ministers of Oil, Finance, and Planning;
2. the Governor of the Central Bank;
3. a representative of each Region;
4. a representative of each oil-producing governorate that is not organized into a Region;
5. the chief executives of the most important oil agencies, including the Iraqi National Oil Company and the Oil Marketing Company; and
6. a number, not to exceed three, of experts in oil, gas, finance, and commerce that shall be appointed by the Council of Ministers for a term not to exceed five years.

The Council is vested with the authority to approve all oil and gas contracts, including those intended to explore for new resources; develop existing discoveries not

[1] Republic of Iraq, Draft Iraq Oil and Gas Law, 15 February, 2007 [draft legislation], *available at* Regional Government of Kurdistan, http://www.krg.org/articles/detail.asp?smap=&Ingnr=12&asnr=&anr=16644&rnr=95. The website of the Regional Government in Kurdistan is the best available source for the text of the draft law.

yet producing; or service and enhance the performance of current oil producing fields. The draft legislation allows the Federal Council to approve production-sharing agreement (PSA) contracts that give investors, Iraqis, and foreigners equity ownership in the oil reserves existing in their contract areas.

This type of contract is traditionally used when granting the contractor/investor the right to explore for hydrocarbon resources in new prospective geographic areas. In this type of aleatory[2] contract the investor undertakes the risk of losing all his investment capital if no commercially exploitable quantities of oil or gas are found within the contract areas.

It would be highly unusual in the industry, however, to use this type of contract to develop existing oil discoveries not yet developed, or to service and improve the performance of oil fields already producing.

The proposed law divides the oil resources in Iraq into three categories:

1. currently-producing fields identified in Annex 1;
2. discovered but not yet producing fields identified in Annexes 2 and 3; and
3. prospective exploration areas identified in Annex 4.

The draft law gives the Iraq National Oil Company (INOC) the right to manage, develop, and operate the fields identified in Annexes 1 and 2,[3] with the authority to enter directly into service and management contracts regarding the producing fields when necessary.[4] It also gives the Regional Authorities the right to carry out the licensing process related to the development of the discovered but not yet producing fields identified in Annex 3, through the contracting process adopted by the Federal Council with qualified international oil companies.[5] The prospective exploration areas identified in Annex 4 seem to have been left to be auctioned off to qualified persons by the Ministry of Oil and the regional authorities, each within their respective jurisdictions.

The draft law stipulates that the right to conduct petroleum operations shall be granted on the basis of exploration and production contracts concluded, in accordance with the relevant contracting process, between the Ministry of Oil or the regional authority and a person, Iraqi or foreign, natural or legal, who can prove to the Ministry or the regional authority, based on the criteria adopted for companies by the Federal Council, that he has the technical and financial ability necessary to conduct effective petroleum operations.[6] The Ministry of Oil is to prepare and the Federal Council is to approve model exploration and production contracts.[7]

The model contracts may be based on a service contract, development and production contract, or aleatory risk-based exploration contract.[8]

The Ministry of Oil, the Iraqi National Oil Company, and the regions shall each, within its respective jurisdiction, sign the initial contract with the selected contractor. A provision shall be included in the contract stating that the contract will become binding if not objected to by the Federal Council in accordance with the Federal Oil and Gas Law.[9]

The initial contract shall be referred to the Federal Council within thirty days from the date of signing; it otherwise shall be considered null and void.[10]

The Federal Council shall review the contract and inform the Ministry of Oil, the INOC, or the regional authority of its objections, if any, within sixty days, or within an additional forty-five days in certain circumstances. The contract will become final and binding if the Federal Council does not have any objections or does not act within the prescribed period of time.[11]

Of special interest is the situation in which there is serious departure in the initial contract from the criteria and model contracts adopted by the Federal Council. In such an instance, the objection to the initial contract by the Federal Council requires a two-thirds majority of the members present.[12]

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[2] An aleatory contract is one that depends upon uncertain contingencies. *See* BRYAN A. GARNER, A DICTIONARY OF MODERN LEGAL USAGE (2d ed. Oxford University Press, 1995).
[3] Republic of Iraq, Draft Iraq Oil and Gas Law, 15 February, 2007, Article 6 (B) (First and Second) [draft legislation], *available at* Regional Government of Kurdistan, http://www.krg.org/articles/detail.asp?smap=&lngnr=12&asnr=&anr=16644&rnr=95.
[4] *Id.* Article 8 (A).
[5] *Id.* Article 5 (F) (Second).
[6] *Id.* Article 9 (A).
[7] *Id.* Article 8 (C).
[8] *Id.* Article 9 (B) (Fifth).
[9] *Id.* Article 10 (A & B).
[10] *Id.* Article 10 (C).
[11] *Id.* Article 10 (D) (Third).
[12] *Id.* Article 10 (D) (Second).

The Federal Council may appoint Iraqis and foreign oil and gas experts to an advisory board called the Office of Independent Advisors to assist the Council in reviewing and evaluating exploration and production contracts and oil and gas field development plans. The Federal Council decides on the number of the advisors and appoints them by a unanimous decision for a period of one year, which can be extended.[13]

The role of the federal authorities in managing oil and gas resources beyond those identified in Annex 1 raises a potential constitutionality issue in the proposed law. Article 111 of the Iraqi Constitution[14] stipulates that oil and gas existing in all the regions and governorates of Iraq is the property of the Iraqi people. This implies that the Federal Government should have original power to regulate and manage all oil and gas activities. But articles 110, 112, and 115 of the Constitution may suggest otherwise.

Article 110 enumerates the powers exclusively reserved to the Federal Government such as conducting foreign policy, raising an army, and regulating trade across regional and governorates lines.[15] Concerning oil and gas resources, Article 112 stipulates that the Federal Government, concurrently with the governments of the regions and the producing governorates, undertakes the management of oil and gas produced from current fields and ensures the equitable distribution of the resulting revenue in a manner commensurate with population distribution in the various parts of the country. It further stipulates that the Federal Government and the governments of the regions and producing governorates together formulate the strategic policies needed to develop the oil and gas resources.[16]

Therefore, the power to manage existing oil and gas producing fields and to formulate development plans for oil and gas resources seems to be shared between the Federal Government and the governments of the regions and the producing governorates. The Constitution is silent on the role of the Federal Government in the management of future oil and gas discoveries or discoveries that have not yet been developed. Under Article 115 of the Constitution this means that the management of future or not yet developed discoveries belongs to the regional and local governments. Article 115 stipulates that all powers not exclusively reserved to the federal government are to be exercised by the regions and governorates; and that with respect to shared powers the priority shall be given to the regional and local laws in the event of a conflict arising between such laws and federal law.[17]

Another constitutional issue meriting attention, irrespective of the nature of the division of powers between the federal and regional or local governments, is whether an independent body such as the Federal Council can be given the power to issue final binding decisions on matters, such as managing oil and gas activities, that belong under the Constitution to other federal, regional, or local governmental bodies.

Final important points are:

1. there is apparently no agreement, yet, as to the content of the Annexes that must be a part of the present legislation;
2. the Kurdistan Region is proceeding with the enactment of its own oil and gas law that may be in conflict with the proposed federal legislation; and
3. that the proposed legislation does not address the issue of how the oil revenue should be equitably distributed among the various parts of Iraq. This has to be addressed in a separate law that the Council of Ministers must submit to the Council of Representatives.[18]

Thank you for your attention, and I would be happy to answer any questions you may have.

Mr. ACKERMAN. Thank you both very, very much.

First, let me ask some concerns that people have raised in general, concerns based on their concerns.

Do you have a concern that foreign interests will be heavily involved in reaping much of the profits that would be made from the oil and gas industry of Iraq?

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[13] *Id.* Article 5 (C) (Sixth).
[14] IRAQI CONST. art. 111 (2005).
[15] *Id.* art. 110.
[16] *Id.* art. 112.
[17] *Id.* art. 115.
[18] Republic of Iraq, Draft Iraq Oil and Gas Law, 15 February, 2007 [draft legislation], *available at* Regional Government of Kurdistan, http://www.krg.org/articles/detail.asp?smap=&lngnr=12&asnr=&anr=16644&rnr=95.

Mr. Saliba first.

Mr. SALIBA. Okay. Mr. Chairman, I will just address the legal question. The law as written now allows the Iraqi Government to sign contracts and to conclude contracts with anyone whether it is an Iraqi person, natural person, legal person or a foreign person, and they define foreign person as being also as a natural person or as a company.

So the potential is there to do any type of contracts. Now whether they will do this type of contract that the foreign contraction would reap the benefits or not, it is up to what they will be doing along the line, but the law as written now allows for such type of contracts to be concluded.

Mr. ACKERMAN. Mr. Shafiq?

Mr. SHAFIQ. Yes, sir. Thank you, Mr. Chairman.

First, I would like to point out that the PSA about included in the draft contract, in the draft law neither in our first draft nor in the latest draft.

Two is that the attachment recently had been omitted from the latest draft negotiated by the negotiating committee, and that is only really to close the Kurdistan Regional Government because they objected to the fact that they had not seen it, seen all of these attachments.

As a result, all these attachments have been dropped out and left for the council to decide on, and as I said, this is not a very good choice at all. So that is the up-to-date information on the subject.

As to the profitability really, I think that has been exaggerated media reference to the windfall profit. The INOC actually stipulate that the maximum return should be to the nation. There should be participation to the nation. However, the investor should get commensurate rate to their risk and investment.

I interpret this and should any future negotiator in Iraq to interpret this to mean something of the order of 10 percent, 15 percent, certainly not more than 20 percent.

Mr. ACKERMAN. Let me give you the same question rephrased with its political intent. How would you respond or address those critics who say that America is in Iraq for the oil? Mr. Saliba?

Mr. SALIBA. Mr. Chairman, I cannot address this question. It is really political. What I can say is the process by which they are—this law allows a contract to be granted, whether to Iraqi or non-Iraqi, very, very loose.

Mr. ACKERMAN. Very?

Mr. SALIBA. Very loose.

Mr. ACKERMAN. Loose.

Mr. SALIBA. The process is very loose. For example, if the created department and the ministry of oil negotiated a contract and signed an initiated contract the only oversight is going to be when they send it to the federal, newly created Federal oil and gas council. The council has 60 days, I think, to review this contract. If it didn't object to it within that time limit, or if it fails to act, then the contract will become valid, effective, and binding.

Not only that, let us say if some 50 percent of the council members found that this oil contract is way against the principles stated by the law, what they can do nothing unless they secure the two-third majority vote on the council. If this happen, regardless of whether the contract is in accordance with the principles stated in the law or not, the law provides no remedy what to do with this contract. This contract would be come binding, would become in force, and nobody can do anything about it.

So I am not questioning the principle that I stated in the law, but the process is——

Mr. ACKERMAN. Based on what you just said and allow you to add to your statement before turning to Mr. Shafiq, how easy would it be to corrupt that process given what we are seeing right now with what we believe is massive wholesale corruption of the petroleum industry?

Mr. SALIBA. Again, I believe if a contract of this magnitude is dependent only on one person or five person in a department of the government, and the only oversight is a two-third vote of a council that may or may not act within certain period of time, I think there is a problem there.

Mr. ACKERMAN. Mr. Shafiq.

Mr. SHAFIQ. Sir, I will try to be very frank with you, Mr. Chairman, to answer your question, was America there for the oil, and I will come to address all the other points.

The First World War decidedly was not for oil. However, the Middle East became the best prize to the victorious powers at the time. We live in a world where economics dictates. Now, I don't know what to say in this instance that America was there for oil, but much depends on how America behaves in this particular area.

And example where now there are some 65 blocks with rich oil for our grants of rights to international oil companies, and certainly the American companies are the most qualified to bid for these and getting them, this grant of right for the real oil, as I explained, is not graded at all because today Iraq has some 115 billion barrels in storage in the reservoirs in the ground. That 115 can build a capacity up to 10 million barrels a day intended for a decade, before we reach 10 million to start with, it will take us a decade and decade and a half.

Now, why are we going for exploration in oil wells to get additional new oil? The introduction of such article where even it state it should immediately be implemented would be futile to such an argument that the light forces, America and the British are there for the oil. So I would like to conclude much depends on what will be the end result of this law and how the attitude of the American intention is expressed.

Mr. ACKERMAN. I have a feeling we are going to——

Mr. SHAFIQ. So, Mr. Chairman, as to the criticism of Dr. Saliba, I am afraid I do agree with his interpretation of the procedure and the makeup of the council, and I would not hesitate to say I am afraid it open itself for corruption.

Mr. ACKERMAN. Thank you for your candor. I have a feeling we are going to explore this issue a little bit further. We are facing several votes. A quick rundown of the chair's intent. It is right now to yield 2 minutes to the ranking member, Mr. Pence; 3½ minutes to the chairman; and 2 minutes to Mr. Rohrabacher. We will then recess for the votes in progress, come back in approximately half an hour or so. If you would all stand down at that point, we will go to Mr. Pence right now.

Mr. PENCE. Thank you, Chairman, and I want to thank both of the witnesses. This has been enormously illuminating, and I thank you for the expertise and efforts that you have taken on behalf f your homeland. It is a service to the world.

Let me just ask very specifically. Mr. Shafiq, you made a comment in your opening statement I am very interested in asking you to briefly expound upon. I am particularly curious about whether there is a will on the part of the Iraqi Parliament to finish the hydrocarbon law and its four component parts. I believe you closed your testimony, Mr. Shafiq, saying that you expected there to be "movement within a week."

Did I hear you correctly, and if so, might you expand on that prediction and what we might expect within that period of time?

Mr. SHAFIQ. I could say that certainly the government and the Parliaments are serious to examine the draft petroleum law.

Now, the stalemates can't be resolved during the present and the ongoing negotiation between the Federal Government and the government of Kurdistan Region, and I do understand that there is going to be a very high-level meeting shortly to discuss this very same subject.

What is holding the law today is basically the Kurdistan Regional Government who refuse or change their mind to approve it on account of what the Shoura Council have decided and suggested.

Mr. PENCE. But your expectation, Mr. Shafiq, is that there will be movement within a week. Did I hear you correctly?

Mr. SHAFIQ. Potentially, yes, sir.

Mr. PENCE. On that issue?

Mr. SHAFIQ. Yes, sir.

Mr. PENCE. Thank you. Thank you, Chairman.

Mr. ACKERMAN. Thank you. Chairman Delahunt.

Mr. DELAHUNT. Again, thank you both, and I just want to review your testimony, Mr. Shafiq, and then Mr. Saliba, I would ask you to comment on it.

As I indicated in my opening, I am very concerned about the perception, the perception among many quarters that the United States went to war because of oil, and I am concerned about fueling, fueling that particular perception because it harms our national interest. In your written testimony and what I just heard from you is that when it comes to Annex 4 the unexplored potential oil fields, that is open to auction, if you will, by international oil companies, according to the current status of the hydrocarbon, the framework draft. Is that an accurate statement on my part?

Mr. SHAFIQ. Are you asking me, sir?

Mr. DELAHUNT. Yes. I am asking both of you, but let me begin with you.

Mr. SHAFIQ. Okay. Yes. It will be open to bidding.

Mr. DELAHUNT. Okay.

Mr. SHAFIQ. The procedure is for the companies interested to be prequalified and then invited to bid in accordance to other contracts which are to be prepared by the council. They have not been prepared yet.

Mr. DELAHUNT. They have not been prepared, and in terms of the size of those unexplored areas, are they considerable?

Mr. SHAFIQ. Yes.

Mr. DELAHUNT. They are?

Mr. SHAFIQ. I should think so. They are all over the country, and they contain very high potential. I have in the past estimated Iraq future potential to be in the region of 215 billion barrels, and these should recover most of that potential.

Mr. DELAHUNT. And what you have been saying, sir, you in London have been saying is that at this point in time that is unnecessary because there are adequate existing supplies in areas that have been explored and discovered but not producing. Is that correct?

Mr. SHAFIQ. Well, in oil, what we call proven reserves are the stored oil in the drained fields, and in Iraq we have some 115 billion today——

Mr. DELAHUNT. Okay.

Mr. SHAFIQ [continuing]. Scattered or housed in 80 oil fields. Some of these, in fact, only 20 are under current being produced.

Mr. DELAHUNT. And that will go on for 10 more years.

Mr. SHAFIQ. Sorry?

Mr. DELAHUNT. And that will go on for 10 more years. As you said, a rush for exploration contracts at this particular juncture would be viewed as mortgaging the reserves of future generations and it would provide fuel to the view that the war was for oil.

Mr. SHAFIQ. I would, yes, be prepared to defend that argument.

Mr. DELAHUNT. Thank you.

Mr. ACKERMAN. Thank you very much.

Mr. Saliba, very briefly?

Mr. SALIBA. I would just add, Mr. Chairman, you are right but also Annex 1 and 2 could be also optioned off, not only Annex 4. Could be under the law. In other words, the law permit that.

Mr. SHAFIQ. May I intercept at this point?

Mr. ACKERMAN. Briefly, and we'll come back to this.

Mr. SHAFIQ. These discovered fields, which are being produced or shall be produced by the international oil companies, they shall not go for option. The National Oil Company has the jurisdiction to get international oil companies on service contract to help them with the management and technology.

Mr. ACKERMAN. Thank you. Mr. Rohrabacher.

Mr. ROHRABACHER. Thank you, Mr. Chairman and let me just note that I was a little bit late today so I didn't have a chance to say happy birthday to Congressman Delahunt.

Mr. DELAHUNT. Thank you.

Mr. ROHRABACHER. Who is my fearless leader of my subcommittee, and no one ever thought he would last this long. [Laughter.]

To the question at hand, I would just like to know whether or not the Government of China or any Chinese companies have had any type agreement? Has there been any deal with them over the oil that will be produced in Iraq? Either or both of you.

Mr. SALIBA. I believe there were some contracts prior to the 2003 from the Saddam era. There were some contracts. My understanding——

Mr. ROHRABACHER. There has been no contracts with the Chinese since for this new development of oil?

Mr. SALIBA. I have no information about that.

Mr. ROHRABACHER. Do you have any, sir? Do you have any?

Mr. SHAFIQ. Are you addressing me, sir?

Mr. ROHRABACHER. Yes, I am.

Mr. SHAFIQ. China has had a contract during the Saddam regime, which is a PSA, by the way, contract. However, what is expected and I think this is on the way, that these contracts need to be reformed to conform to the present petroleum law before they can proceed and be given a life injection.

Mr. ROHRABACHER. Let me just note for the record, Mr. Chairman, that I did vote with the Democrat alternative that suggested that a certain amount of oil revenue in the future by Iraq should be dedicated to paying back the expenses to the United States Government for what we have expended here for the past few years, and I would hope that the people of Iraq understand that—whether you say this war was for oil or not—that there has been a tremendous expenditure of treasure on the part of the United States, not to even mention the blood and value of our people, and I would hope that in the future that if there is oil production in Iraq, that the people of Iraq will be mindful that this is a great cost to the United States and we deserve to be treated better than the Chinese when it comes to this type of bidding.

So thank you very much.

Mr. ACKERMAN. You are very welcome.

The chair will note that your voting record has much improved. [Laughter.]

And your——

Mr. DELAHUNT. But it has got a long way to go, Mr. Chairman.

Mr. ACKERMAN. It does, but he is indeed becoming more and more sartorially splendorous.

Just quickly one word answer, one number answer, and then we are going to adjourn and conclude the hearing for today, and both chairs will confer as to whether or not we want to have a follow-up hearing on this matter.

On a scale of one to ten, with zero being the lowest, and ten being the highest, what is the possibility under this proposal that there will be high corruption within the oil and gas industry? Mr. Saliba, pick a number.

Mr. SALIBA. All I can say, Mr. Chairman, that the law as written it is very open to any type of corruption if the people in charge want to do that.

Mr. ACKERMAN. High possibility.

Mr. Shafiq?

Mr. SHAFIQ. Really that is a very difficult one to decide on, but the rules of the game are open to malpractice, and as such I would give it six out of ten that there can be malpractice.

Mr. ACKERMAN. Thank you both very much for your expertise and the time you have dedicated to helping us in our deliberations. The panel is dismissed with the thanks of both subcommittees, and the hearing is concluded.

[Whereupon, at 3:45 p.m., the subcommittees were adjourned.]

APPENDIX

Material Submitted for the Hearing Record

Prepared Statement of the Honorable Sheila Jackson Lee, a Representative in Congress from the State of Texas

Thank you, Mr. Chairman, for convening this extremely important hearing. As we work to find a way to end our military commitment in Iraq, it is vital that we focus a great deal of attention on Iraq's oil and gas industry, which will play an crucial role in the reconstruction of that nation. May I also take this opportunity to thank the Ranking Member, and to welcome our three witnesses: Mr. Joseph A. Christoff, Director of International Affairs and Trade, Government Accountability Office; Mr. Tariq Shafiq, Director, Petrolog and Associates; and Mr. Issam Michael Saliba, Senior Foreign Law Specialist, Middle East and North Africa, Law Library of Congress. I look forward to your informative testimony. As the Co-Chair of the Congressional Black Caucus' Energy Taskforce as well as a Representative of Houston, the "Energy Capital of the World," I am extremely interested in further discussion of how to successfully reconstruct Iraq's energy sector.

Mr. Chairman, in 2003 the Bush administration chose to invade Iraq without laying out a clear and realistic plan for reconstructing the nation after the conflict. This administration incorrectly predicted that the reconstruction of post-Saddam Hussein Iraq would be quick, easy, and financed by Iraq's own resources. Instead, the rebuilding of Iraq's infrastructure, devastated by years of war, sanctions, Saddam's depredations, and the looting and chaos that followed his overthrow has proven difficult and costly.

Though much of Iraq's infrastructure now lies in ruins, the country still has an immense abundance of energy resources. In proven oil reserves, Iraq ranks behind only Saudi Arabia and Canada, though the exact extent of its reserves remains controversial. Most estimates are in the range of 115 billion barrels, with approximately 65% located in the southern fields, particularly the Rumalia fields. In addition to known reserves, with only about 10% of Iraq having been adequately explored for oil to date, many experts estimate that large additional reserves may be located in the Western Desert region.

Iraqi oil production is currently at around 2 million barrels per day. Due to ongoing problems of a lack of technology, damage from previous mismanagement, the effects of looting, and water intrusion, it has been estimated that it could take up to three years for Iraqi oil production levels to significantly expand. Iraq currently has the infrastructure to export a potential 6 million barrels per day, though exports via these pipelines have been threatened by substantial numbers of attacks on the infrastructure, as well as wear and damage to the pipelines. The repair and protection of these pipelines would allow the export of all Iraqi oil.

Reconstruction of Iraq's oil industry must be a key element of any national reconstruction effort. The energy sector is vital to the nation's political and economic future, with oil exports funding virtually all imports of basic goods, including food and medicine. Oil exports currently provide about 95% of Iraq's foreign exchange earnings.

This lucrative industry is also potentially the basis for an agreement between the nation's three main communities: Shiite and Sunni Arabs, and the Kurds. While both the Kurds and the Shiite Arabs inhabit lands high in oil resources, Sunni Arabs primarily live in territories with relatively few oil reserves. As a result, an effort to create and support a unified central government will require an oil-wealth-sharing agreement between these groups.

The United States has provided some assistance to the rehabilitation of Iraq's oil sector, largely because the Bush Administration expected revenue from this industry to shoulder the financial burden of national reconstruction. U.S. assistance has focused on initiatives to increase the production and exportation of crude oil, and has seen mixed results. Investigations by the Special Inspector General for Iraq Reconstruction (SIGIR) have revealed substantial flaws in numerous reconstruction projects, highlighting serious problems including waste of significant amounts of funds, loss of potential revenue, and inconsistent or inadequate output.

An additional component to the evolving situation is the ongoing debate within the Iraqi government on a package of hydrocarbon sector and revenue sharing legislation. Included in this legislation is an outline of the regulatory and policy framework for future oil and gas exploration and production. While this draft legislation states that the nation's oil wealth belongs to all citizens, it does not delineate the specific manner in which revenue will be shared. This will continue to be a crucial issue, with the Kurdistan Regional Government seeking to preserve regional authority to direct oil and gas policy, and the Sunni Arabs, who primarily occupy regions with few proven oil and gas deposits, seeking to ensure the equitable distribution of future oil revenue.

These tensions have been seen in the increasingly frequent bombings in Kirkuk, an oil rich city in the north of the country whose status has been hotly disputed by these groups. Just this week, a suicide bomb attack in this city killed over 85 people and wounded at least 180 others.

Mr. Chairman, the United States invasion and occupation of Iraq has been a misguided, mismanaged, and costly debacle. This Democratic Congress has made a clear effort to end U.S. military engagement in Iraq, an effort that I firmly support and believe must continue until U.S. troops are removed. Though I and several of my colleagues disapproved of this war from the beginning, now that ill-conceived invasion has occurred, and Iraq's political and economic infrastructure is mortally wounded, we have a responsibility to not leave Iraq in ruins.

I very much look forward to hearing the testimony of our witnesses today. Thank you, Mr. Chairman, and I yield back the balance of my time.