



*A Global Pro Bono Law Firm*

# A PRIMER ON THE EQUITABLE DISTRIBUTION OF OIL FOR IRAQ

## Legal Memorandum

Prepared by Yoonie Kim  
With Alexandros Aldous, Jason Crosby, Kate Ellis,  
Ethan Ostroff and Valbona Sherifi

September 2004

## PREFACE

With the transfer of power from the Coalition Provisional Authority to the Iraqi Interim Government, the people of Iraq and their political representatives will soon find themselves engaged in the process of reconstituting Iraq's sovereignty. While rebuilding a country is a difficult and contentious process for any country, the challenges are magnified for Iraq given its complex mosaic of ethnic and religious identities, the history of repression under Saddam Hussein, the likely continuation of an American military presence, and Iraq's complex relations with its neighboring states.

As a part of its Iraq Program, the Public International Law & Policy Group has prepared a series of memoranda engaging the salient issues surrounding the rebuilding of Iraq: autonomy, oil ownership and distribution, property claims, military, and refugees and internally displaced persons. This memorandum is one in the series, addressing the ownership equitable distribution of oil in Iraq. The other memoranda may be accessed on the Internet at <http://www.pilpg.org>.

The memorandum has been prepared on behalf of the Public International Law & Policy Group in cooperation with American University, and is made possible by a grant from the Plowshares Fund (<http://www.plowshares.org>). The Public International Law & Policy Group (PILPG) is a 501(c)(3) non-profit organization, which operates as a global *pro bono* law firm providing free legal assistance to developing states and states in transition involved in conflicts. To facilitate the utilization of this legal assistance, PILPG also provides policy formulation advice and training on matters related to conflict resolution. To date, PILPG has advised over a dozen countries on the legal aspects of peace negotiations and constitution drafting, and over fifteen countries in Europe, Asia and Africa concerning the protection of human rights, self-determination, and the prosecution of war crimes.

# **A PRIMER ON THE EQUITABLE DISTRIBUTION OF OIL FOR IRAQ**

## **Executive Summary**

The questions of oil resource ownership and the allocation of oil revenue pose a potentially divisive question for Iraq. An array of issues accompany any discussion on oil in Iraq, however, this memorandum focuses on the two core issues of ownership and formulas for allocation of oil revenue.

Currently, the Iraqi oil industry is under the control of the Ministry of Oil, which oversees North Oil and South Oil, the two major state companies, as well as other agencies in charge of exploration, extraction, pipelines and other oil-related activities. The Transitional Administrative Law (TAL) preliminarily addresses the two core issues: ownership and revenue allocation. The TAL vests ownership of Iraq's natural resources in "the people of all regions and governorates of Iraq," and grants the Transitional Government the authority to "distribute the revenue resulting from their sale through the national budget in an equitable manner."

In other oil-producing countries, ownership of oil has been handled in one of three ways: national ownership, regional ownership and shared ownership. With the majority of oil located in northern and southern Iraq, it is likely that the population in those regions will move for regional ownership. An arrangement similar to what the Russian federal government has negotiated with the republics of Tatarstan and Bashkortarstan may be applicable.

Oil-producing countries have implemented numerous formulas for the allocation of oil revenue. Some apply the same formula to share oil revenue as used for other budgetary distributions, while others favor the derivation principle, whereby each subnational government's share is tied to the oil revenue originating from its territory. Still others follow different criteria for revenue allocation such as population, basic needs or unique historical circumstances. A fairly recent mechanism for oil revenue allocation and management has been to create oil funds. Several countries have established oil funds with varying degrees of success.

Often, resource ownership and wealth-sharing is closely tied to concerns with power-sharing or the division of power between central and regional/local governments. By presenting a broad overview of different approaches to oil ownership and formulas for the allocation of oil revenue, as well as examining the creation of oil funds, this memorandum aims to stimulate creative solutions to bridge the gaps between the diverse interests within Iraq.

## TABLE OF CONTENTS

<b>Statement of Purpose</b>	1
<b>Introduction</b>	1
<b>Ownership of Oil Resources</b>	2
<i>Ownership</i>	2
<u>National Ownership</u>	3
<u>Regional Ownership</u>	3
<u>Shared Ownership</u>	4
<i>Applicability to Iraq</i>	6
<b>Formulas for Allocation of Oil Revenue</b>	7
<i>Saudi Arabia Approach</i>	7
<i>United Arab Emirates Approach</i>	8
<i>Chad Approach</i>	8
<i>Sudan Approach</i>	9
<i>Canada Approach</i>	9
<i>Applicability to Iraq</i>	10
<b>Creation of Specialized Oil Funds</b>	10
<i>Stabilization Fund</i>	11
<i>Intergenerational Fund</i>	12
<i>Applicability to Iraq</i>	13
<b>Conclusion</b>	14
<b>Annex I    Tables</b>	15
<i>Ownership and Management of Oil-Producing Countries</i>	15
<i>Existing Oil Funds</i>	16

<b>Annex II</b>	<b>Oil Infrastructure Map</b>	17
<b>Annex III</b>	<b>About PILPG; About the Author</b>	18

## A PRIMER ON THE EQUITABLE DISTRIBUTION OF OIL FOR IRAQ

### Statement of Purpose

This memorandum serves as a primer on oil resource ownership and revenue allocation and distribution, and describes how these issues have been handled in various oil-producing countries with varied geography and governmental structures. A host of issues accompany any discussion on the Iraqi oil sector. However, this memorandum focuses on the two core issues of ownership and formulas for the allocation of oil revenue. Furthermore, the memorandum limits its discussion to the upstream oil sector.<sup>1</sup>

### Introduction

The question of oil resource ownership and allocation of revenue to be derived from oil poses a potentially divisive question for Iraq. For decades, the Iraq Petroleum Company, a consortium of international oil companies that included ExxonMobil, British Petroleum, Shell and TotalFinaElf controlled Iraq's oil industry until 1972, when the oil industry became nationalized. Thus, any reversion to foreign control, or the appearance of foreign control under the U.S.-led military intervention, will likely be a major issue of contention and popular opposition in Iraq.

Currently, the Iraqi oil industry is under the control of the Ministry of Oil, which oversees North Oil and South Oil, the two major state companies, as well as other agencies in charge of exploration, extraction, pipelines and other oil-related activities.<sup>2</sup> An initial substantial debate is underway currently over the control of oil production, concessions, royalties and revenues generated by its sale.

The distribution of oil in Iraq presents several issues concerning the development of the Iraqi oil industry. The two primary issues are 1) the ownership of and right to extract Iraq's oil resources and 2) the formula for the allocation of the revenues collected from the sale of oil. Following the section on formulas for the allocation, the creation of oil funds—a fairly new mechanism of allocating and

---

<sup>1</sup> Upstream oil refers to activities related to exploration, extraction, development, production and shipping or transportation of crude oil. Downstream oil refers to all activities related to refining, marketing, and transporting finished petroleum products. The two terms attempt to divide into two parts a cluster of related activity that ranges from production of the crude oil at the well head and ending with the consumer filling her gasoline tank.

<sup>2</sup> In March 2003, Halliburton Corporation, a U.S.-based engineering company, was awarded a contract by the U.S. Army Corps of Engineers to handle emergency repairs to the Iraqi oil industry. In addition, Halliburton's subsidiary, Kellogg Brown and Root, was awarded a contract over Iraq's downstream oil sector.

managing oil revenue—will be discussed. Other secondary issues, such as ownership and operation of the downstream oil sector (oil refining and transportation), involvement of foreign companies, and mechanisms to ensure accountability and transparency, are to a large extent likely to be shaped by the resolution of the issue of ownership.

The **Transitional Administrative Law (TAL)** preliminarily addresses the two primary issues. The TAL vests ownership of Iraq’s natural resources in “the people of all regions and governorates of Iraq,” and grants the Transitional Government the authority to “distribute the revenue resulting from their sale through the national budget in an equitable manner.”<sup>3</sup> Questions of oil ownership and allocation of revenue are almost certain to become contentious issues in future negotiations over the Iraqi oil sector.

## **Ownership of Oil Resources**

The following provides a discussion of the various approaches to oil resource ownership employed in many oil-producing countries. Given the variations among many oil-producing countries, such determinations ultimately depend on country-specific factors. Nonetheless, the following general arrangements serve to illustrate potential ways Iraq may resolve questions of ownership and management.

### *Ownership*

Oil-producing countries utilize various arrangements for determining ownership of oil resources and the attendant rights to extract and develop these resources. Although each nation is unique, these arrangements can be broadly classified into three categories:

- **National Ownership** – vests ownership and control of oil resources in the national government.
- **Regional Ownership** – vests ownership and control of oil resources in the people or government of the region where the resources are located.
- **Shared Ownership** – vests ownership and control of oil resources among the national and regional/provincial governments.

---

<sup>3</sup> IRAQ CONST. (Transitional Administrative Law, 2004) art. 25(E).

Many oil-producing countries resolve the question of oil ownership in the national constitution.

**National Ownership.** The vast majority of oil-producing countries maintain national ownership of their oil resources. **Generally, national ownership is constitutionally protected**, as in the cases of Russia, Norway, Venezuela, Indonesia and the majority of Middle Eastern and African (MEA) oil-producing countries. Of the fourteen MEA oil-producing countries,<sup>4</sup> thirteen exert complete state ownership.<sup>5</sup> Additionally, in the MEA states, only the constitutions of Egypt, Libya and Qatar do not contain provisions designating national ownership of oil. Even in these three countries, however, oil resources are owned by the sovereign.

Oil-producing countries that employ **national ownership over their oil resources are characterized commonly by highly centralized governments.** Most of the Gulf States are monarchies; other Middle Eastern oil-producing countries are highly centralized (e.g., Egypt, Iran). A significant number of the non-Gulf States are represented by a republican form of government yet often these governments are weak democracies (e.g., Indonesia, Russia, Venezuela), non-democratic (e.g., Chad), de facto military dictatorships (e.g., Libya), or marked by civil unrest (e.g., Angola).

Although a system of national ownership seems likely to reduce the potential for regional, sectarian or ethnic conflict over oil resources, the opposite may also result. Sovereign ownership may potentially create friction between central and regional/provincial governments over revenue, geographic boundaries and/or regional wealth disparities.

**Regional Ownership.** Very few oil-producing countries vest ownership of oil resources in regional or provincial governments. Regional ownership of oil resources is usually found in federal states and seem to be most compatible with decentralized governments. The most cited examples of regional ownership are the U.S./Alaska and United Arab Emirates approaches.

The **U.S./Alaska approach**, though providing for regional ownership of oil resources, claims some unique features. In the United States, federal government

---

<sup>4</sup> For the purposes of this memorandum, the MEA oil-producing countries include: Algeria, Angola, Chad, Egypt, Iran, Kuwait, Libya, Nigeria, Oman, Qatar, Saudi Arabia, Syria, the United Arab Emirates and Yemen.

<sup>5</sup> The United Arab Emirates is the only MEA country that does not provide for national ownership of its oil resources.

ownership of oil resources is not constitutionally enshrined. Rather, **each state maintains ownership over oil resources within its territorial boundaries.** Specifically, the State of Alaska owns the oil resources within its land unless provided otherwise.

In the U.S./Alaska approach, the right to drill for oil belongs to the owners of the land being drilled and they may lease that right. While Alaska asserts ownership to oil within its territory, a unique provision in the Alaskan Constitution grants ownership to any individual or entity that extracts the oil out of the ground.<sup>6</sup> This concept is known in American jurisprudence as the “right to capture.”<sup>7</sup> Thus, in the U.S./Alaska approach, oil resources may be owned by the government of Alaska, the U.S. federal government, and private individuals and corporations. Attendant to ownership of oil resources is the requirement to pay fees, rents, royalties or other requirements as may be prescribed by Alaskan law.

The **United Arab Emirates (UAE)** is a federation of seven emirates, with political power concentrated in Abu Dhabi, which controls the vast majority of the UAE’s economic and resource wealth.<sup>8</sup> Under the UAE’s Constitution, **each emirate owns its oil resources and controls oil production and development.** Although Abu Dhabi joined the Organization of the Petroleum Exporting Countries (OPEC) in 1967 (four years before the UAE was formed), Dubai, one of the seven emirates, does not consider itself part of OPEC or bound by its quotas.

A system of regional ownership is well suited to a federal system of government as it fulfills the goal of enabling regional entities to retain a high level of autonomy from the central government. However, regional ownership may generate conflict between oil-rich and non-oil producing regions of a country.

**Shared Ownership.** A few states use a system of shared national and regional ownership of oil resources. The prime example of shared ownership is the Canadian approach.

**In Canada, each province owns and administers oil within its borders,** whereas the federal government owns and administers oil resources on Canada’s

---

<sup>6</sup> ALASKA CONST. art. 8, § 11 (stating that “discovery and appropriation shall be the basis for establishing a right in those minerals reserved to the State”).

<sup>7</sup> The right to capture, which accompanies land ownership, permits an owner of land to bring fugitive resources such as oil and gas to the surface, where they can be sold as personal property, regardless of whether the oil or gas was actually underneath the property where the drilling takes place.

<sup>8</sup> Abu Dhabi is by far the biggest oil producer in the UAE, controlling more than 85% of the UAE’s total output capacity and over 90% of its crude oil reserves. Dubai is the next largest, with 4% of the UAE’s crude oil reserves.

frontier lands (north and offshore).<sup>9</sup> The federal and provincial governments both exercise constitutional powers in energy development, transportation, marketing, and use regarding oil and natural resources. More specifically, the provinces retain responsibility over oil exploration and production within provincial boundaries. The federal powers in petroleum are primarily associated with inter-provincial and international oil transportation and marketing.

**Canada's unique system of federalism** grants ownership of natural resources to the provinces. This approach permits oil-rich provinces to maintain direct control over its oil resources. As a result, local administrators of the oil resources are directly accountable to the citizens of the province rather than the federal government. Canada has achieved a highly developed political culture of transparency and accountability, where regional officials have not attempted to exploit the immense power of their ownership interest in oil resources. Furthermore, the establishment of regional ownership has not been an overtly contentious political issue<sup>10</sup> because Canada is not dependent solely on its oil industry (the oil industry is Canada's seventh largest industry).

**Russia** exercises national ownership over its oil and mineral resources. However, **the central government in Moscow has also worked out special arrangements with certain resource-rich republics, e.g., Bashkortan and Tatarstan.** Article 72 of the 1993 Russian Constitution allows the execution of bilateral treaties between the central government and subnational entities on power-sharing.<sup>11</sup> For example, in 1994, the republic of Tatarstan brokered a treaty with the central government in Moscow, where Tatarstan relinquished claim to sovereignty and accepted Russia's taxing authority in exchange for Russia accepting Tatarstan's ownership and control over oil and other natural resources and Tatarstan's right to sign economic agreements with other sovereign nations.

**A shared ownership approach may provide a compromise** between those who desire regional ownership and those who desire national ownership of oil resources. This approach allows regional entities to maintain control over substantial portions of their oil resources while also allowing the central

---

<sup>9</sup> Some provincial governments dispute this, and in the offshore area of Nova Scotia and Newfoundland, the question of ownership has been set aside and the oil and gas industry is jointly managed. In both these areas, an independent offshore petroleum board regulates oil and gas exploration, development and production for both federal and provincial governments; mirror legislation and regulation are enacted both federally and provincially.

<sup>10</sup> Oil became a politically contentious issue in the 1970s with the OPEC oil crisis.

<sup>11</sup> The Russian Federation is comprised of eighty-nine subnational jurisdictions (republics, territories, regions, federal cities, the autonomous region and autonomous areas), including twenty-one ethnic enclaves with the status of republics, ten autonomous regions, six territories and forty-nine provinces.

government to regulate the transportation of oil inter-regionally and internationally. One drawback, however, may be the difficulty in deciding how to divide ownership between the central government and regional entities to the satisfaction of all.

### *Applicability to Iraq*

Generally, in most federations the competencies allotted to the federal government include defense, foreign affairs, monetary and fiscal policy, financial equalization, and management of the federal economy, while the competencies devolved to the constituent regional units relate to language, cultures, education, health, natural resources, and social policy. The TAL follows this general division of power on competencies, but parts on the issue of ownership of natural resources. Rather than vesting ownership of natural resources to the regional units, the TAL vests ownership of natural resources to the national government.

Regional ownership will likely raise a few major obstacles in Iraq. This system of ownership may be a source of conflict between various groups regarding the drawing of regional borders within Iraq. The Sunni are likely to advocate for national ownership. The Shi'a may claim ownership rights to the southern oil fields. Also, the Iraqi Kurds will likely favor regional ownership of oil resources in the North. Debate over Kirkuk is underway currently and will likely become a flashpoint in future negotiations over governorate boundaries and oil ownership.<sup>12</sup>

A shared ownership approach akin to the arrangement that the republics of Tatarstan and Bashkorstan worked out with the federal government in Moscow may be an amenable solution in Iraq. Even though experts estimate that Tatarstan and Bashkorstan combined comprise almost half of Russia's oil wealth, and thus, perhaps possessed sufficient leverage to work out a favorable scheme of ownership, the Kirkuk oil field which partially lies in Iraqi Kurdistan is a significant bargaining item for the Kurds.<sup>13</sup> For the Iraqi Kurds, maintaining regional ownership over oil likely remains a high priority, and the Kurdish region may be able to negotiate a compromise with the central government in Baghdad.

---

<sup>12</sup> Historically an ethnically-mixed city populated predominantly by Kurds and Turkomen, Kirkuk is important to Kurdish national identity. The Turkomen also have asserted a claim to Kirkuk as a majority-Turkmen city, and have called for a census to be conducted before any permanent decisions as to the status of Kirkuk are made. Kirkuk is also the northern center of the Iraqi oil industry and thus strategically and economically important to the Iraqi state. To ensure Arab control of the oil fields, successive governments in Baghdad have implemented a policy of deliberate Arabization of the city, forcing population movement and ethnic registration changes.

<sup>13</sup> The Kirkuk oil field—the largest oil field in northern Iraq—is estimated to hold over seven billion barrels of recoverable crude oil. Northern Iraq holds less than one-third of all of Iraq's oil wealth.

## Formulas for Allocation of Oil Revenue

The next question facing any oil-producing country is how to use its oil wealth. One of the most pressing issues in post-conflict Iraq is the allocation of the country's oil revenues. Developing a system of equitable allocation of revenue earned by the sale of Iraqi oil will likely be a pivotal issue in upcoming negotiations over the Iraqi oil sector.

The TAL addresses this issue by granting the **Transitional Government the authority to distribute oil revenue through the national budget, proportional to the distribution of population** throughout the country. The TAL does not entertain an allocation system based solely on regional concerns. However, the TAL does state that oil revenue allocation will be made “with due regard for areas that were unjustly deprived of these revenues” by Saddam's regime or whether the region requires revenue for development.

Oil-producing countries have implemented numerous formulas for the allocation of oil revenue.<sup>14</sup> Some apply the same formula to share oil revenue as used for other budgetary distributions, while others favor the derivation principle, whereby each subnational government's share is related to the oil revenue originating in its territory. Still others follow different criteria such as population, basic needs or tax capacity.<sup>15</sup> The approaches used by these countries do not readily fall into discrete categories nor is there a systematized method of addressing the issue of revenue allocation. The following section surveys several approaches to oil revenue allocation employed by various oil-producing countries.

### *Saudi Arabia*

In Saudi Arabia, as well as the other oil-producing Gulf monarchies, the **ruling family directly controls the allocation of oil revenue**. For example, the Saudi government provides free health services and subsidized housing, which is

---

<sup>14</sup> A corollary issue to formulas for allocation is the question of which entity controls the physical collection and disbursement of oil revenues. The methods oil-producing nations have used to address this issue can be classified into the following categories: 1) centralized approach, 2) decentralized approach and 3) hybridized approach. The centralized approach calls for central government oil revenue collection and disbursement with regional governments receiving a fixed percentage or an agreed share of a national program of expenditure. The decentralized approach delegates the right to collect oil revenue to regional or local entities. Moreover, regional governments often oversee disbursement within its subnational borders. The central government, however, often reserves the right to impose taxes and earnings on oil. Under the hybridized approach, oil revenue collection is commonly shared between central and regional governments.

<sup>15</sup> Ehtisham Ahmad and Eric Mottu, *Oil Revenue Assignments: Country Experiences and Issues*, 203 INT'L MONETARY FUND WORKING PAPER (2002).

financed through its oil revenue. Oil revenues have enabled the government to provide its citizens with infrastructural and social services. However, a vast majority of the expenditures have been concentrated in a few metropolitan cities, predisposing these areas to more rapid economic growth.

The Saudi Arabia approach vests discretion in the central government over how oil revenue is to be allocated. No clear set formula for allocation of oil revenue can be distilled in Saudi Arabia. This approach to allocation provides no guarantees for equitable distribution, and appears to be problematic in countries lacking sufficient transparency and accountability standards.

#### *United Arab Emirates*

The approach the United Arab Emirates adopts allows **each emirate to collect its oil revenue and maintain control over its allocation**. Nonetheless, each emirate is required to devote a certain percentage of its oil revenue to the UAE central government. The UAE is the only country that fully decentralizes allocation of oil revenue and has an upward revenue-sharing arrangement. Regional allocation of oil revenue with a contribution to the central government functions well within the UAE's federal structure, without noticeable tensions among the seven emirates.

#### *Chad*

In 1998, the World Bank began the Petroleum Development and Pipeline Project to develop and export Chad's oil resources in an attempt to improve its development prospects and to generate additional revenue to finance poverty alleviation expenditures. As a prerequisite for the project, Chad adopted the **Petroleum Revenues Management Law (PRML)** in 1999, outlining the government's planned allocation of the oil revenues. Under the PRML, the government is obligated to **utilize 80% of the oil revenues on its "priority sectors"** (education, health, social services, environment and infrastructure development); however, there are no fixed allocations for the various sectors.

The **remaining 20% is portioned accordingly**: 5% is reserved for the oil-producing region of Doba, 10% is allocated to an escrow account for future generations, and 5% is left to the government's discretion. Chad is the first oil-producing country to accept a conditional loan from the World Bank, which hopes to replicate this approach in other oil-producing countries. However, fears still

exist that the money has not and will not go to the earmarked social programs but to build the military.

### *Sudan*

Under the peace agreement between the Sudanese Government and the Sudanese People's Liberation Movement/Army (SPLM/A), **revenue is allocated to three separate entities**. According to the agreement, oil revenue will first be channeled into a national Oil Stabilization Account. After this payment is made, at least 2% of the oil revenue will be allocated to the oil-producing region in proportion to the output produced in that region. Finally, the remaining oil revenue will be divided equally between the Government of Southern Sudan (GOSS) and the national government in Northern Sudan. Thus, a sizeable portion of the oil revenue is allocated to regional entities.

Distribution is overseen by the National Petroleum Commission (NPC) among its other responsibilities. The NPC is comprised of the President of Sudan and the President of the GOSS as permanent co-chairs and eight permanent members, four each from the national government and the GOSS. A maximum of three representatives of an oil-producing region in which oil production is being considered are also admitted as non-permanent members.

While demonstrating valuable principles of distribution, the primary purpose of this arrangement was to facilitate a ceasefire between the Sudanese Government and the SPLM/A until a referendum for southern Sudanese independence is held, not to create an institution for the long-term management of oil revenues.

### *Canada*

The Canadian approach is complex: ownership and control over natural resources is provincial, and thus, **each province collects and allocates its oil revenues in its own chosen manner**. The Canadian federal government, however, does possess the ability to levy taxes and regulate certain aspects of each province's oil industry through its other powers, i.e., control over foreign investment. While oil revenue is strongly concentrated in a few provinces, on aggregate, oil revenues account for less than 5% of the total revenue of the provincial governments. The decentralization of oil revenue has contributed to disparities in fiscal capacity among the provinces, but the federal government has taken this into consideration by not providing any equalizing grants to the relatively rich, oil-producing provinces.

### *Applicability to Iraq*

Whatever approach Iraq takes in designing a formula for allocation of its oil revenue, the following key considerations should be taken into account: 1) a coherent energy policy; 2) distributional principles; 3) compensation to producing areas for costs of production; 4) national and regional/local economic stability; and 5) expenditure responsibility.

Several key distributional principles to consider in designing a revenue allocation system are derivation, population, basic needs, and unique historical circumstances. Other important considerations to undertake are national and local economic stability. Funding for infrastructure, modernization, health care, education and security must also not be forgotten. After the fall of Saddam Hussein, many areas in Iraq are still deprived of the basic needs of modern life such as running water, electricity and telecommunications. Central governments need adequate revenue to carry out agreed national functions while regional entities need stable income and insurance against resource price fluctuations.

The principle arguments for assigning oil revenues to subnational jurisdictions are mainly political and turn on either constitutional stipulations that delineate the regional or local ownership of natural resources or the right to levy taxes on certain sources of income. Another conventional arrangement—to share revenues between central and regional governments—is often the result of attempts by central governments to appease separatist tendencies in natural resource-producing regions.<sup>16</sup> Large unitary states tend to be pressed into revenue-sharing arrangements with subnational governments. The same issue arises in federal states. Thus, the multi-tiered allocation of oil revenue employed by Sudan may be instructive for Iraq as it seeks to satisfy the revenue needs and claims of various groups as well as ease political tension over oil resources.<sup>17</sup>

### **Creation of Specialized Oil Funds**

Managing oil revenue well involves traditional issues of budgetary management, but the following issues are more important for oil-producing countries: how much to save for future generations; how to achieve economic stability in the face of uncertain and widely vacillating oil prices and avoid “boom-

---

<sup>16</sup> Ehtisham Ahmad and Eric Mottu, *Oil Revenue Assignments: Country Experiences and Issues*, 203 INT’L MONETARY FUND WORKING PAPER (2002).

bust” cycles; and how to ensure that spending is responsible, whether in the form of large investment projects, public consumption or subsidies.

A fairly new mechanism for oil revenue allocation and management has been to create oil funds. The creation of oil funds has become particularly attractive in the wake of past high and volatile oil prices and new oil discoveries. Some objectives of oil funds have been to combat commodity price volatility, currency appreciation or volatility, inflation, and political and economic dependency on oil revenues. Other objectives have included a desire to pay for social and economic development needs, provide financial resources for future generations, and provide an incentive for prudent financial management by putting revenue away for later use.

Surveying oil-producing countries that have established an oil fund, the funds can be classified into two basic categories: 1) stabilization funds and 2) intergenerational funds. (See Table 2 for a list of countries with oil funds).

### *Stabilization Fund*

A stabilization fund sets aside a percentage of income for national financial reserves and national emergencies. Such funds may be used to stabilize a country’s economy during particularly volatile periods. Stabilization funds have also been used to spur development in non-oil sectors of a country’s economy.

The Government Petroleum Fund of Norway, established in 1990, acts as a financial buffer to smooth short-term variations in oil revenues and as a mechanism to cope with the long-term challenge of funding government expenditures when oil resources are exhausted. The primary income sources for the fund are from central government cash flows from petroleum activity and returns on invested capital. Money from the fund is solely intended for transfers to the Norwegian government’s fiscal budget, upon approval from the Norwegian Parliament. The fund is managed by the Norwegian Central Bank according to Ministry of Finance guidelines.

Kazakhstan created a stabilization fund in August 2000, which aims to reduce the economy’s susceptibility to unfavorable external factors. The National Fund of Kazakhstan acts to ensure stable social and economic development of the country. Proceeds from oil royalties and the sale of oil as well as other mineral assets capitalize the fund. Fund activity requires annual approval by Parliament, and the Management Council formed by the President, Prime Minister, and

members of Parliament provides oversight. Furthermore, an annual independent audit is conducted on the fund.

Iran created the Foreign Exchange Reserve Account in 1999 to reduce budget reliance on oil revenues and to ensure the sustainability and preservation of national wealth. The Iranian stabilization fund aims to build up a reserve to balance future downturns in oil prices and to support Iran's industrial sector and non-oil exports. The Reserve Account is managed by the Central Bank of Iran.

Stabilization funds often accrue revenue not just from oil sales, but also from royalties, pipeline fees, rental fees, bonus payments and interest income. In the case of Kazakhstan, a transfer of 10% of baseline oil revenues finances the fund's savings portfolio, but the fund also receives large privatization receipts and bonus payments from other activity within the petroleum sector.

One disadvantage of stabilization funds is that the government may treat them as slush funds. For example, in Azerbaijan, the government recently used part of the governmental oil fund to finance commercial pipeline development, although the fund was set aside specifically to benefit the non-oil sectors.

### *Intergenerational Fund*

An intergenerational fund saves a share of oil income for future generations. The purpose of such funds is to ensure that future generations reap benefits from prior oil production.

Alaska is the most often cited example of an oil-producing region that has established a successful intergenerational fund. The primary goal of the Alaska Permanent Fund is to conserve a portion of the state's oil revenue (as well as other mineral resources) to benefit all generations of Alaskans. A secondary goal of the fund is to serve as a savings account for other appropriations by the Alaskan state legislature. The fund accrues revenue from oil and mineral lease rentals, royalties, special legislative appropriations, and an annual transfer of fund income to protect the principle against inflation.

Revenue from the fund is only distributed for two purposes: 1) annual dividend payment and 2) "inflation proofing."<sup>18</sup> The principle of the fund remains

---

<sup>18</sup> Inflation proofing is the annual transfer (by legislative appropriation) of a portion of Fund income to the principal to protect the value of the principal from inflation. Over time, US \$7.9 billion has come into the principal through inflation-proofing.

to benefit future generations, while cash dividends on the principal are paid out annually to all Alaskan residents.<sup>19</sup> The Alaskan Permanent Fund is managed by the Alaska Permanent Fund Corporation and oversight is provided by a Board of Trustees, the Alaskan state legislature and the public.

Under World Bank guidelines, Chad has also established an intergenerational fund. The Revenue Management Plan reserves 10% of oil revenues in a trust fund for the benefit of future generations. The funds are held in an offshore escrow account, audited by the World Bank. (*See Formulas for Allocation* section for an accounting of the remaining 90%).

Kuwait has also established a successful intergenerational fund. The Kuwaiti Reserve Fund for Future Generations, established in 1976, receives an annual allocation equivalent to 10% of the government revenue. The Fund is managed by the state-run Kuwait Investment Authority.

The greatest challenge with any intergenerational fund is ensuring that the fund is preserved for future generations, particularly during a financial crisis or other significant emergency. Recently, for example, there has been pressure on the Alaskan legislature to open up its intergenerational fund to deal with the budgetary crisis gripping the state government.

As the use of oil funds is a relatively new mechanism for revenue allocation and management, some key issues to scrutinize are: who manages, who audits and who decides disbursements. Some fundamental factors in the success of oil funds are establishing clear goals on the objectives of the funds, transparency of operations, and fund management rules that guarantee accountability.

### *Applicability to Iraq*

There is a trade-off between spending on current economic development needs and saving for future generations. However, these are not mutually exclusive goals. Several oil-producing countries have established oil funds with dual objectives. Considering the enormous capital needed to reconstruct Iraq, establishing an oil fund to aid in the development needs of Iraq seems advisable.

---

<sup>19</sup> Approximately 50% of the fund income is used for the annual dividend payments, while the rest is saved. In 2003, the cash dividend paid out to each Alaskan resident was US \$1108. From 1982 through 2003, the Fund has paid out \$12.5 billion in Fund income as dividends to qualified Alaskans.

In the discussion of oil funds, the Alaskan approach is often cited as an example. Nevertheless, Alaska possesses some unique characteristics that have made its intergenerational fund successful. Alaska is able to pay out cash dividends because it is a state within a larger federation of the United States, and thus does not need to spend its oil revenue on defense/national security as many other oil-producing countries do. Furthermore, Alaska is sparsely populated, with only 640,000 citizens. The large population, as well as the enormous administrative and cost, is an obstacle in Iraq to implement a similar Alaskan-styled fund.

Creating a dual purpose oil fund—for stabilization as well as saving purposes—should be discussed for Iraq. Iraq will need to protect against oil-price volatility as well as save for future generations.

## **Conclusion**

As Iraq moves into rehabilitating its oil sector, the two main issues regarding Iraq's oil resources which will have to be negotiated are the ownership of resources and the allocation of oil revenue. The resolution of oil ownership and allocation of oil revenue is likely shaped by state structure (e.g., federal or unitary). Regardless of state structure, there are numerous points on which agreement can be reached. If oil is nationally owned, then a revenue-sharing agreement benefiting oil-producing regions can be negotiated. Conversely, if oil is owned by subnational entities, then an upward revenue-sharing arrangement may be appropriate.

Often resource ownership and wealth-sharing is closely tied to concerns with power-sharing or the division of power between central and regional/local governments as well as economic rehabilitation and reconstruction. Understandably, the various groups in Iraq have a vested stake in the final agreement on oil. The presentation of a broad overview on the issues of oil ownership and formulas for allocation of oil revenue, as well as examining the creation of oil funds, will hopefully stimulate creative solutions to bridge the gaps between the diverse interests within Iraq.

## ANNEX I

Below are two tables: Table 1 lays out questions of ownership, operation and the degree of privatization of the oil sector in oil-producing countries; Table 2 lists the existing oil funds.

**Table 1. Ownership and Management of Oil-Producing Countries**

REGION	OWNERSHIP	OPERATING FRAMEWORK	PRIVATIZATION
WESTERN EUROPE			
Norway	national	mix <sup>20</sup>	no privatization
United Kingdom	shared	concession	priv. substantially complete
CENTRAL/E. EUROPE			
Kazakhstan	national	joint venture/PSA	priv. underway
Russia	national/shared	mix	priv. underway
Turkmenistan	national	joint venture/PSA	no privatization
AFRICA/MIDDLE EAST			
Algeria	national	mix	no privatization
Angola	national	mix	no privatization
Kuwait	national	mix	no privatization
Nigeria	national	mix	no privatization
Oman	national	mix	no privatization
Qatar	national	mix	no privatization
Saudi Arabia	national	mix	no privatization
UAE	regional	mix	no privatization
Yemen	national	PSA/concession	no privatization
ASIA			
Australia	shared	mix	always private
China	national	PSA	no privatization
India	national	PSA	priv. underway
Indonesia	national	PSA	no privatization
SOUTH AMERICA			
Argentina	regional	concession	priv. substantially complete
Brazil	national	joint venture	no privatization
Columbia	national	joint venture	no privatization
Venezuela	national	joint venture/PSA	no privatization
NORTH AMERICA			
Canada	shared	concession	priv. substantially complete
Mexico	national	service agreement	no privatization
United States	regional	concession	always private

Source: Adapted from *The Benefits and Deficiencies of Energy Sector Liberalisation*, WORLD ENERGY COUNCIL, at <http://www.worldenergy.org/wec-geis/publications/default/online.asp> (1998).

<sup>20</sup> Mix is defined as a combination of joint ventures, production-sharing agreements, concessions and service agreements that serve as the operating framework for the oil industry in a particular country.

**Table 2. Existing Oil Funds**

<b>Name</b>	<b>Country</b>	<b>Inception Date</b>	<b>Size</b>
General Reserve Fund	Kuwait	1960	Approx. USD \$65bn
General Stabilization Fund	Papua New Guinea	1974	N/A
Alaska Permanent Reserve Fund	United States	1976	Approx. USD \$27.4bn
Alberta Heritage Savings Trust Fund	Canada	1976	Approx. CAD \$12bn
State General Reserve Fund	Oman	1980	Approx. USD \$2bn
Government Petroleum Fund	Norway	1990	Approx. NOK \$625bn (USD \$82bn)
Nunavut Trust	Government of Nunavut (Canada)	1990	Approx. CAD \$475m
State Oil Fund	Azerbaijan	1999	Approx. USD \$538m
Revenue Management Fund	Chad	1999	Not yet funded
Foreign Exchange Reserve Account	Iran	1999	Approx. USD \$1.2bn
Investment Fund for Macroeconomic Stabilization	Venezuela	1999	Approx. USD \$3.7bn
National Fund	Kazakhstan	2000	Approx. USD \$1.2bn
Oil Stabilization Fund	Sudan	2004	Not yet funded

Source: Eric D.K. Melby, *A Global Overview of Oil Funds*, INTERGOVERNMENTAL AUTHORITY ON DEVELOPMENT SYMPOSIUM (2002) at [http://www.csis.org/africa/0208\\_SudanMelby.pdf](http://www.csis.org/africa/0208_SudanMelby.pdf) (last visited Apr. 12, 2004).



## ABOUT THE PUBLIC INTERNATIONAL LAW & POLICY GROUP

**The Public International Law & Policy Group (PILPG)** is a 501(c)(3) organization, which operates as a global *pro bono* law firm providing free legal assistance to developing states and sub-state entities involved in conflicts. PILPG also provides policy formulation advice and training on matters related to conflict resolution.

PILPG has advised over a dozen countries on the legal aspects of peace negotiations and constitution drafting, and over fifteen countries in Europe, Asia and Africa concerning fundamental questions of public international law and foreign relations. PILPG has also advised four international criminal tribunals.

The four primary practice areas of PILPG are:

- **Peacebuilding**
- **International Justice**
- **Post-Conflict Political Development**
- **Public International Law**

As a *pro bono* law firm, PILPG relies almost exclusively on volunteer legal assistance from more than sixty legal advisors and former diplomats, as well as major international law firms. On average PILPG is able to provide over \$1.5 million worth of *pro bono* services annually.

PILPG provides legal assistance to a large number of clients without a physical infrastructure or any full time paid staff, and is thereby able to commit over 95 percent of its resources directly to project activities. Frequently, PILPG sends members in-country to facilitate the provision of legal assistance, and its members often serve on the delegations of its clients during peace negotiations.

PILPG maintains volunteer points of contact in Washington DC, New York, Boston, Cleveland, Seattle, London, Paris, Rome, The Hague, Stockholm, Belfast, Krakow, Budapest, Zurich, and Nairobi.

From 1996–1998, PILPG operated under the auspices of the Carnegie Endowment for International Peace. In July 1999, PILPG was granted official Non-Governmental Organizations status by the United Nations.

## ABOUT THE AUTHORS

**YOONIE KIM** is a Senior Research Associate for the Public International Law & Policy Group (PILPG). Ms. Kim is currently co-leading PILPG's Iraq Program, which is analyzing the salient issues surrounding the rebuilding of Iraq. Ms. Kim is also coordinating PILPG's collaboration with several law firms to prepare an array of memoranda that will serve as step-by-step guides for evaluating constitutional issues: executive, legislature, judiciary, electoral system and human rights. In her work for PILPG she has conducted research and drafted legal memoranda on the restitution of property claims, repatriation of internally displaced persons and refugees, and distribution and allocation of oil resources. In addition to her work for the PILPG, Ms. Kim works as a research assistant for the United States Institute of Peace (USIP) in its Rule of Law Program, where she works on post-conflict transitional justice and constitution-making issues. Ms. Kim will receive her J.D. from the Washington College of Law and M.A. from American University's School of International Service in 2005. She holds B.A., *magna cum laude*, in Sociology from the University of Washington in Seattle.

**JASON CROSBY** is a Senior Research Associate, who has been with the Public International Law & Policy Group (PILPG) since May 2003. Currently, Mr. Crosby is co-leading the PILPG's Iraq Program, which is analyzing the salient issues surrounding the rebuilding of Iraq. His work for PILPG has included research on constitutional guidelines, allocation of oil revenue and ownership, and Shari'ah law. Prior to his work with PILPG, Mr. Crosby provided executive protection and security consulting services to Venkateshwara Hatcheries LTD, a multi-national poultry conglomerate headquartered in Pune, India. Mr. Crosby received his Bachelor of Arts from Texas A&M University in 1999, and will receive his Juris Doctor and Master of Arts in International Studies, both from American University, in 2005.

We would like to thank the other individuals who contributed to the research and writing of this legal memorandum.