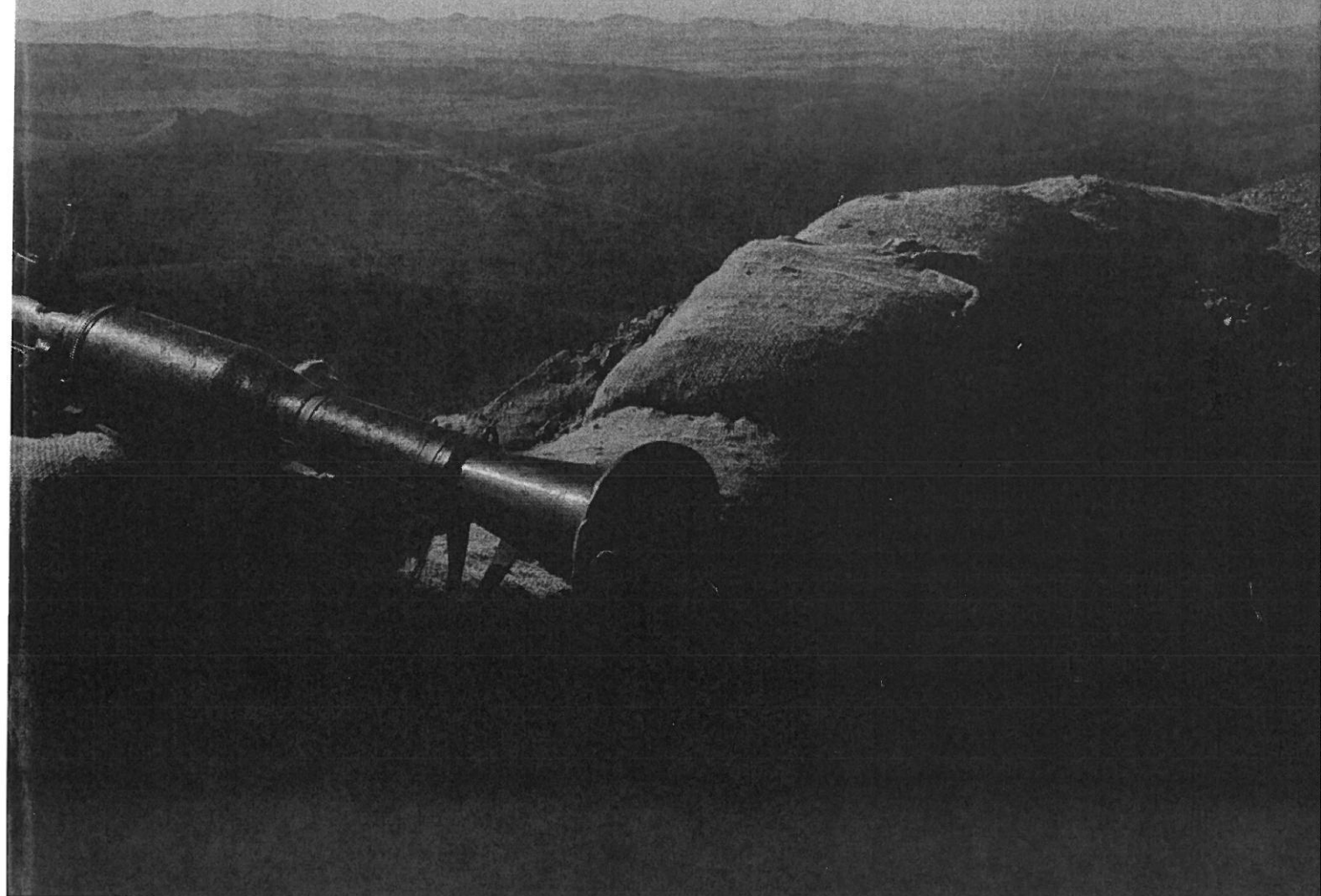


WORLD

BLOOD FOR OIL

Iraq could face a civil war with its
Kurds over the right to drill for crude

BY JAY NEWTON-SMALL/KIRKUK



LOOK EAST FROM THE KURDISH TRENCHES

on a dusty ridge outside the northern Iraqi city of Kirkuk and you can see the cause of it all: a rudimentary oil field where water wells are being sunk and sites are being cleared for drilling.

Now look south into the valley below the Kurdish positions and you can see two Iraqi army units poised to make sure that drilling never begins.

Since November, a crisis of oil, money and history has been building in the semiautonomous northern Iraqi region of Kurdistan. Some 30,000 Kurdish soldiers face just as many regular Iraqi army troops, setting the stage for a civil war in a country that has already endured more than its share. Under these lands lie an estimated 66 billion barrels of oil, enough to shift the global market for crude and alter Iraq's economic fortunes—provided the resource doesn't tear apart the country first.

Both armies arrived in Kirkuk at the end of November after a gas-station shoot-out nearby between Iraqi police and Kurdish troops left one dead and both sides furious. The forces have been tripping over each other since, in patrols through the divided city of Kirkuk and throughout the surrounding disputed territory, which is a bit larger than Kuwait. The situation has become tense for both sides. "I'm going to fight them," Iraqi Prime Minister Nouri al-Maliki warned his staff and allies in December. "I will use force to prevent them from working in the disputed area." With the two armies mustered in such close proximity, war may not wait; a suicide bomber killed at least 36 people and wounded more than 100 at a Kirkuk police station on Feb. 3. "Accidents happen," says Harry Schute, a former U.S. Army colonel who led U.S. forces into Kurdistan in 2003 and returned in his retirement to advise the Kurdish government on security issues. "This could blow up to be a war that no one wants."

Civil Affair

THE TINDERBOX HAS BEEN YEARS IN the making. Kurds—a nomadic Indo-European ethnic group spread across parts of Turkey, Syria, Iran and Iraq—have sought an independent state since 1920, with limited success. But Kurds in

northern Iraq were largely able to govern themselves from 1991 to 2003 in Iraq and had little or no contact with Baghdad. Only after the fall of Saddam Hussein, however, did the Iraqi Kurds begin to flex their muscles on energy policy, claiming the right to sign deals with foreign oil companies and drill on lands they historically claimed. When the Kurdistan Regional Government opened up to drilling in 2004 it sweetened the offer by allowing foreign oil companies to keep far more of the profits than the post-Saddam government was offering from oil fields in southern Iraq. Baghdad in 2011 threatened to cancel all its contracts with companies drilling elsewhere in the country if they signed up with the Kurds, but that didn't deter more than 50 multinationals from making deals with the north, including majors like ExxonMobil, Chevron, Total and Gazprom. "U.S. firms want to be able to work anywhere in Iraq and base their business decisions on which province or region is the most attractive for investors," says Hussain Qaragholi, president of the U.S. Business Council in Iraq, whose board includes ExxonMobil and Chevron.

Of course, oil isn't worth much unless you can ship it to the people who want to buy it, and Iraqi Kurdistan is landlocked. So last month the Kurds struck a provisional deal with neighboring Turkey to build a pipeline to carry any oil drilled on Kurdish lands—or even disputed territory—out of Iraq. There's just one problem: under the new Iraqi constitution, Baghdad controls all oil exports. And without a pipeline to move the crude to market, drilling in Kurdistan makes little sense. The result is an increasingly nasty standoff that's brought to the surface deep divisions between the Kurds and Baghdad.

The Iraqi government has threatened to forcibly halt any Kurdish exports of oil by truck—about 70,000 barrels a day head out by road to Turkey—and to stop the pipeline's construction, which is scheduled to begin later this year. Last May, al-Maliki sent President Obama a letter asking him to persuade ExxonMobil to either abandon or slow down its Kurdish activity. The appeal had little effect; Obama informed al-Maliki that he has no control over private companies, though



DIFFERENT TAKES

\$1.50

Amount of profit per barrel that the Iraqi government allows oil companies

\$30.00

Amount of profit per barrel that the Kurdish government allows oil companies

the White House warned all U.S. oil firms working in Iraq that signing contracts without the approval of Baghdad exposed them to international legal risks.

The company with the most at stake is ExxonMobil, the first oil major to sign on with the Kurds in 2011. It is the only company to own contracts—three of its six Kurdish parcels—in the disputed territory. The company began exploratory work on one of those disputed plots early this year, and ExxonMobil representatives arrived in Baghdad in January to try to negotiate a peaceful solution. Those talks are ongoing. For ExxonMobil and the other oil majors, the political risk of taking sides in a civil dispute is balanced by major potential rewards. Some of the best oil fields in all of Iraq happen to be in territory that's under dispute. A 2012 International Energy Agency report predicted that with the right investment, Iraq as a whole could double oil production to 6.1 million barrels a day by 2020 and raise it to 8.3 million barrels by 2030, making it the single biggest contributor to global oil-supply growth.

But that can happen only if Baghdad and the Kurds can reconcile their differences, and by late November, it became clear just how dire the dispute



A separate people From top: tankers are lined up to export oil; young Kurdish men smoke shisha in Erbil; a Kurdish family rides a gondola high over the city



was. An estimated 60,000 Kurdish and Iraqi troops marched to Kirkuk, taking up positions across the disputed territory. On Dec. 19, the *peshmerga*, as the Kurdish troops are called, fired on an Iraqi helicopter. The disputed region has been hit by a wave of sectarian bombings in the past month that have killed more than 90 people and injured more than 500—violence that alarmed State Department officials. Administration officials, including U.S. Ambassador to Iraq Robert Beecroft, have stepped in to try negotiating a settlement, but no timeline has yet been set for troops to withdraw. On top of everything else, Iraqi President Jalal Talabani, a Kurd and an experienced peacemaker, has been incapacitated since suffering a stroke on Dec. 17.

Battle Lines

DESPITE THE DRAMA, WAR SHOULD STILL be avoidable, in part because peace would be a lot more profitable. Until they can start exporting their oil in bulk, the Kurds remain reliant on Baghdad for revenue. When the new Iraqi government was formed, the Kurds were given 17% of all oil revenue annually, which today accounts for nearly all the Kurdistan Regional Government's budget. Turkey, thirsty for oil and concerned with its own Kurdish population, prefers to maintain the peace. For its part, Baghdad has its hands full with an outbreak of Sunni violence in recent weeks spilling over from neighboring Syria, including mass protests and a bombing of Shi'ite pilgrims after al-Maliki moved against his Sunni Finance Minister Rafia al-Issawi.

Still, nerves are so tense that even a minor blunder could spark a war that neither side really desires. Back in Kirkuk, a Kurdish soldier named Weli Abdulla stands on that dusty ridge looking down through the row of machine guns and rocket-propelled-grenade launchers aimed at his fellow Iraqis below. In between the weapons someone has propped a solitary rose and a tiny Kurdish flag. "We do not want to fight," he says, grasping the rifle slung diagonally across his chest and glaring down the hill. "But if we have to fight, we will defeat the Iraqi army." There will be oil—or there will be blood. ■