American University of Iraq, Sulaimani
Institute of Regional & International Studies

IRIS REPORT
June 2023

Iraq Economic Review

Energy, Power & Politics: Assessing the Baghdad-Erbil Oil Deal

In this issue:

ABOUT IRIS

The Institute of Regional and International Studies (IRIS) is an Iraq-based research center committed to producing independent and empirically rigorous political analysis of Iraq and the broader Middle East region. Housed at the American University of Iraq, Sulaimani (AUIS), the Institute partners with academic institutions and funding agencies from across the world that share IRIS' mission of grounding the policy conversation on Iraq in rigorous research and local expertise. IRIS convenes events throughout the year, including the annual Sulaimani Forum, in order to disseminate research findings and to promote dialogue among a broad range of stakeholders on the most complex policy challenges facing Iraq and the region. Finally, IRIS builds the skills and capacity of young researchers, policymakers, and leaders towards the aim of leveraging policy research into political and social change.

ABOUT THE AUTHORS

Ahmed Tabaqchali is Senior Fellow at IRIS and the Chief Strategist of the AFC Iraq Fund. He formerly served as the Executive Director of NBK Capital, the investment banking arm of the National Bank of Kuwait, and Managing Director and Head of International Institutional Sales at WR Hambrecht + Co. In addition to his research at IRIS, Tabaqchali writes regularly on the Iraqi economy for the LSE Middle East Centre. He tweets @ AMTabaqchali.

Karam F. Robeil serves as a Research Associate at IRIS where he focuses on the environment and politics of Iraq. He has assisted in multiple projects at IRIS and holds a bachelor's degree in Mechanical Engineering from the American University of Iraq, Sulaimani.

Mera Bakr is a Non-Resident Fellow at IRIS, where he primarily focuses on youth dissatisfaction, political dynamics and security issues in the Kurdistan Region of Iraq (KRI). Previously, as a Non-Resident Fellow at the German Konrad Adenauer Stiftung (KAS), he published numerous policy reports on elections, migration crisis and security sector reform in the KRI. In addition to consulting and briefing on security, energy, and domestic politics developments, he has, likewise, worked on other projects, including federal elections in his hometown, Kirkuk, as well as State and International Non-Governmental Organizations relations in the KRI. Currently, he is pursuing his master's of science in Politics, Economics and Philosophy at the University of Hamburg, Germany.

Yesar Al-Maleki, Research Fellow at IRIS, is a Gulf Analyst at MEES and Non-Resident Scholar at the Middle East Institute. He's an energy economist with expertise in energy, geopolitics, and economics in Iraq and the Gulf. Formerly he was the Managing Director of Iraq Energy Institute and worked for the International Energy Agency and various international oil companies. He holds a master's in Energy Economics from IFP School and is a PhD candidate at the University of Exeter. He tweets @yesar

CONTENTS

It Takes Two to Tango: Ramifications of the Baghdad-Erbil Oil and Budget Deals

Ahmed Tabaqchali

INTRODUCTION

The Kurdistan Region of Iraq's (KRI) nine years of independent oil exports – and by extension Iraq's two separate oil production and export policies – came to a formal end on March 25, 2023 in response to the International Chamber of Commerce's (ICC) arbitral award[1] in Iraq's favor in its nine year arbitration case against Turkey over the Iraq-Turkey Pipeline (ITP) Agreements. The actual end, however, was precipitated by Federal Supreme Court's (FSC) ruling in 2022 that the Kurdistan Oil and Gas Law (KOGL) was unconstitutional. That latter ruling, irrespective of the debate over its timing and politicization, upended the legal and legislative framework governing hydrocarbon production in the KRI and spelled the beginning of the end for the long-running dispute over the development of the country's hydrocarbon resources. Together, the FSC and ICC rulings have instigated a fundamental shift in the relationship between the Government of Iraq (GoI) and the Kurdistan Regional Government (KRG).

The process of refashioning the GoI-KRG relationship gained momentum during the long political bargaining process that eventually led to the formation of Iraq's current governing alliance, known as the State Administration Coalition (SAC), which includes the two main Kurdish parties. Reflecting SAC internal discussions, the government program published in October 2022 stipulated that federal and Kurdish authorities should work towards a negotiated resolution of the conflict over the development of the country's hydrocarbon resources and the KRI's share of the federal budget.[2] It also aimed to pass a federal oil and gas law within six-months of coming to power. The initial results of negotiations between the GoI and the KRG were evident in the sections that address the KRI's oil exports and its share of the federal budget within the proposed 2023 federal budget, which was presented to parliament for review in mid-March. These negotiations progressed further with the GoI-KRG agreement in early April[3] on the resumption of oil exports through the Turkish port of Ceyhan. Taken together, the agreement and the terms of with KRI's share of the federal budget, effectively amount to an oil and gas revenue sharing mechanism.

This article unpacks this oil and gas revenue sharing mechanism through the fundamental changes it brings to the KRG's oil export infrastructure, which flow into its contributions in oil export revenues to the federal budget and subsequently the KRI's enhanced allocations in the budget. It also looks at how those changes mean increased financial flows to the KRG's public sector payroll. The potential benefits of these changes will become clear through a comparison with what would likely have happened if things had remained as they were under the prior situation.

1 Zaid Al Ali, and Ahmed Tabaqchali, "Commentary, "Iraq-vs-Turkey-ICC Final Award", 1001 Iraqi Thoughts, May 24, 2023. commentary-iraq-v-turkey-international-chamber-of-commerce-final-award-13-february-2023

2 Ahmed Tabaqchali, "Debt and the Ides of March: An Overview of Iraq's 2023 Federal Budget Proposal", LSE Middle East Centre, May 8, 2023. https://blogs.lse.ac.uk/mec/2023/05/08/debt-and-taxes-of-what-can-we-be-certain-in-iraqs-2023-federal-budget/

3 Ben van Heuvelen and Mohammed Hussies, "Baghdad, Erbil sign temporary deal to resume northern exports", Iraq Oil Report, April 4, 2023. https://www.iraqoilreport.com/news/baghdad-erbil-sign-temporary-deal-to-resume-northern-exports-45634/

Fundamental Changes in the KRG's Oil Export Infrastructure

The new oil and gas revenue sharing mechanism involves three fundamental departures from past practice that will have far-reaching implications for the development of the country's hydrocarbon resources: first, the inclusion in sovereign expenses of IQD 2.4 trillion for payments to international oil companies (IOCs) operating in the KRI; second, the marketing of the KRG's oil exports; and third, the flows of revenue from these exports. Collectively, they seem to address the FSC's ruling and satisfy the priorities of both the GoI and the KRG, in that they create a framework of federal control of the KRI's oil production and exports while ensuring that the KRG receives the full revenue flows of these exports. However, a number of key details in each of the three changes have not been addressed. As a result, either further negotiations are needed to resolve them, or details of past negotiations have not yet been publicly disclosed.

The first change is that the federal Ministry of Oil (MoO) will allocate IQD 2.4 trillion[4] in sovereign expenses for payments to IOCs operating in the KRI. This implies an acknowledgement by the GoI that these IOCs are operating officially under accepted oil production contracts, but it does not necessarily mean that the conditions under which they operate will remain the same. Specifically, it is not clear (1) whether the original contracts signed by these IOCs will be re-negotiated or kept largely unchanged;[5] (2) whether MoO payments to IOCs will be in bank transfers in the same way they currently operate in the KRI, or will change to allocations in oil export revenues for their benefit directly in the way the MoO works with IOCs in federal Iraq;[6] and (3) the IQD 2.4 trillion payment, is 48% of the estimated IQD 5.0 trillion[7] in payments that would accrue to them under the prior conditions. Which implies either a change in their renumeration terms, or more likely that the balance of IQD 2.6 trillion will be paid by the KRG from its share of the budget.

The second change is that the federal State Organization for Marketing of Oil (SOMO), and not the KRG's Ministry of Natural Resources (MNR), will take primary responsibility for marketing the KRG's oil exports, with the MNR providing inputs to SOMO. This will lead to higher realized prices for the KRI's crude, known as Kurdistan Blend Test (KBT).[8] However, no clarification was provided for how this change will affect the KRG's debt to oil traders of IQD 4.2 trillion (in the form of forward oil sales[9]) and, as such, how this may affect SOMO's marketing of KBT given the consequent claims that these traders have on future oil sales.

Finally, gross revenues from the KRG's oil exports will be deposited into a bank account managed by the KRG's prime minister, subject to supervision and audit by the GoI. Once again, no clarity was provided on the nature of this account, specifically whether: (1) it would operate on the lines currently used by the GoI where oil revenues are deposited into an account managed by the Central Bank of Iraq (CBI) on behalf

4 All figures have been rounded.

5 The oil production contracts signed by the MNR with these IOC has been a source of conflict between the KRG and GoI. Tabaqchali et al, "Breaking the Impasse: The Baghdad-Erbil Budget Divide", IRIS, May 2021. https://auis.edu.krd/iris/sites/default/files/20210516-IER2-Final.pdf

6 Deloitte reports for 2017-2022. https://gov.krd/english/information-and-services/open-data

7 Based on oil exports 400,000 bpd, at $70/bbl, and applying the IOCs 37.3% share of oil export revenues in 2022 (Deloitte).

8 Ahmed Tabaqchali, Twitter, October 20, 2022. https://twitter.com/AMTabaqchali/status/1583040834324561920?s=20

9 Deloitte report for 2022. Forward oil sales are loans that will be repaid from future oil sales.

of the federal Ministry of Finance (MoF) or (2) be deposited into a KRG bank account with Citi Bank in the United Arab Emirates.[10]

The first effect implied by these fundamental departures is that the GoI accepts that the oil production contracts the MNR signed with the IOCs are legal and that the KRG-GoI conflict over these contracts is effectively resolved. This would end the uncertainty IOCs face when operating in the KRI, which will have a positive effect on future development of the KRI's hydrocarbon resources, in particular its gas reserves. Developing the KRI gas resources would improve Iraq's electricity production by providing a local source of fuel for power plants.[11] Second, these changes would also lead to higher prices for KBT, which would mean higher oil export revenues[12] and, ultimately, increased federal budget allocations to the KRI. Third, the higher oil export revenues would flow directly into a bank account managed by the KRG's prime minister, and not to MoF. Additionally, SOMO's marketing of KBT will enhance its competitive market position by increasing its total marketed oil by about 12%. Finally, the GoI's acceptance of the contracts signed by the IOCs with the KRG would enable Iraq to equitably fulfil its commitments on oil production agreements within OPEC+.[13]

These positive effects notwithstanding, it is important to clarify the details of these arrangements, whether they are technical, like payment mechanism for IOCs, or more fundamental to the new relationship between the GoI and the KRG, like the control of the bank account where oil export revenues are deposited.

The KRI's Share of the Federal Budget Proposal

The direct flow of KRI oil export revenues into a bank account managed by the KRG would ensure that the region receives its share of the federal budget directly from oil sales, not indirectly via a budget allocation from MoF. The marketing of the KRI's oil by SOMO would result in higher revenues and a greater allocation from the federal budget.

The KRG's proposed share of the federal budget is structured as 12.7% of total federal expenditures after the deduction of sovereign expenses, which amounts to IQD 16.2 trillion (effectively 8.1% total federal expenditures before the deduction of sovereign expenses). This share is increased by 24% through indirect federal allocations of IQD 3.9 trillion, to IQD 20.1 trillion. These are made up of MoO payments of IQD 2.4 trillion to the IOCs operating in the KRI, federal Ministry of Defense (MoD) payments of some salaries of the Peshmerga, and the social welfare allocations to the KRI citizens such as the food basket distributions under the Public Distribution System (PDS). Furthermore, the KRG will keep 50% of the custom tariffs that it collects directly.[14](Table 1).

10 Amina Ismail et al, "Iraq's oil minister expects northern exports to resume within two weeks", Reuters, May 3, 2023. https://www.reuters.com/world/middle-east/baghdad-krg-yet-reach-deal-resume-oil-exports-iraqi-oil-minister-2023-05-03/

11 Ahmed Tabaqchali, "The Kurdistan Region of Iraq's Gas-Export Potential: Deja Vu All Over Again", The Atlantic Council, November 16, 2022. https://www.atlanticcouncil.org/in-depth-research-reports/report/kurdistan-positioned-in-prominent-role-in-global-gas-markets/

12 Every $1/bbl increase in the KBT's oil price for a year is estimated as being equal to IQD 200 billion in increased oil revenues for the year.

13 OPEC+ views Iraq in totality in setting its production quota, i.e., both federal Iraq oil and KRI oil production. But Iraq in the past had no control over the production of oil in the KRI. Thus, the burden on compliance with oil production cuts fell on federal oil fields.

14 The last public figures for the KRI custom tariffs were made in 2013-2014, and as such the figures used here are estimates that are subject to major revisions.

Table 1: KRI's share and contributions to the federal budget[15]

Kurdistan Region of Iraq (KRI) Share & Contribution to Federal Budget Proposal (IQD bn)						
		% of Total			% Total	
KRI Share of Federal Budget		**10.1%**	**20, 143**	**KRI Contribution to Federal Budget**	**11.6%**	**15,651**
Direct			16,210	Oil Export Revenues : 400k bpd @ $70/bbl		13,286
	Budget Allocation	16,210		Non-oil Revenues- 50% KRI Custom Tariffs (est)		1,804
				Non-oil Revenues- Others (est)		561
Indirect			3,933			
	MoO KRI IOC Payments	2,448				
	MoD Peshmerga Salaries	228		**Balance: Contribution less effective share**		**-4,492**
	Social Welfare Allocations	1, 117		**Balance: Contribution less direct share**		**-559**
	Others	140				
KRI Revenues: Budget Allocations (Direct & Indirect) + KRI Direct Revenues						
KRI Total Revenues						**21,947**
KRI Share of Federal Budget (Direct + Indirect)						20, 143
Non-oil Revenues- 50% KRI Custom Tariffs (est)						1,804

In return, the KRG's contributions to the federal budget are: (1) IQD 13.3 trillion in oil export revenues based on exports of 400,000 barrels per day (bpd) at an average price of $70 per barrel (bbl), (2) 50% of custom tariffs, and (3) other non-oil revenues such as taxes and fees, for a total of 11.6% of federal revenues (Table 1). As the KRG's gross oil revenues are less than its share of the budget, the arrangement implies that the MoF will transfer the difference to the KRG.

A major effect of these arrangements will be certainty and continuity for the KRG, allowing it to fulfil its budget obligations – particularly by making full and timely payments for salaries and pensions. The direct federal budget allocation (Table 2) includes significant increases in federal budget allocations for the KRI's public sector salaries and pensions. Specifically, the allocation for salaries is IQD 9.3 trillion or 58% higher than the IQD 5.9 trillion allocated in the 2021 budget and 103% higher than the IQD 4.6 trillion paid in 2019. The allocation for pensions is IQD 1.3 trillion or 42% higher than the IQD 0.9 trillion allocated in the 2021 budget, and IQD 0.9 trillion paid in 2019.[16]

Crucially, the combined federal budget allocations to the KRI public sector salaries and pensions of IQD 10.6 trillion, almost matches the IQD 10.7 trillion payroll bill for 2019 that was disclosed by the KRG in 2020[17], implying a closer alignment between the KRG and GoI on the KRI's public sector wage bill.

In addition to the extra revenue that will result from the changes to the oil export infrastructure discussed earlier, the direct federal budget allocation to the KRI will enable the KRG to fully meet its oil production and export costs without diverting funds from other

15 Data for all tables from the 2023 federal budget proposal. http://iraqieconomists.net/ar/wp-content/uploads/sites/2/2023/04/Budget-bill-2023-complete-with-tables.pdf

16 Comparisons are against 2021 and 2019, as no budgets laws were passed for 2020 and 2022. The allocations were not paid in 2021 due to the ongoing conflict over the KRG's oil exports.

17 KRG responds to the Federal Government of Iraq with legal documents and evidence, April 29, 2020. https://gov.krd/english/news-and-announcements/posts/2020/april/krg-responds-to-the-federal-government-of-iraq-with-legal-documents-and-evidence/

Table 2

KRI Direct Budget Allocations (IQD bn)`		
Direct Share Allocation		**16,210**
KRI Share of Investment Spending		2,781
		2,781
Note: MoO Pays for IQD 2,448 bn of KRI's est. IOCs payments IQD 4,958 bn		
KRI Share of Current Expenditures		**13,429**
Public Sector Salaries		9,300
Public Sector Pensions		1,346
Goods & Services (inc. maintenance)		2,455
Includes oil transportation fees of	1,428	
Grats, subsidies, intrest payments, forein aid, ...etc		328

budget expenditures. Firstly, the investment spending allocation to the KRG more than covers the IQD 2.6 trillion that the KRG needs for its share of payments to IOCs of IQD 5.0 trillion (Table 1 and Table 2). Secondly, the services section in the KRG's budget allocation includes IQD 1.4 trillion for oil export transportation fees. This is treated as a sovereign expenditure, but is payable by the KRG,[18] and more than covers the IQD 1.3 trillion that the KRG paid for oil export transport fees in 2022.

Potential Positive Consequences for the KRI's Economy

The new oil and gas revenue sharing mechanism meaningfully improves the financial position of the KRG, which in turn will have positive consequences for the KRI's economy. This can clearly be seen by making comparisons to the KRG's budget revenues under the previous state of affairs: that is, a situation where the ICC did not make its arbitration ruling and without the oil and gas revenue sharing mechanism agreed by the KRG and GoI.

Two essential differences result if one compares the present situation with that of the previous situation: first, under the prior arrangement, the KRG would not benefit from the IQD 3.9 trillion in indirect budget allocation and, second, that realized prices for KBT would be lower than those for Iraqi oil by about $10/bbl.[19] Assuming KRG oil exports of 400,000 bpd as in the budget proposal, then KBT's realised prices would be $60/bbl (assuming Iraqi oil price of $70/bbl). If the same assumptions are used for the KRI's non-oil revenues (Table 1), this would mean that the KRG would have an estimated gross revenue of IQD 15.5 trillion (Table 3).

Therefore, under the new oil and gas revenue sharing mechanism, federal budget allocations to the KRG of

18 This means an equal treatment with federal oil exports costs, which are IQD 2.7 trillion and are included in the services section of MoO's budget allocation.

19 The FSC's ruling in February 2022 further widened the KBT realised price differential versus Iraqi oil to an average of about $10/bbl for March-December 2022 – which is assumed here. Source: Deloitte report, and SOMO exports for 2022.

Table 3

KRG REVENUES - Hypothentical Scenario	
Oil Exports Revenue IQD bn (est)	**11,331**
Oil Price $/bbl (est)	60
Oil Export bbl mn	146
Non-oil Revenues IQD bn (est)	**4,169**
Non-oil Revenues- Custom Tariffs (est)	3,609
Non-oil Revenues- Others (est)	561
Total Revenues IQD bn (est)	**15,500**

IQD 20.1 trillion would be IQD 4.6 trillion higher than under the previous arrangement, or a 30% increase. This increase would be larger still with the KRG keeping 50% of the custom revenues it collects directly (Table 1 and Table 3).

Policy Implications

The new mechanism has the potential to evolve into Iraq's first real oil and gas revenue sharing agreement. This should be a mutually beneficial, implementable, and constitutionally compliant solution that can serve as a building block for a federal oil and gas law.

The SAC's political agreement stated that draft legislation for a federal oil and gas law would be introduced within six months. This was ambitious both in timescale and, more importantly, in terms of allowing for sufficient consensus and trust among the political parties in parliament to develop. Crucially, the FSC and the ICC rulings effectively resolved many of the fundamental issues that stood in the way of such a law in the past, particularly the divergent interpretations of constitutional articles that relate to the development of hydrocarbon resources. However, related disagreements over the nature of the state's federal structure as enshrined in the constitution remain live areas of debate.[20] The GoI and the KRG are fundamentally at odds over the balance of power between the center and subnational entities, including the Kurdistan Region and the governorates.

Legislating a federal oil and gas law, however, is only a prelude to building and creating institutional structures that allow the law to function as intended. Constitutional scholar Zaid Al-Ali argues that what is needed is a **"clear, equitable and reliable mechanism through which revenues are shared between different federal entities"** and a **"revenue allocation commission that will work in a transparent manner to allocate revenue across the board in an equitable manner."**[21]

However, two key challenges need to be addressed by the parties within the SAC in order to avoid a repeat of the failed attempt to write a federal oil and gas law in 2007.[22] The first challenge is that KRI's

20 Raad Alkadiri, "Federalism and Iraq's constitutional stalemate," Chatham House. November 2020. https://www.chathamhouse.org/sites/default/files/2020-11/2020-11-27-iraq-federalism-alkadiri.pdf.pdf

21 The quotes and the institutional structure needed are taken from Zaid Al Ali, "The Baghdad-Kurdistan deal to resume oil exports is promising but incomplete, The National, April 05, 2023 https://www.thenationalnews.com/opinion/comment/2023/04/05/the-baghdad-kurdistan-deal-to-resume-oil-exports-is-promising-but-incomplete/?utm_source=twitter&utm_medium=socialsharebtn

22 James Glanz, "Compromise on Oil Law in Iraq Seems to be Collapsing," New York Times. September 13, 2007. www.nytimes.com/2007/09/13/world/middleeast/13baghdad.html

share of the budget is only valid during the effective period of the budget once it's passed into law, i.e., whether it's for 2023-2025 as proposed by the GoI or the usual one year of prior budget laws. Which means, that the clauses, and allocations for the KRI share in subsequent federal budgets will be subject to new political negotiations influenced by an ever-changing political landscape, which could upend the foundations of the new oil and gas revenue sharing mechanism.

The second challenge is that the ICC's ruling has effectively ended the KRG's ability to resume independent oil exports through the ITP system[23] at least for a year, if ever. This suggests a major shift of the relative bargaining power of the KRG against the GoI and, more importantly, of the Kurdish parties within the SAC. The contours of this shift will be evident in two ways: first, in how the debate over the draft budget plays out and how it becomes law and, second, in which side ultimately controls the bank account where the KRI's oil export revenues are deposited.

The enormity of these challenges was brought into sharp focus by the radical changes proposed by the parliamentary finance committee in late May as part of its review of the budget legislation. These amendments relate to the control and management of the bank account where the KRG's oil export revenues will be deposited, and revive old disputes about contested oil fields[24] that would meaningfully curtail the KRG's oil production, all of which would effectively degrade the KRG – and by extension the Kurdish parties within the SAC — to a subordinate role. They expose the fragility of the political agreements within the governing coalition, which were arrived at out of necessity and not conviction. Moreover, they perpetuate a perpetuate a history littered with political agreements, that sacrificed sustainability and continuity for short-term political compromises, and that always changed with the shifts in relative bargaining powers among the political elite.

23 The ICC's arbitral tribunal only effects the terms of the ITP agreement while it is valid, i.e., until 2025 or until renewed (see footnote 1).

24 Khurmala field issues (footnote 9): Ahmed Tabaqchali, "Statehood in the Kurdistan Region of Iraq through an Economic Lens", IRIS, March 2018. https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pdf

Economic Policy Dialogue at the 2023 Sulaimani Forum

Karam F. Robeil

Convened by the Institute of Regional and International Studies (IRIS) on March 15-16, the 2023 Sulaimani Forum came at a time of major economic uncertainty in Iraq. The lingering Iraqi dinar crisis and anticipation about the Turkey-Iraq arbitration ruling regarding the Kurdistan Region's independent oil sales hung in the air as different policymakers and analysts vied to influence the conversation.

This policy brief summarizes and reflects on the debates about economic policy that took place during the Forum. In particular, it looks at the panel on "Economic Policy: The Dinar and the Challenge of Growth," which featured Minister of Planning of Iraq Mohammed Tamim, Deputy Prime Minister of the Kurdistan Regional Government (KRG) Qubad Talabani, Governor of the Central Bank of Iraq (CBI) Ali Al-Allaq, Chargé d' Affaires of the US Embassy Baghdad David Burger, and CEO of KESK Company Basima Abdulrahman. This brief also takes stock of a separate economic policy roundtable led by IRIS researchers Ahmed Tabaqchali and Ranya Bakr. Overall, the debates during the Forum left many core policy questions unanswered, meaning that much work remains to be done.

Takeaway 1: Intra-Kurdish differences on oil sales and the relationship with Baghdad remain profound

"We've got applause for that controversial opinion," said Raya Jalabi of the Financial Times, moderator of the "Economic Policy" panel, in response to a statement by Talabani about the KRG's oil dilemma. The KRG deputy prime minister had just controversially said: **"I don't care who sells our oil. Whoever sells it for the best price should sell our oil."** His remark reflected the growing divide between his party, the Patriotic Union of Kurdistan(PUK), and the Kurdistan Democratic Party (KDP) on energy policy.

Historically, both Kurdish parties have strongly backed the right of the KRG to sell its oil via Turkey without Baghdad's consent or oversight. In recent years, however, the two parties' views have diverged due to the PUK's increasing frustration about its inability to influence oil policy in the face of the KDP's control of the KRG Ministry of Natural Resources. Regardless, it was provocative that any major Kurdish official would publicly state that the Iraqi government should control the sale of the Kurdistan Region's oil. It represents a profound shift with direct consequences for any future notion of sovereignty and independence. The statement "I don't care who sells our oil" suggested that Talabani was unequivocally coming down in favor of control by Baghdad.

For many observers in both Erbil and Sulaimani, Talabani's statement was alarming, but not unexpected. Speculation had been growing in the weeks ahead of the Forum that the International Chamber of Commerce (ICC) would hand down a ruling in the arbitration case about the Kurdistan Region's independent oil exports that would favor Iraq. Indeed, this is exactly what happened on March 23, just days after the Forum. The ICC ruling represented a final blow to the KRG's authority to sell oil independently, by favoring Iraq's claim that Turkey had transported oil exports from the KRG without Baghdad's authorization. As a result, Turkey was immediately obliged to halt oil flows from the Kurdistan Region through the pipeline to the port of Ceyhan. For oil exports to begin again, Baghdad and Ankara will need to reach a new agreement.[1]

Reflecting the depth of the PUK-KDP rift, negotiations between Baghdad and KRG officials about how to resume oil exports almost exclusively involved members of the KDP, with Talabani and other PUK officials excluded from the talks. At the time, Talabani was actively boycotting meetings of the KRG cabinet, though he returned in early May. [2]

Baghdad and Erbil eventually struck a deal that would allow the KRG to sell its oil through the federal State Organization for Marketing of Oil (SOMO),[3] but exports have not resumed. Turkey says that it needs to address undefined "technical issues" before turning the taps back on. When this happens, however, exports will be under the authority of Iraq's federal government, not the KRG. How the KDP and the PUK react to this change will affect other aspects of their relationship and have consequences for the economy of the Kurdistan Region.

1 Edwards، Rowena, Sezer, Can , and Rasheed, Ahmed. "Iraq's northern oil exports stuck on Turkey negotiations." Reuters, April 14, 2023. https://www.reuters.com/article/iraq-oil-kurdistan-turkey-idAFL1N36H0ZY.

2 Al Jazeera. " PUK returns to Kurdish Regional Government meetings after boycott." May 14, 2023. https://www.aljazeera.com/news/2023/5/14/puk-returns-to-kurdish-regional-government-meetings-after-boycott.

3 Chalak, Chenar. "Kurdistan Region oil exports to resume by mid-May, says MP." Rudaw, May 2, 2023. https://www.rudaw.net/english/kurdistan/020520231.

Takeaway 2: The Central Bank hints at a departure from the past, but offers few details on policy

"It's a very dangerous phenomenon," said Ali Al-Allaq, the recently appointed head of the Central Bank of Iraq (CBI), about the government's dependence on borrowing from CBI reserves. During the panel, Al-Allaq explained that Iraq's deficit had increased from 14% in 2017 to well over 25% in 2023. He argued that the gap between revenues and expenditures led the previous government to pursue short-term solutions like devaluing the Iraqi dinar and borrowing internally to cover the deficit and pay public sector salaries and pensions.[4]

While Al-Allaq expressed his dissatisfaction with the policy of currency devaluation and internal borrowing, he did not explicitly reject pursuing those policies in the future to deal with the 64.5 trillion Iraqi dinar deficit outlined in the 2023 budget bill. Nor did he explain how Iraq will settle the current debt that the government owes the CBI.[5]

Al-Allaq's comments at the Forum also provided few concrete details about the steps the CBI may take to stabilize the Iraqi dinar. Instead, he dedicated most of his remarks at the Forum to criticizing CBI policies under his predecessor, Mustafa Mukhif, in particular that inflation had risen by 7% and that the spread between the official and market exchange rate for the Iraqi dinar had gone up from 2% to more than 20%. Al-Allaq can only blame his predecessor for so long and, moreover, his criticisms ring hollow because he was the governor of the CBI himself between September 2014 and September 2020. Therefore, he certainly shares a degree of responsibility for the current state of affairs.

4 Aljazeera. "لمواجهة أزمة الرواتب.. برلمان العراق يمرر قانون الاقتراض" [To face the payroll crisis.. Iraq's Parliament Passes Borrowing Bill]. November 12, 2020. https://www.aljazeera.net/ebusiness/2020/11/12/لمواجهة-أزمة-الرواتب-برلمان-العراق

5 "روداو تنشر مسودة قانون الموازنة الاتحادية لثلاث سنوات" [Rudaw Publishes the Draft of the 3-years Federal National Budget]. March 18, 2023. https://www.rudawarabia.net/arabic/middleeast/iraq/180320237

Takeaway 3: Iraqi businesses are facing immense uncertainty and are looking for the new administration to offer a sense of predictability

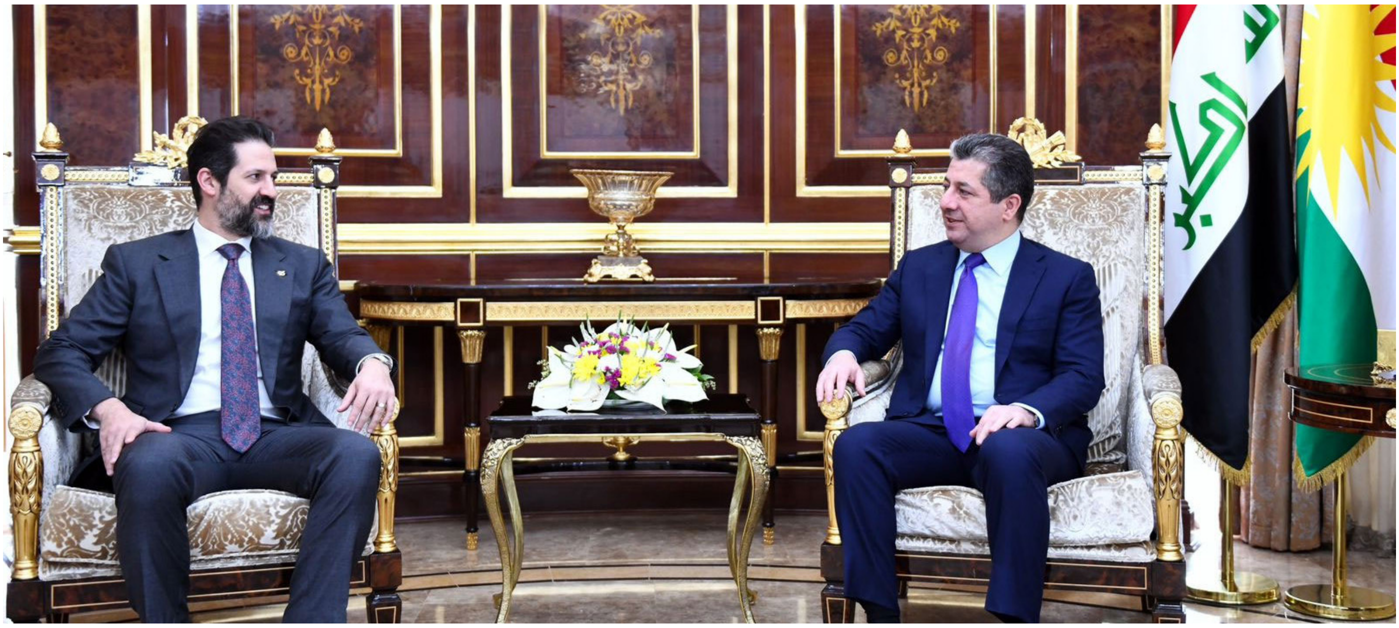
Ordinary citizens and Iraqi-run businesses need and want a degree of predictability in the economy and the currency exchange rate. Following Al-Allaq's remarks, Basima Abdulrahman, CEO of Iraqi green energy company KESK, argued that "the ongoing fluctuation and the stability of the Iraqi dinar affects the value of the US dollar they are putting into investing into our companies, and it's definitely going to affect future investments on the long term." Her comments reverberated throughout the discussions that followed, including the roundtable that was held on the sidelines of the Forum.

That gathering, which explored the theme of **"Iraq Economic Review: What to Expect in 2023 and Beyond,"** included IRIS researchers Ahmed Tabaqchali and Ranya Bakr and other experts. They debated practical pathways forward to promote healthy growth for Iraqi businesses. Tabaqchali and Bakr stressed that the lack of predictability for businesses and investors hinders investment opportunities and is largely the result of continuously changing economic policies.

Over the past three years, the Iraq Economic Review team, which is led by Tabaqchali, has frequently advised and briefed government officials in the CBI, the Ministry of Finance, and the prime minister's office. They have used the findings of the Review to advocate for sound and sustainable economic policy. However, there is still much work to do. During the roundtable, Tabaqchali and Bakr called on the new Iraqi government to work directly with stakeholders in key sectors to ensure that economic policy takes their perspectives into account.

An Oil Deal for the Elites: What the Kurdish Public Demands

Mera Bakr



Turkey halted oil exports by the Kurdistan Regional Government (KRG) through its Ceyhan port on March 25, 2023 after a ruling by the Paris-based International Chamber of Commerce (ICC).[1] The court favored Iraq's case against Turkey, ruling that the latter had violated the 1973 Iraq-Turkey Pipeline treaty by transporting the Kurdistan Region of Iraq's (KRI) oil without Baghdad's approval. Overnight, the decade-long independent oil policy of the KRI came to a halt, creating an immediate economic and political crisis. Within ten days of the ruling, the KRG sent four delegations to Baghdad. The last one was led personally by KRG Prime Minister Masrour Barzani on April 4 and resulted in a temporary deal between Baghdad and Erbil to resume northern crude oil exports under a new arrangement.[2]

This brief examines the short- and long-term implications of the ICC ruling, with a focus on the stability of the KRI. The main argument is that the ICC ruling may generate a measure of short-term stability within elite-level politics between the major party leaders in Baghdad and Erbil. However, the prospect of a durable rapprochement may be upended by two factors (1) the deterioration of relations between the two largest Kurdish parties and (2) the deterioration of state-society relations within the KRI itself.

Despite initial optimism, the ICC ruling and the deal that followed are unlikely to deliver a significant or durable shift in the economic fortunes of ordinary citizens in the KRI. This may furnish a basis for grassroots unrest in the future.

1 Ahmed Rasheed and Rowena Edwards, "Iraq halts northern crude exports after winning arbitration case against Turkey," Reuters, March 25, 2023, https://www.reuters.com/business/energy/iraq-halts-northern-crude-exports-after-winning-arbitration-case-against-turkey-2023-03-25/

2 Ben Van Heuvelen and Mohammed Hussein, "Baghdad, Erbil sign temporary deal to resume northern exports," Iraqi Oil Report, April 4, 2023, https://www.iraqoilreport.com/news/baghdad-erbil-sign-temporary-deal-to-resume-northern-exports-45634/

Signs of improved Erbil-Baghdad relations, but problems are on the horizon

Since late March, the ICC ruling has forced KRI leaders in Erbil to adjust to a new reality. It ended nearly ten years of reliance on Turkey for oil exports, which had allowed the KRG to pursue a policy of increasing its financial and political separation from Baghdad.[3] Erbil's reliance on Turkey for exports deepened mistrust between the federal government and the KRG and eroded incentives for cooperation with Baghdad. Although the ruling ended independent exports from the KRI, Erbil has not lost all leverage.[4] The current governing coalition in Baghdad, which operates under the leadership of a multi-party alliance known as the Coordination Framework (CF), is inclined to appease Erbil by allowing the KRG to retain significant power over its energy sector and near total control over the way revenues are dispersed.[5]

What likely explains the CF-led government's policy of appeasement is the bloc's need to manage parliamentary dynamics and keep the Kurdistan Democratic Party (KDP) in their corner. In other words, the CF's primary aim is to disincentivize Kurdish parties, in particular the KDP, from forming electoral alliances with other key political actors, as nearly happened with the abortive "tripartite alliance" of Muqtada al-Sadr, Mohammed al-Halbousi, and Masoud Barzani after the 2021 federal elections.[6] This means ensuring that the KDP perceives the post-ICC reality as one in which they retain a measure of control over the oil sector.

Young Kurds protesting in Sulaymaniyah in December 2020. Photo Credit: Rebaz Majid.

While political dynamics between the CF and the KDP have opened the door for improved Erbil-Baghdad relations, a major potential spoiler is the highly volatile situation between the two major parties in the KRI, the KDP and the Patriotic Union of Kurdistan (PUK).[7]

3 Ben Van Heuvelen, "Turkey, Kurdistan cement massive energy deal," Iraqi Oil Report, November 29, 2013, https://www.iraqoilreport.com/news/turkey-kurdistan-cement-massive-energy-deal-11574/

4 "Why a Northern Iraq Oil Dispute Doesn't Stay in Iraq," Italian Institute for International Political Studies, April 13, 2023, https://www.ispionline.it/en/publication/why-a-northern-iraq-oil-dispute-doesnt-stay-in-iraq-125732

5 See Tabaqchali and Al-Maleki articles in this Review for more details.

6 Farhad Alaadin, "Iraq's tripartite alliance is pressing, Framework is threatening," Rudaw, January 21, 2022, https://www.rudaw.net/english/opinion/230120221

7 "Power sharing rows, assassination case threaten Iraqi Kurdistan's unity," The Arab Weekly, November 14, 2022, https://thearabweekly.com/power-sharing-rows-assassination-case-threaten-iraqi-kurdistans-unity

In previous negotiations between Baghdad and Erbil over oil production and revenues, the PUK had little choice but to negotiate directly with the KDP in order to ensure favorable terms for its zone of control in Sulaymaniyah governorate. In the aftermath of the ICC ruling, there is now considerable debate over the extent to which the PUK can appeal to Baghdad directly to settle disagreements over revenue distribution.[8]

For instance, on May 25, an amendment was added to the draft budget law by the Iraqi parliament's finance committee that allows the federal government to allocate funds to Sulaymaniyah if the provincial authorities claim that they were not given fair revenue allocations by the KRG.[9] Following the amendment, the KRG said in a statement that it was "resolute in adhering only to the agreement previously reached with Prime Minister Mohammed Shia' Al-Sudani's government and will not accommodate any other alternative arrangement."[10]

The bottom line is that politics in the KRI are moving into a new era where intra-Kurdish struggle is increasingly externalized, with the KDP insisting on direct federal and regional cooperation and the PUK looking for direct allocation of funds to Sulaymaniyah from Baghdad.

Will the Kurdish public support or oppose the new deal?

The streets in the KRI's major cities were decidedly quiet following the announcement of the ICC ruling and the subsequent deal between Erbil and Baghdad with no notable expressions of dissent or protest. The apparent lack of public engagement with a series of events that fundamentally reshapes the economic arrangement in the KRI is due to the widespread public perception that current economic arrangements have been a disastrous failure. The majority of the Kurdish public was cautiously optimistic that the ICC ruling might force a shift in a different direction. However, the negotiations since the ruling in late March have indicated that the Kurdish public's aspirations for fundamental changes may not occur as they hoped.

Understanding the Kurdish public's seemingly counterintuitive attitude requires some historical context. Between 2006 and 2013, the KRI did not have a formally enshrined independent oil policy and, instead, relied largely on funds from Baghdad. Under that arrangement, the KRG received approximately 17% of the federal budget, in addition to revenues from border crossings, commerce, and smuggling routes.[11]

During this period, the KRI's economy boomed and the public payrolls increased from 450,000 public servants in 2000 to 1,400,000 in 2013.[12] Despite the existence of dissent among some sections of the population, which was expressed through the rise of opposition movements, a large enough portion of the

8 On April 27, 2023, PUK sent a senior delegation to Baghdad, where they met with key CF leaders, including Nouri Al-Maliki, to secure direct Baghdad allocation of funds to Sulaymaniyah. Look at; "An Old Attempt in a New Framework," DrawMedia, April 29, 2023, https://drawmedia.net/page_detail?smart-id=12726

9 "Will changes to Iraq's federal budget shift Baghdad-Erbil relations?," Amwaj Media, May 31, 2023, https://amwaj.media/media-monitor/will-changes-to-iraq-s-federal-budget-shift-baghdad-erbil-relations

10 See the statement here; https://gov.krd/dmi-en/activities/news-and-press-releases/2023/may/statement-from-the-kurdistan-regional-government/

11 Zmkan Ali Saleem and Mac Skelton, "Assessing Iraqi Kurdistan's Stability: How Patronage Shapes Conflict," Institute of Regional and International Studies (IRIS), July 2020, https://www.auis.edu.krd/iris/frontpage-slider-publications/assessing-iraqi-kurdistans-stability-how-patronage-shapes-conflict

12 Mera Bakr, "Escaping from Duopoly Rule: How a Two-party System Drives Iraqi Kurdish Migration En Masse?" Konrad Adenauer Stiftung, May 2022, https://www.kas.de/en/web/irak/single-title/-/content/escaping-from-duopoly-rule

public economically benefited and were generally well-off as a result of these arrangements. In short, there was enough money in the system to sustain a sufficiently broad and inclusive patronage system. Indeed, the KRI experienced reverse migration, with Kurds living abroad returning in the hopes of gaining a stake in the new wealth.

Riding high on economic optimism, Kurdish leaders attempted to sell a new independent oil export policy as the logical next step. The Kurdish public was repeatedly promised greater wealth and prosperity by their leaders. During the September 2013 elections, former KRG Prime Minister and current Kurdistan Region President Nechirvan Barzani claimed that: "Our policy is to propose legislation to the Kurdistan Region Parliament to directly benefit people from oil revenue. The way this is going to happen is through the formation of a company that will be called KAPKO. Citizens will have shares from the company and its benefits will reach every citizen in the Kurdistan Region."[13]

However, what materialized was the opposite of these promises. In the nine years since the KRG launched its independent oil policy, the Kurdish public has endured a chronic economic crisis where public employees were subjected to severe austerity measures. Many have lost track of when they will receive their next monthly salary.[14] In retaliation for the independent oil policy, Iraq's federal government cut off payments of the KRG's share of the federal budget, leading to the abrupt collapse of the welfare economics that had underpinned public support for the KRI's political system.

Salary payments were delayed or stopped altogether, contracts were hard to come by, and economic activity declined to a trickle. With the KDP and the PUK limited to local oil sales, the patronage system became increasingly exclusive and limited to the elite, party-affiliated companies, and the security forces.[15]

Salaries of teachers and other ordinary public servants were rarely paid, while security personnel saw regular payments throughout the multi-year crisis. Of the 769,705 youth who entered the labor force between 2014 and 2021, many found themselves without any job prospects.[16] Consequently, voter apathy increased and the PUK and the KDP lost a substantial number of raw votes. The number of votes cast for the KDP declined by 26.5% and the PUK lost 56.9% between 2014 and 2021, despite hundreds of thousands of new voters coming of age during that period.[17]

Given this background, it was not surprising that the Kurdish public looked at the ICC ruling with a measure of optimism. Perhaps, they reasoned, it would force the KDP and the PUK to change their ways, as oil funds would be subject to external oversight and accountability. But it would appear that the CF's need to appease powerful actors in Erbil was stronger than anticipated. The status quo of de facto KDP control over the oil sector now seems much more likely, which is a negative development for ordinary citizens in Erbil and Sulaymaniyah alike. While it is conceivable that the KDP may ultimately make concessions to the PUK to appease them, even intra-Kurdish rapprochement at the level of political elites will not solve the problems facing Kurdish citizens: They want an inclusive government that serves the people. With the new deal

13 See Barzani's promise here: https://www.facebook.com/watch/?v=182333003303671

14 Dana Taib Menmy, "Iraqi Kurdistan doctors, teachers, and garbage collectors go on strike over unpaid salaries," The New Arab, March 7, 2022, https://www.newarab.com/news/iraqi-kurdistan-public-workers-strike-over-unpaid-salaries

15 Bakr (2022).

16 "Patriotic Union of Kurdistan in front of Voters," DrawMedia, 18 October, 2021 https://drawmedia.net/page_detail?smart-id=9033, "Kurdistan Democratic Party in front of Voters," Drawmedia, 18 October, 2021, https://drawmedia.net/page_detail?smart-id=9032

17 Mera Bakr's report on Iraqi Kurds migration.

preserving the domination of the Kurdish parties, state and society relations in the KRI will keep deteriorating, turning the region into a fertile ground for grassroot unrest in the future.

Conclusion

While the ICC ruling in March and the temporary oil deal in April have resulted in signs of rapprochement between Baghdad and Erbil, significant uncertainty remains about how durable the new relationship might be. The difficulties faced by the KDP and the PUK at home and inability to present a united front in Baghdad could easily hinder progress to improve relations between the federal government and the KRG. The PUK's support for the amendments by the finance committee to the draft budget law are a good example of this dynamic.[18]

However, the externalization of the KDP-PUK feud is not the only long-term threat to the KRI's stability. Increasing political dissatisfaction and economic distress for the Kurdish public poses a major challenge as well. When they come to terms with the fact that they may not see changes to the way the economy is managed in the KRI and that the KRI's political status, under the KDP and PUK reign, fails to offer meaningful future prospects, it is very possible that disillusionment, voter apathy, violent demonstrations, and mass exodus will occur. This will put the already fragile stability of the KRI in jeopardy.

18 Dana Taib Menmy, Iraq: Parliament finance committee suspended amid budget bill row," The New Arab, May 29, 2023, https://www.newarab.com/news/political-disagreements-freeze-iraqs-budget-bill, Also see; Julian Bechocha, "Iraqi fronts to meet to discuss disputed budget amendments: Official," Rudaw, May 29, 2023, https://www.rudaw.net/english/middleeast/iraq/290520231,

Implications of the ICC Ruling for Iraq and the Kurdistan Region's Oil Sector

Yesar Al-Maleki

On March 23, the International Chamber of Commerce (ICC) concluded a nine-year arbitration case between Iraq and Turkey regarding independent oil exports from the Kurdistan Region through the Iraq-Turkey Pipeline (ITP).[1] The tribunal's decision favored Baghdad and effectively ended the Kurdistan Regional Government's (KRG) aspirations of creating a self-sufficient economy that is not reliant on Baghdad. Practically speaking, Erbil has been stripped of its ability to establish facts on the ground by marketing its oil independently. That said, the federal government has proceeded cautiously and has not overplayed its hand.

Prime Minister Mohammed Al-Sudani has shown willingness to compromise following the ICC's ruling, driven by a desire to secure parliamentary support from the Kurdistan Democratic Party (KDP). The KDP is part of the fragile State Administration Coalition (SAC) alliance that formed the current government in October 2022. Al-Sudani's practical approach has helped accelerate political rapprochement between Baghdad and Erbil and mitigated the immediate political and economic impacts of the ICC ruling on the Kurdistan Region. First, there was a budget agreement between Baghdad and Erbil in mid-March.[2] Then, after a flurry of talks, the two governments reached a temporary agreement in early April to resume oil exports.[3] These political arrangements are pragmatic, but the hard work of addressing contentious issues such as sector governance, existing contracts, and revenue sharing will come when a federal oil and gas law is drafted.

While the Baghdad-Erbil deals following the ICC ruling are promising, they are political in nature and subject to changing political dynamics at the domestic and regional levels. Domestically, growing divisions between the major Kurdish parties – the KDP and the Patriotic Union of Kurdistan (PUK) – inject immense uncertainty into any negotiations with Baghdad. Moreover, there is also the potential for opposition from hardliners within Al-Sudani's own Shia Coordination Framework (SCF) bloc who disapprove of his conciliatory approach towards the Kurdistan Region. Regionally, Turkey's policies towards both Baghdad and Erbil present a wild card, as seen in Ankara's ongoing refusal to resume northern exports despite Baghdad's request. Failure to address these challenges at the political level could impede rapprochement and exacerbate the Kurdistan Region's economic troubles going forward.

Recognizing that much remains uncertain, this policy brief provides an overview of the key political and economic implications of the ICC ruling for Baghdad, Erbil, and Ankara, mainly arguing that the KRG and the federal government should prioritize enacting a federal oil and gas law to resolve their oil sector disagreements.

1 Yesar Al-Maleki, "Baghdad & Erbil Locked In Standoff As Oil Exports To Ceyhan Come To Complete Halt", Middle East Economic Survey (MEES), March 31, 2023.

2 Yesar Al-Maleki, "KRG-Baghdad Rapprochement To Be Tested By Budget Agreement", MEES, March 24, 2023. https://www.mees.com/2023/3/24/geopolitical-risk/krg-baghdad-rapprochement-to-be-tested-by-budget-agreement/

3 Yesar Al-Maleki, "Baghdad & KRG Sign Landmark 'Temporary Deal' To Resume Exports", MEES, April 7, 2023. https://www.mees.com/2023/4/7/geopolitical-risk/baghdad-krg-sign-landmark-temporary-deal-to-resume-exports/

KRG holds the line, but troubles lie ahead

Erbil was able to extract favorable terms under the early April interim deal signed with Baghdad. Despite conceding responsibility for oil marketing at Ceyhan to federal marketer SOMO, it secured full revenues from oil sales and retained full agency over the sector. Revenues are to be deposited at a bank of KRG's choosing, allowing it to maintain spending autonomy while giving account monitoring capacity to Baghdad. Whether these arrangements remain as agreed remains to be seen.

Historically, the Kurdistan Region's oil was sold at a discount due to the political and legal risks borne by buyers, undervaluing it and depriving Erbil of additional revenue. Over the past two years, additional quarterly revenues were missed due to price discounts ranging between $220 million and $750 million (see Chart 1). After the Iraqi Federal Supreme Court's (FSC) ruling nullified the Kurdistan Region's Oil and Gas Law, which was followed by intensified legal threats to buyers from SOMO, the discount to Kirkuk[4] widened to $10 per barrel.[5]

Aside from discounts, Erbil's net oil revenues often were significantly reduced by payments to IOCs, hefty pipeline fees, and servicing of onerous pre-payment debts owed to oil traders. Net oil revenues mostly stood at half of gross oil revenues. Even with higher oil prices thanks to Russia's invasion of Ukraine pushing gross revenues to a quarterly record of $3.79 billion in 2Q22, Erbil only kept $1.57 billion (see Chart 1). For 2022, out of $12.42 billion in gross oil revenues, net oil revenues stood at 46% or $5.7 billion.

The SOMO takeover arguably benefits both sides. Erbil will accrue higher revenues by selling oil without discounts, while Baghdad can gain market share in the Mediterranean basin where crude oils similar to Russian Urals[6] are in demand after the EU's embargo on Russian oil entered into force on December 5, 2022.

Importantly for Erbil, the deal includes favorable provisions for the KRG to maintain its existing relationships with IOCs. Production Sharing Contracts (PSCs), which are criticized by Baghdad for allocating a large share of profits to IOCs, will not be impacted. Moreover, around $1.9 billion of IOC expenses will be included in the federal budget.[7]

Since the Kurdistan Region's independent pipeline sales began in 2014,[8] budgetary payments from the federal government have been intermittently suspended, leading Erbil to enter unfavorable pre-payment sales agreements to finance its fiscal needs. Under the new deal, Baghdad will assist in restructuring approximately $3.35 billion in debt owed to trading firms, with proposals focused on deducting the amount from Erbil's future budgetary shares. This figure is based on official audits of the KRG Ministry of Natural Resources' (MNR) finances by Deloitte, but some alternative estimates amount to as much as $6 billion.[9] Erbil also owes large sums to IOCs due to

4 The KRG's exported oil cargos, usually designated as Kurdistan Blend Test (KBT), are chemically identical to SOMO's Kirkuk crude. Both have a crude oil assay with a specific gravity of 34°API and 2.2% sulfur-content.

5 Jamie Ingram, "Pipeline Closure Brings KRG Oil Sector To Standstill", MEES, March 31, 2023. https://www.mees.com/2023/3/31/oil-gas/pipeline-closure-brings-krg-oil-sector-to-standstill/

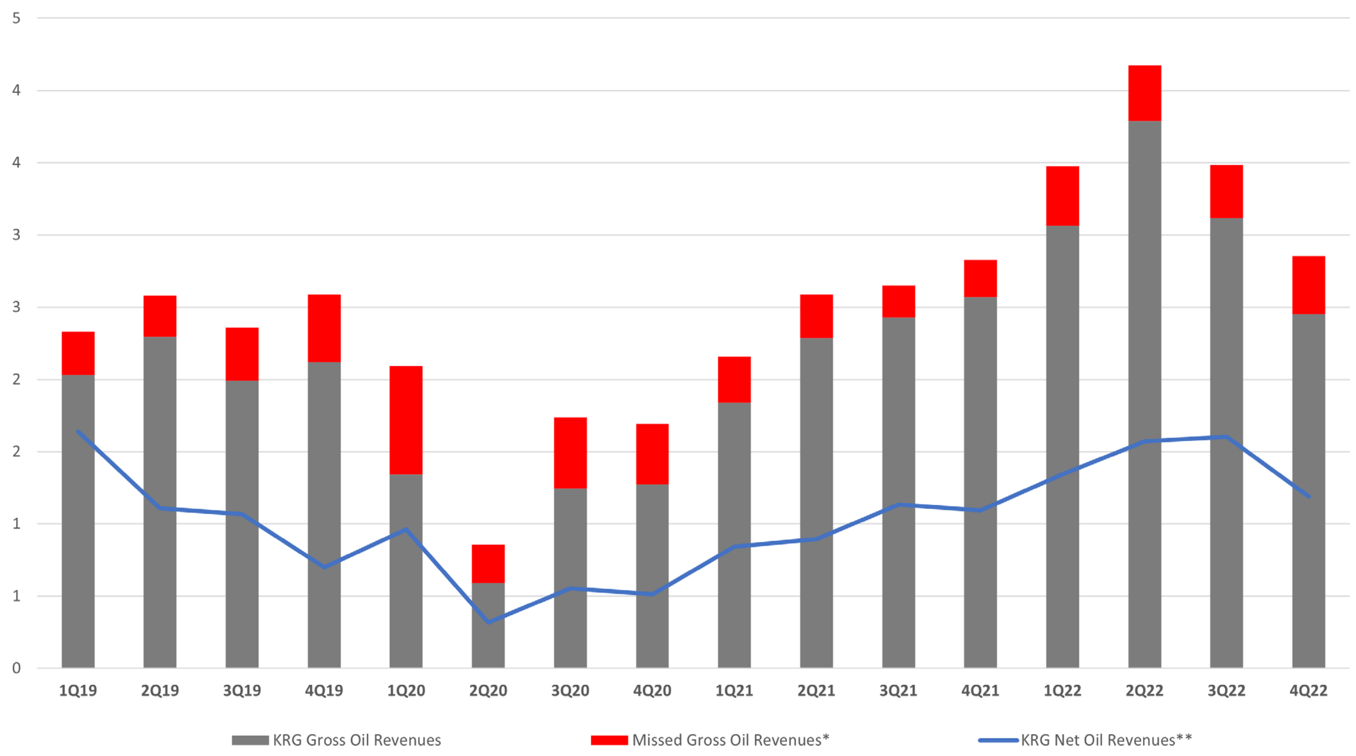
6 Russian Urals has a specific gravity of 31°API and 1.5% sulfur-content, closely matching those of Kirkuk.

7 Ahmed Tabaqchali, "Debt and the Ides of March: An Overview of Iraq's 2023 Federal Budget Proposal", LSE Middle East Center Blog, May 8, 2023. https://blogs.lse.ac.uk/mec/2023/05/08/debt-and-taxes-of-what-can-we-be-certain-in-iraqs-2023-federal-budget/

8 "KRG At Point Of No Return As Baghdad Sues Over Oil Sale", May 30, 2014, MEES. https://www.mees.com/2014/5/30/oil-gas/krg-at-point-of-no-return-as-baghdad-sues-over-oil-sale/

9 "Iraqi Kurdish oil stoppage halts $6 billion debt repayment to traders – sources", March 30, 2023, Reuters. https://www.reuters.com/business/energy/iraqi-kurdish-oil-stoppage-halts-6-billion-debt-repayment-traders-sources-2023-03-30/

1. KRG GROSS, NET & MISSED OIL REVENUES ($ BILLION):



*Missed additional revenues due to the discount suffered by KRG crude oil compared to the chemically-identical Kirkuk grade marketed by Somo. ** After payment of IOC expenses, profit share, pipeline transport fees, pre-payment debts and other expenses.
Source: MNR, Deloitte, Somo, MEES, Yesar Al-Maleki

delayed payments in the past. These firms have quietly welcomed SOMO's involvement in hopes that higher revenues may lead to payment. [10]

Incentives for Baghdad to support the Kurdistan Region's oil exports

While Baghdad could have pushed for far more concessions following the FSC and ICC rulings, the federal government appears to have chosen a more conciliatory and gradual approach, despite opposition by hardliner SCF elements.

Fundamental changes to the existing realities on the ground would have been very challenging for Baghdad. IOCs contracted by the KRG have invested billions of dollars and are not readily replaceable. Absorbing their contracts will also entail assuming Erbil's legal obligations and financial liabilities, which Baghdad is reluctant to do. Hence, maintaining an active role for the MNR serves Baghdad's interests. SOMO's careful approach in signing new marketing contracts with traders of the Kurdistan Region's oil under power of attorney[11] also partly reflects legal caution.

Ceyhan is the Kurdistan Region's sole marketing conduit, and the ongoing export stoppage has created a significant revenue gap for the KRG, with oil revenues making up 70% of its monthly income. Before the interruption in late March, the Middle East Economic Survey (MEES) estimated gross revenues for 1Q23

10 "DNO scraps output guidance amid Kurdistan export uncertainty", May 11, 2023, Reuters. https://www.reuters.com/business/energy/dno-scraps-output-guidance-amid-kurdistan-export-uncertainty-2023-05-11/

11 "Baghdad, KRG take step towards resuming Iraq northern oil exports", April 17, 2023, Reuters. https://www.reuters.com/business/energy/baghdad-krg-take-step-towards-resuming-iraq-northern-oil-exports-2023-04-17/

were $2.29 billion, implying net revenues of around $1.15 billion. At the time of writing, the pipeline has been shut for more than two months, costing Erbil at least $1.5 billion in gross revenues. In comparison, the financial impact on SOMO is relatively minor, losing just over $400 million.

Some 98% of the federal government's oil is exported via Basra's Gulf terminals and Baghdad has utilized the stoppage by maxing southern exports. By the end of April, SOMO had added 98,000 barrels per day (bpd) of exports from the southern port. This raised output to 3.29 million bpd, representing the highest since October 2022. As a result, SOMO's revenues rose to $7.69 billion. This was the highest then since December, despite losing 75,000 bpd to 90,000 bpd of exports from Kirkuk.

Al-Sudani and his allies in the SAC have little interest in seeing the Kurdistan Region's economic situation deteriorate and, thereby, losing the support of the KDP. Despite historic tensions, political stability and financial self-sufficiency in the Kurdistan Region are in the best interest of the SAC and the federal government. Resuming the Kurdistan Region's oil exports is necessary for maintaining the political reconciliation process with Erbil and to relieve Baghdad of the task of supporting some of the KRG's expenses.

The federal government authorized monthly loans from state-owned banks starting in March[12] to support the KRG's payroll expenses, totaling nearly $1 billion. These sums will be reconciled later once the budget is passed. Erbil's monthly expenses are dominated by salaries, running to 80% of expenditures or approximately $640 million per month.[13] These loans are designed to withstand legal scrutiny by the FSC, which ruled in January[14] against direct payments to the KRG.

Domestic political challenges on the horizon

Erbil's intention is to incorporate the concessions obtained from Baghdad in the April interim deal into a federal oil and gas law, ensuring direct access to oil revenues, maintaining relationships with IOCs, and retaining jurisdiction over the oil fields it currently oversees. This would require driving a hard bargain against the federal Ministry of Oil, which would prefer to consolidate its position against the KRG and preserve its authority over the sector outside the Kurdistan Region. Therefore, Al-Sudani's current conciliatory approach may not last nor be reflected in future law.

Arguably, the most significant obstacle to reaching a final agreement relates to the issue of the disputed territories, particularly in Kirkuk. Article 140 of the 2005 Constitution calls for a referendum to determine whether Kirkuk remains under the federal government or joins the Kurdistan Region. The Khurmala dome, which is part of the Kirkuk oil field, is the KRG's largest producing field, accounting for over one-third of its total oil production (see Chart 2).

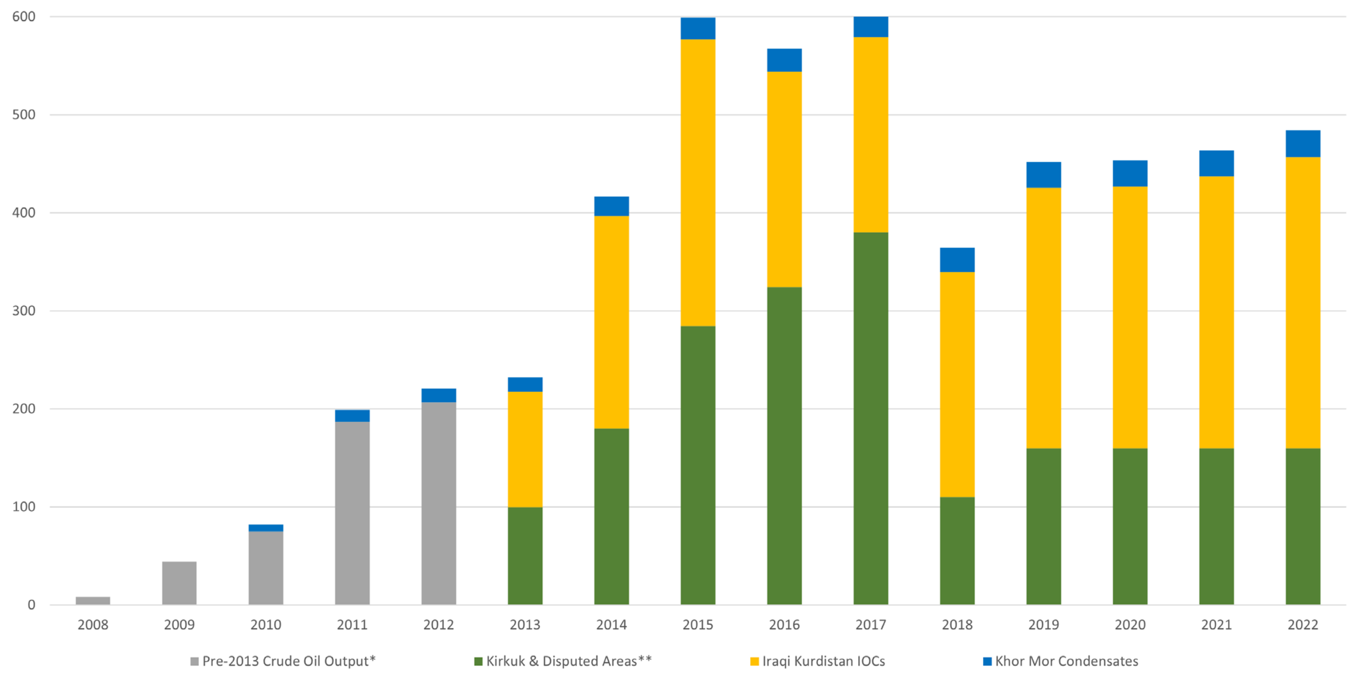
Intra-Kurdish tensions pose an additional obstacle and represent a significant source of uncertainty. The KRG's oil policy, like most of other KRG affairs, has largely been shaped by the KDP. Its historic rival, the PUK, resents this and sees a built-in disparity in resource sharing, budgets, and civil servant payroll allocations for its territory.

12 "Budget loans give KRG financial lifeline", May 25, 2023, Iraq Oil Report. https://www.iraqoilreport.com/news/budget-loans-give-krg-financial-lifeline-45746/

13 Yesar Al-Maleki, "KRG Revenues Up But Dire Finances & Political Disputes With Baghdad Linger", MEES, July 29, 2022. https://www.mees.com/2022/7/29/economics-finance/krg-revenues-up-but-dire-finances-political-disputes-with-baghdad-linger/

14 "المحكمة الاتحادية بالعراق تمنع تمويل إقليم كردستان.. ضرب لمصالح أميركا أم عرقلة لحكومة السوداني؟", January 27, 2023, Al-Jazeera. https://www.aljazeera.net/politics/2023/1/27/المحكمة-الاتحادية-بالعراق-تمنع-تمويل

2. KRG OIL PRODUCTION FROM 2008-2022 (THOUSAND BPD):



Iraqi Kurdistan IOC output sums by field production based on company reports and MEES estimates. *2008-2012 KRG crude output based on Iraq's overall produciton. **Includes the KAR Group operated Khurmala dome part of Kirkuk field and Avana/Bai Hassan until being reclaimed by the central government in 2017.
Source: MNR, Deloitte, Iraq's Oil Ministry, Company Reports, MEES, Yesar Al-Maleki

The PUK's limited participation in recent talks with Baghdad and a six-month boycott of KRG cabinet meetings, along with disagreements over parliamentary elections, highlight the disunity within the Kurdish political front. The participation of PUK MPs in controversial budget amendments by the Iraqi Parliament's Finance Committee on May 26[15] indicate a challenge to the KDP's control over the sector. The amendments aim to impede the mid-March budget deal and even include calls for the KRG to cease production from Khurmala.

Turkey'slong-overdue reassessment of its Iraq policy

Turkey's continued suspension of exports is aimed at pressuring Iraq into withdrawing from a second arbitration case and negotiating a settlement. Ankara has yet to welcome the early April interim deal between Baghdad and Erbil and its pipeline operator, Botas, continues to cite technical reasons for not resuming exports.

Turkey's past involvement in the Kurdistan Region's independent oil sector and the benefits accrued from that involvement have complicated its relationship with Baghdad. Despite public expressions of economic cooperation, Iraqi politicians view Turkey's policy as favoring the Kurdistan Region.

Ankara has capitalized on Erbil's fragile legal and geographical position by building political, economic and trade leverage over the authorities there. Turkish firms' involvement in the Kurdistan Region's oil and gas sector dates as far back as 2003. The KRG's oil revenues are kept at Turkish state-run Halkbank and Turkish state-firm TEC has received $2.5 billion in tariff payments for transporting oil on the Turkish stretch of the ITP since 2018.[16] Promoting benign relations

15 "پشکی هەرێم لە بودجەی عێراق", May 26, 2023, Draw Media. https://drawmedia.net/page_detail?smart-id=12937

16 Yesar Al-Maleki, "Baghdad Pressures Turkey To Restart Pipeline Flows", MEES, April 14, 2023. https://www.mees.

with the KRG had, at least initially, served Ankara's reconciliatory agenda with Kurds domestically as well.[17]

In the long term, Ankara may need to reassess its Iraq policy as a result of Baghdad's new involvement in the Kurdistan Region's oil affairs. Iraq's expectations of using the arbitration ruling to press for a quota-based water-sharing treaty with Turkey or to secure the withdrawal of Turkish troops from the Kurdistan Region are domestically problematic for the Turkish government.

To address these expectations, Ankara may focus talks on energy issues, taking advantage of the looming September 2025 expiration of the 2010 amendment to the ITP treaty.[18] However, a unilateral Turkish exit from the accord could deepen Baghdad's mistrust and, if coupled with the resumption of KRG exports without federal involvement, may even negatively impact Erbil politically and economically.

Conclusions and Policy Recommendations

Iraq's arbitration victory over Turkey has effectively ended the Kurdistan Region's aspirations of economic self-sufficiency through independent oil exports. Since its inception, the Kurdistan Region's oil sector has operated in a legal grey area and the sudden loss of its primary marketing conduit of Ceyhan has confirmed its vulnerability. After the ICC ruling, the KDP has focused its politicking on safeguarding key aspects of its powers over the sector. Despite handing over marketing to SOMO, the KRG's deals with Baghdad allow it to retain oil revenues, maintain contracts with IOCs, and engage in oversight of operations.

These wins are fragile, both legally and politically. As political understandings, they are hostage to any deterioration of relations between political leaders in Baghdad and Erbil. Moreover, divisions between the KDP and the PUK could destabilize the process, as could anti-KRG factions within the Iraqi political landscape.

Recent history shows a track-record of non-compliance with deals between Baghdad and Erbil, which continues to foster a lack of trust. Therefore, the KRG must prioritize working with the federal government to draft and enact a federal oil and gas law as early as possible. This process should aim to permanently legitimize agency over the sector and to mitigate future risks to its business environment.

A precondition for the success of this policy is reaching sustainable reconciliation, not mere détente, between the KDP and the PUK. This entails adopting transparent and equitable resource sharing mechanisms and consolidating KRG institutions.

The passage of an oil and gas law, however, is expected to be a lengthy process. The recovery of the Kurdistan Region's oil sector is tied to the resumption of pipeline exports to Ceyhan. Even once restarted, the specter of future closures will continue to be a source of volatility and political risk, absent a legislative agreement that clearly defines the management of the Kurdistan Region's oil sector.

Realistically, Baghdad cannot impose concessions on Turkey and the inclusion of non-energy related bilateral issues in future talks will be futile. Ceyhan is Iraq's only other available oil marketing conduit besides the Gulf and will play a crucial role for Baghdad if SOMO is to

com/2023/4/14/geopolitical-risk/baghdad-pressures-turkey-to-restart-pipeline-flows/

17 Umut Uras, "Kurdish leader makes historic Turkey visit", Al-Jazeera, November 20, 2013. https://www.aljazeera.com/features/2013/11/20/kurdish-leader-makes-historic-turkey-visit

18 Yesar Al-Maleki, "KRG Finance Crunch As Export Halt Continues", MEES, April 21, 2023. https://www.mees.com/2023/4/21/geopolitical-risk/krg-finance-crunch-as-export-halt-continues/

succeed in its ambition to strengthen relationships with refiners in the Mediterranean basin.

The best course of action for the federal government is to reach an amicable settlement with Turkey, leveraging that to build trust with Ankara and enhance economic cooperation.

** The author would like to thank the Middle East Economic Survey (MEES) for providing the data necessary for generating the charts used in this paper.*

IRIS
American University of Iraq, Sulaimani
Institute of Regional & International Studies

CONTACT US

iris@auis.edu.krd
+964 773 152 6206

Energy, Power & Politics: Assessing the Baghdad-Erbil Oil Deal

www.auis.edu.krd/iris