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Autonomy Curbed? Kurdish Oil Exports Hit Snags from Turkey and Baghdad

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For the past three months, the Kurdish region in northern Iraq and its government, the Kurdish Regional Government (KRG) have been facing one of the most serious challenges in the two decades of its formal existence. The pipeline through which it exports some 400,000 barrels of oil a day (b/d) – 10 percent of the overall Iraqi exports and 0.5 percent of global production – has been closed since March 25, at an estimated cost of close to a billion dollars a month (approximately $30 million daily). The KRG has depended on income from oil exports for some 80 percent of its budget.

The stoppage came after a decade-long arbitration between the Government of Iraq (GOI) and Turkey by the Paris-based International Chamber of Commerce was decided in March in Iraq's favor. Turkey was ordered to cease loading Kurdish oil without GOI supervision, and to pay Baghdad $1.5 billion in owed fees (Baghdad had demanded $30 billion). Baghdad had claimed that use of the pipeline from northern Iraq to the port of Ceyhan in Turkey by the Kurds without GOI consent was in violation of a bilateral agreement between the two countries from 1973, the annex of which states Turkey would only buy oil from Iraq's state-owned oil marketer.[1]

The pipeline was laid in 2013 to facilitate the independent export of oil produced in Iraqi Kurdistan, previously carried in tanker trucks, through Ceyhan. Kurdistan's economy has been dependent on independent export of their oil production since 1991. This followed the First Gulf War and the establishment of the de facto Kurdish autonomy in the governorates of Dohuk, Erbil and Sulaymaniyah, which was formalized upon the creation of federal Iraq in 2003. Iraq had tried for the past decade

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[1] Mehmet Alaca, "Long-Running Turkey-Iraq Oil Dispute Continues to Simmer, Despite Court Decision," Arabian Gulf States Institute in Washington (AGSIW), April 20, 2023.

to gain control of the Kurdish oil exports, as part of a larger effort to curtail Kurdish autonomy in Iraq, as well as to limit its competition with other Iraqi oil exports: Kurdish oil has been offered at a discount of $10-20 per barrel, creating a two-tiered market for Iraqi oil.[2]

After the arbitration ruling, Turkey immediately stopped the loading of Iraqi oil at Ceyhan. This included 75,000 b/d exported through the pipeline by the Iraqi government oil company from the oil fields of Kirkuk, seized by the GOI after the abortive 2017 Kurdistan-wide referendum on independence.[3] On April 4, Erbil and Baghdad quickly reached an interim agreement on the method of export of northern Iraqi oil in the future, and, on May 10, Baghdad formally requested from Turkey to renew exports. Turkey has yet to do so. It apparently wants to use the current leverage to open direct negotiations over the amount of money it has to pay to Iraq, and to perhaps pressure Iraq to suspend its efforts in US courts to enforce the arbitration ruling, as well as to settle a second ongoing arbitration between the two countries regarding oil flows since 2018. It is reported that Turkey also wants to pressure Baghdad and the KRG to settle their own oil dispute so as to avoid disputes in the future. It is also fair to note that Turkey suffered major earthquakes in February (which it claims also affected the Ceyhan facilities and has been the cause of delays in renewing shipments) and that the country has been embroiled in the past months in crucial elections, which may have distracted the political level from other issues.[4]

In any case, Iraq's overall exports dropped in May to their lowest in nearly two years, due to the stoppage of northern oil exports. The IMF said earlier this month that it has caused Iraqi economic growth to slow in recent months.[5]

A first technical meeting was held between a Turkish technical delegation and the Iraqi oil ministry on June 19. Additional meetings are expected, but renewal of

[2] The Kurdish region is also reportedly the major channel for smuggling of over 40,000 barrels oil a day, from Iraq proper to neighboring countries. Various Iraqi actors – especially Iranian-backed Shi'i militias –take advantage of the differentials between heavily subsidized prices for oil products inside Iraq (not in Iraqi Kurdistan) and the prices in neighboring countries (notably Syria), to obtain profits through arbitrage (Laura Adal and Sarah Fares, "*Smuggling, subsidies and shortages: Iraq's latest oil troubles*," Global Initiative Against Transnational Organized Crime, February 10, 2023).

[3] Iraq as a whole accounted for 27 per cent of Turkey's imports of oil and other petroleum products in December 2022, behind only Russia, according to the most recent data from the Turkish Energy Market Regulatory Authority.

[4] Adam Lucente, "Oil flow from Iraqi Kurdistan to Turkey remains stopped, threatening sector," *al-Monitor*, April 14, 2023; and, "Iraq Petitions US Court to Enforce Oil Export Arbitration Award Against Turkey," *Reuters*, April 11, 2023.

[5] Khalid Al-Ansary, "Iraq Is in Talks With Turkey to Resume Oil Flows From Ceyhan," *Bloomberg*, June 3, 2023 and "IMF Staff Concludes Staff Visit to Iraq," *IMF*, May 31, 2023.

exports does not seem imminent. An Iraqi official noted that "a decision to restart oil flow needs political talks on higher levels: issues blocking the resumption of oil exports are more political than technical."[6]

Oil and the Struggle for Kurdish Autonomy

There has long been bitter dispute between Erbil and Baghdad regarding who controls the energy sector in Iraqi Kurdistan. At the time of the establishment of the new Iraqi system in 2003, it was agreed that the KRG would export from its fields via Iraq's State Oil Marketing Organization (SOMO), and refrain from marketing oil independently. In return, it would receive a percentage from Iraq's central budget. However, a federal oil and gas law was never approved by parliament, and in 2007 the Kurdish regional parliament passed its own oil and gas law. Deals were struck in 2014 and 2018, under which KRG would export oil through SOMO in return for a percentage of the federal budget, but the budget transfers – used *inter alia* to pay KRG government salaries - were sporadic, and unreliable due to political manipulation. As the KRG continued to export oil independently, Iraq has retaliated by cutting off budget payments, causing financial crises in the KRG and damaging the KRG's ability to regularly pay the salaries of many of the large number of KRG public sector employees.

The Kurdish oil industry, and Kurdish political and economic autonomy in general, have been under especially severe pressure in the past year. In February 2022, the activist, Shiʿi-influenced Federal Supreme Court of Iraq ruled that the KRG oil and gas law of 2007 was unconstitutional.[7] The court then ordered the Iraqi government to take measures to force the Kurdish authorities to hand over their crude supplies to the Iraqi federal government. The ruling granted Baghdad the power to pursue the nullification of contracts signed with foreign states international oil companies relating to the exploration, production, export and/or sale of crude oil from Kurdistan. This led to a campaign by the Iraqi oil ministry and SOMO against Kurdistan-based operators and service companies, as well as traders handling Kurdish oil, warning of legal action if they handled the oil without their consent, and bringing suit in Iraqi courts – which annulled four contracts – against some of them.[8] Large oilfield services firms Schlumberger, Baker Hughes, and Halliburton pledged to

[6] Ahmed Rasheed and Rowena Edwards, "More talks needed to resume Iraq's northern oil exports," *Reuters*, June 19, 2023.

[7] "Iraqi Supreme Court casts doubt over legitimacy of Kurdistan's oil and gas sector," *Norton Rose Fulbright*, March 2022.

[8] "Baghdad court declares four KRG oil contracts void, service firms exit – IOR," *qcintel.com*, July 6, 2022; and, "KRG Eyes Oil & Budget 'Grand Bargain' With Baghdad," *Middle East Economic Survey* (MEES), November 18, 2022.

curtail operations in the Kurdish region.[9] The U.S. State Department has expressed concern that the dispute risks driving U.S. firms out of Iraq, but the official U.S. reaction to both the clash between GOI and KRG, and the Turkish suspension of oil exports, has been, at last publicly, surprisingly low-key, in view of the close ties between Washington and the Iraqi (and Syrian) Kurds.

Kurdish authorities rejected the decision and described it as "politically motivated," saying the court's ruling was not aligned with the Iraqi constitution. The judicial system is seen, not only by the KRG, as being controlled/coopted by the Iranian-oriented parties that form the Shiʿa Coordination Framework (SCF), and acting in its interests.[10] The Supreme Court decision was celebrated by the SCF, who have since then advanced parliamentary legislation to bring the Kurdistan oil industry even more under Baghdad's control. In January 2023, the Federal Supreme Court ruled also against new national fiscal transfers to the KRG.

Since the February 2022 Supreme Court decision, the KRG found it harder to find buyers for its crude, and the discount it offered for political risk increased. KRG has also been late in making payments to suppliers and traders, and owes them hundreds of millions of dollars. The international oil companies working in Kurdistan are small – the major companies such as Chevron, Total and Exxon-Mobil, with the notable exception of Russian companies, reduced their activity in the region in recent years due to political risk – and mostly are focused only in the region. This makes them highly exposed in the current situation. Since March, they have mostly been forced to suspend production, due to Turkey's decision to close the pipeline and the limits of their own modest storage capacity.

In addition to the tension between the KRG and the GOI, the recent developments also put intra-Kurdish tensions on display. The Kurdish region has long been characterized by competition, occasionally breaking into open warfare, between the Kurdish Democratic Party (KDP) of the Barzani clan, who control the Dohuk and Erbil governorates and therefore, most of the energy resources and the border with Turkey, and the Patriotic Union of Kurdistan (PUK), of the Talabanis, whose power base is Sulaymaniyah governorate. The PUK, as well as other, smaller, Kurdish parties, feels that its personnel and territory are neglected by the KRG, which is dominated by the KDP, and that if KDP lost its ability to manage and sell oil independently, its power would be reduced in both Kurdish and Iraqi politics.

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[9] "Iran Strikes Kurdistan as Baghdad Offers Olive Branch," *Middle East Economic Survey* (MEES), October 7, 2022.

[10] Michael Knights, "Iraq Is Quietly Falling Apart: Iran's Proxies Have Seized Power in Baghdad—and Are Gutting the State," *Foreign Affairs*, June 5, 2023.

Under the aforementioned temporary agreement reached by KRG Prime Minister Masrour Barzani and Iraqi Prime Minister Mohammed al-Sudani on April 4, SOMO would have the authority to market and export KRG oil (at the same price as its other exports), and the revenues will be deposited in an account at the Iraqi Central Bank under the control of the KRG: government authorities in Baghdad would have access to audit the account. KRG oil would also be restricted from export to Asia, where southern Iraqi oil has major markets.[11] Thus, in a grand compromise, the KRG dropped its insistence on marketing its own crude, and Baghdad for its part relaxed its demands for revenue control.[12]

That deal was, as noted, temporary, and superseded by arrangements anchored in the new 2023-2025 budget law, approved by parliament on June 12. Under the new budget law, Iraqi Kurdistan will provide 400,000 b/d to the GOI, to be marketed by SOMO or used domestically; the KRG will be compensated for the costs incurred to produce and transport the oil. The revenues will be deposited at a bank account in the Central Bank of Iraq that can be audited by Iraqi officials as well as by an international auditing firm.[13] The KRG had preferred direct access to oil revenues through a single bank account of its own, and had chosen Citibank in the UAE as its preferred option. In return, the federal government will pass 12.7 percent of the $153 billion national budget to the KRG. That is, while the KRG will retain management of its oil production sector (though not of marketing abroad), the finances will now be in Baghdad's hands. The budget process was accompanied by furious debate, with delegates of the SCF and PUK trying to impose further constraints on the KRG (for instance, that oil production, and not only exports, would be handed over to GOI).[14]

The final law included clauses which riled the KDP, especially one which enables funds from the state budget to be provided directly to governorates, without going through the KRG, in case the regional government fails to distribute the budget equitably. This is seen as helping the PUK, which is close to Iran-aligned SCF, since it

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[11] "Iraq's northern oil exports show few signs of restarting after stoppage," *Reuters*, April 24, 2023.

[12] There is an Israeli aspect, as well: Iraqi Kurdistan was Israel's top supplier of oil in 2022 and through April 2023, as well as before 2018. It apparently re-exported the oil from Eilat to customers in Asia. This has ended: SOMO, which has secured oversight over the KRG's oil exports, does not permit exports to Israel. Peter Stevenson, "Israel Turns to Kazakh Crude as KRG Flows Dry Up," *Middle East Economic Survey* (MEES), June 2, 2023.

[13] "Kurdistan Region welcomes passage of Iraq's three-year budget bill, says president," *Kurdistan 24*, June 13, 2023.

[14] "Baghdad-Erbil Agreements Buffeted by Political Headwinds," *Middle East Economic Survey* (MEES), June 2, 2023.

enables direct transfers from Baghdad to Sulaymaniyah governorate, a PUK stronghold.[15]

Looking Forward

It remains to be seen if the Iraqi-Kurdish arrangement now reached is sustainable. The debate over the new budget showed the eagerness of the pro-Iranian Shiʿi groups to further curtail Kurdish autonomy, assisted by long-standing inter-Kurdish rivalry and awareness of KDP-KRG weakness. While it appears that the current Iraqi prime minister, al-Sudani, is committed to reaching an agreed compromise solution to the tension with the KRG, it is not at all clear he has the support of his restive coalition. Any change in the government in Baghdad – and elections may be as early as 2024 – may well lead to changes in policy towards the KRG energy sector. As the EIU notes, a new government might leverage its control over KRG oil revenue to pressure the regional government into offering additional concessions on other matters, such as relinquishing control over territories claimed by the federal government in Nineveh and Diyala provinces.[16] The current budget arrangements may be, as in the past, disregarded or disrupted in Baghdad for political reasons, and in any case, will only be in force until 2026. Iraq is also reported to be examining other export options for oil, including the currently unusable pipeline from Kirkuk to Banias in Syria. Turkey will retain significant influence in Iraq, through its capacity for military intervention against Kurdish targets in the North, its control over much of Iraq's water sources, and the fact that whatever agreement the Iraqis and Kurds have reached, at least 10 percent of Iraqi oil will probably continue to be exported through Turkey in the foreseeable future (unless it is prioritized for domestic use, freeing up other oil for export).

An additional issue which has not yet been significantly addressed, is that of natural gas. Iraq has not yet developed a significant gas industry, and wastes about 50 percent of its gas at wellhead by flaring, which also contributes to significant air pollution problems. Its current weakness in capturing gas makes it dependent on Iran for gas imports and for electricity, especially in summer. This has already led to tensions with Iran – which is owed vast sums for gas – and within Iraq, as Iran often cuts off supplies, preferring to provide its own consumers, during the hot summers (and to use the dependence for political signaling). Kurdistan has been tooling up for major gas projects: these were the target for rocket and missile attacks by pro-Iranian forces in 2022, reportedly aimed at signaling Iranian displeasure to Erbil and at frightening

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[15] "Iraq's 'Final' 2023 Budget: Mixed Fate for KRG Oil Sector," *Middle East Economic Survey* (MEES), June 16, 2023.

[16] "Iraqi Kurdistan will remain restive, despite oil agreement," *Economist Intelligence Unit (EIU)*, June 2, 2023.

off foreign investors. The gas issue has not been publicly mentioned in the recent political discussions.

The arbitration decision, and the Turkish suspension of oil loading, have well served Baghdad's efforts to harm the KRG's international position, and curtail its independent foreign and economic policies. The new political and economic reality is forcing Erbil to accept arrangements under the new budget law which it may well have rejected previously. Loss of control over its major source of income will mean significant loss of autonomy, though it may also somewhat alleviate the economic problems, including corruption and non-payment of salaries and pensions, which have plagued the Kurdish region for a decade. The new situation will help Baghdad manage nationwide energy development and policy, and should also make it easier for Baghdad to ensure that Kurdish energy and export policy does not clash or compete with federal policy, and that the KRG implements its share of any future OPEC cuts Iraq agrees to. In the conflict between the federalist vision of Iraq held by the Kurds, and the centralist-majoritarian one held in Baghdad by the Shiʿi majority, the second seems to be ascendant.

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