

Planning Beyond a Baghdad-Kurdistan Budget Deal

by [Michael Knights \(/experts/michael-knights\)](#)

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ABOUT THE AUTHORS



[Michael Knights \(/experts/michael-knights\)](#)

Michael Knights is the Jill and Jay Bernstein Fellow of The Washington Institute, specializing in the military and security affairs of Iraq, Iran, and the Persian Gulf states. He is a co-founder of the Militia Spotlight platform, which offers in-depth analysis of developments related to the Iranian-backed militias in Iraq and Syria.



Brief Analysis

Iraq's bloated 2023 budget has created space for the Kurds to get a share of the wealth this year, but preparing for the next leap to permanent solutions is more important.

On March 16, Deputy Prime Minister Qubad Talabani of the Kurdistan Region of Iraq (KRI) publicly discussed the country's new draft budget law for 2023, which includes provisions for the Kurds to receive a per capita share of the planned spending. Although the law has yet to receive parliamentary approval a full quarter into the new year, the bigger test will be implementation, particularly if global oil prices hover at or below the \$70 per barrel forecast in the budget. Assuming the deal goes through, policymakers should start thinking ahead to the technical and political challenges of implementation, the unintended second-order effects, and the potential implications for broader understandings on federalism.

What Was Just Agreed?

The budgetary clauses in question would allow the unique four-province KRI to receive a share of federal spending. Unlike the other fifteen provinces of Iraq—officially referred to as “governorates not incorporated into a region”—Kurdistan has a parliament, cabinet, and ministry system of its own, so most of its government functions are not served directly through the line ministries in the budget. Instead, the KRI has repeatedly been compelled to negotiate a per capita share of the cost for services normally provided to provinces by federal ministries (so-called “non-sovereign spending”). For its part, Baghdad has had to factor in the various KRI revenues that a normal “unincorporated” province would not typically earn—most notably the revenue from producing 400,000 barrels per day of oil. Typically, these earnings have been deducted from the KRI's federal budgetary allocation.

In past years, debates over these allocations and deductions have been mired in [broader questions related to](#)

federalism (<https://www.washingtoninstitute.org/policy-analysis/paradox-centralization-and-state-fracture-iraq>): Does the KRI have the legal authority to undertake oil exploration and marketing? What should its per capita share of non-sovereign spending be in the absence of a national census? What portion of the budget should be classified as non-sovereign expenses? The cabinet's approval of the current draft budget does not answer these questions definitively—it is simply an indication that temporary arrangements have once again been found in order to get the national coffers open.

Indeed, every faction in Iraq has a strong incentive to pass the budget as soon as is feasible. Due to the contentious year-long government formation process that followed the 2021 parliamentary election, there was no budget in 2022, so the only spending that could take place was paying salaries and pensions. Consequently, investment was frozen at a time of high oil prices, and federal reserves backed up to the point where they now total a mammoth \$115 billion. All factions are eager to feast on the resultant oversize budget, which is expected to include \$152 billion of spending—a full 50 percent more than the 2021 budget. Setting aside a share for the Kurds is therefore highly affordable this year, and the KRI's spending needs can be met (albeit just barely) without stressing other beneficiaries.

What Remains to Be Negotiated?

As Talabani noted, much has yet to be decided in practice. The most important loose ends relate to marketing and revenue management for the KRI's 400,000 barrels per day of oil production. In the past, Baghdad has developed overly complex schemes for Kurdistan to hand over some or all of its oil exports to federal authorities at the Ceyhan terminal on Turkey's coast, where the Iraq-Turkey Pipeline terminates. This time, Baghdad seems content with a more pragmatic approach. Under the draft budget's current provisions, the KRI will market its own oil and deposit the revenue in a bank account that federal officials can monitor. Baghdad will then deduct that amount from its monthly allocation to the KRI, while also transferring any surplus monies owed to the Kurds.

Yet this is just a one-year arrangement—and probably just a half-year in practice given that finalizing the budget may take a few more months. A more permanent system cannot be established until Iraq passes a federal oil and gas law, and perhaps a revenue sharing law as well. Only that degree of legal reconciliation would be sufficient to trigger reconsideration of the Federal Supreme Court's February 2022 ruling that **KRI oil exports are unconstitutional (<https://www.washingtoninstitute.org/policy-analysis/death-oil-federalism-implications-new-iraqi-court-ruling>)**. Failing that, the 2007 Kurdistan Oil and Gas Law and the investment contracts that rest on it will remain illegitimate.

Baghdad, the KRI, and other oil-producing provinces would also need to agree on a few other matters if they hope to facilitate further progress on these issues beyond the 2023 budget deal:

- **Fixed formula revenue sharing.** In addition to fixing the KRI's per capita share of non-sovereign spending, Baghdad must decide once and for all which expenses are non-sovereign and which are sovereign. This means transparently setting the size of the “cake” from which Kurdistan receives its slice. To safeguard such a deal from any resentments among non-Kurdish constituencies, the government should be encouraged to include offsetting boosts to line ministry projects in Iraq's oil-rich south during 2023-24.
- **Phased changes to oil marketing.** At first, the KRI will need to self-market its oil in order to pay down its \$3.5 billion in debts to traders, since Baghdad seems unwilling to take over these arrears. Once the debt is paid off, a joint marketing arrangement could follow, such as the oft-proposed “State and Kurdistan Oil Marketing Organization” (SKOMO).
- **Grandfathering existing contracts.** Any substantial change to international contracts—almost all of which are written in English law for arbitration in foreign courts—would result in a deluge of court cases that would damage Iraq's

investor-friendliness. Hence, a new federal oil and gas law would need to grandfather the terms of existing contracts signed under the 2007 Kurdistan Oil and Gas Law.

- **Phased changes to sector governance.** A very light touch should be employed in governing the KRI energy sector. If the proposed Kurdistan Regional Oil Company (KROC) is established as a joint company of the federal and KRI oil ministries, it should be given full local authority to approve annual field development plans and budgets. This would require a future Federal Oil and Gas Council to establish a collaborative mechanism that allows Baghdad and Kurdistan to distribute production increases and cuts (e.g., to meet OPEC quotas).
- **KRI economic reforms.** Despite receiving a healthy share of an oversize national budget, Kurdistan will still just barely be able to balance its regional budget this year. Future years will likely be leaner, so the KRI must prepare by undertaking economic reforms such as reducing subsidies, creating efficiencies, and transferring public sector employees to the private sector.

The U.S. Role

Twenty years after the U.S. invasion to topple Saddam Hussein’s brutal regime, the prospect of helping Iraq reach a sustainable peace with its largest ethnic minority remains one of the most important contributions Washington can make. The author’s 2022 paper “[The Necessary U.S. Role in Fixing the Baghdad-Kurdistan Energy Dispute](https://www.washingtoninstitute.org/policy-analysis/necessary-us-role-fixing-baghdad-kurdistan-energy-dispute) (<https://www.washingtoninstitute.org/policy-analysis/necessary-us-role-fixing-baghdad-kurdistan-energy-dispute>)” details specific areas of technical assistance that can help smooth reconciliation of the energy sector, such as establishing the KROC, auditing support, OPEC cut-sharing, and [mediating arbitration \(/node/1751\)](#) over the Iraq-Turkey Pipeline.

At the political level, this promising moment has only become possible because international actors—led by the United States—strongly urged the KRI’s top parties to show greater flexibility on domestic Kurdish issues and greater unity in their dealings with Baghdad. This push needs to be maintained at its current intensity until a hydrocarbons law is ratified; letting up now could quickly lead to [renewed Kurdish quarreling](#) (<https://www.washingtoninstitute.org/policy-analysis/krg-turns-thirty-future-us-kurdish-relations-iraq>) that unravels a potentially historic deal.

Michael Knights is the Bernstein Fellow at The Washington Institute and cofounder of its [Militia Spotlight platform](#) (<https://www.washingtoninstitute.org/policy-analysis/series/militia-spotlight>). ❖

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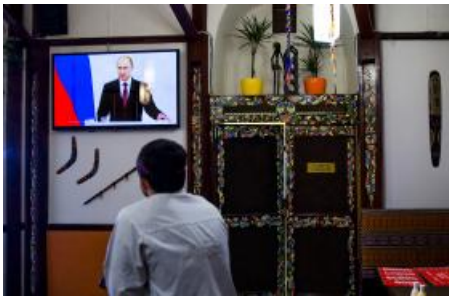
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