Iraq's Future: It's the Oil, Stupid

by Michael Knights **(/experts/michael-knights)**

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ABOUT THE AUTHORS

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At this crucial time in Iraq's history, only one factor is holding the country together: the wealth created by the south's oil exports, and how these funds will be distributed in the 2015 budget.

This week, Iraq's Prime Minister Haider al-Abbadi is scheduled to visit Erbil, his first visit to the capital of the Kurdistan Region of Iraq as premier. The lead-up to the visit has been long and torturous, including months of speculation and tactical manoeuvring over the potential form of a revenue-sharing deal between Baghdad and the Kurds. Though less dramatic than the day-to-day fighting against the Islamic State of Iraq and the Levant (ISIL), the outcome of these negotiations could do more to cement the unity of Iraq -- or hasten its break-up -- than events taking place on the battlefield.

For almost a year now, the Kurds have lived without their customary budget transfers from Baghdad. In previous years, the Kurds received 17 percent of net revenues from Baghdad -- around a billion dollars a month -- to cover $750m of Kurdistan Regional Government (KRG) salaries and pay for ministry programmes. This year, Iraqi Kurdistan has to reckon on hundreds of millions of dollars of additional costs each month to maintain full mobilisation of the Peshmerga to fight ISIL and to support nearly 1.4 million displaced Arabs, Kurds and minorities.

In 2014, Baghdad has only paid about a month and a half of salaries, forcing the KRG to default on salaries despite taking out multibillion dollar loans. The region is now in debt to the tune of about $8bn.

Though the Kurds are earning close to $450m of revenue from their independent oil sales via Turkey, the government in Ankara is only releasing 17 percent of KRG oil revenues to the Kurds while negotiations with Baghdad are under way. This covers less than 10 percent of KRG costs.

Two paths for the Kurds

The situation can resolve in one of two ways. Abbadi and the Kurds could agree on a revenue-sharing deal that would be written into the 2015 budget and implemented for a year. The deal would involve a joint oil marketing arrangement between the Iraqi state and the Kurds, and a commitment of set volumes of KRG-produced oil exports in 2015. The Kurds would receive their oil revenues directly from international banks in a transparent process, and these revenues would be considered a partial advance on the KRG's restored monthly payments from Baghdad.

Such a deal could also allow Iraq to export 200,000-400,000 barrels per day of Kirkuk crude through the Kurds' internal pipeline network. Due to ISIL's destruction of much of the federal Iraqi government's northern export infrastructure, the Kurds offer the only way for Iraq to monetise this oil in the coming years.

Alternately, if Baghdad and the Kurds cannot agree on a deal, the KRG may continue down the path of independent oil exports via Turkey, without Baghdad's cooperation. This path is choked with legal and political challenges and would eventually tear apart Iraq and the Kurdistan Region. Baghdad would lose its northern export route for Kirkuk crude, and collapsed talks might drive Turkey to release the full weight of KRG oil revenues to Erbil, speeding up Kurdish economic independence. For the Kurds, the independent export path represents a slow, painful path to economic self-sufficiency that could entail a year or more of deep recession, and would then only swap dependence on Baghdad for dependence on Ankara.

Abbadi's choice: Unite or split Iraq

At this crucial time in Iraq's history, only one factor is holding the country together: the wealth created by southern Iraq's oil exports and how these funds will be distributed in the forthcoming 2015 budget. Federal government oil revenues are central to every major initiative to strengthen the country. The southern Shia provinces demand economic development through the payment of "petrodollars" to oil-producing provinces. The Sunni provinces want the federal government to fund the National Guard programme, to raise new US-trained military units to allow the Sunni areas to defeat ISIL and thereafter self-police. The Kurds view staying in Iraq as an economic necessity for now, and their benefactor, Turkey, will push them to stay at the negotiating table with Baghdad as long as a deal is possible.

All the factions will have to accept that Iraqi funds will be limited in 2015 due to declining oil prices and skyrocketing war costs. But all factions -- including the Kurds -- also need to be convinced that it is better to stay in Iraq than to go their own way.

When the Iraqi government was formed, Baghdad promised to restore monthly payments to the Kurds, and this should be done in mid-November as a symbol of goodwill as negotiations start. After a year of non-payment to the Kurds and months of non-payment to the ISIL-held provinces, the federal government has the surplus money to restart payments.

The basic truth is that "Sunni uprisings" and "Kurdish separatism" are not the key threats to Iraq's unity. Iraq's Shia are the only power with the ability to break up Iraq, and they can do it in a heartbeat if they decide to cut the Sunnis and the Kurds off from Basra's oil wealth in 2015.

For this reason, Abbadi holds the fate of a unified Iraq in his hands when he travels to Erbil. By paying Kurdish salaries in November and striking a fair revenue-sharing deal for 2015, he can score a major victory for Iraq's future on a vital, if unsung, battlefield.

Michael Knights is a Lafer Fellow with The Washington Institute. This article originally appeared on the Aljazeera website (http://www.aljazeera.com/indepth/opinion/2014/11/iraq-future-it-oil-stupid-201411581225438586.html). ❖

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