Policy Analysis (/policy-analysis) /
PolicyWatch 2208

Baghdad-KRG Negotiations: Closer Than Ever to a Fair Deal

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

Feb 14, 2014

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

Baghdad's promising offer on oil exports and revenues could provide vital breathing room to build a permanent revenue-sharing law, and Washington should encourage the Iraqi Kurds to sign on.

On February 16, the Iraqi central government and the Kurdistan Regional Government (KRG) will hold another round of negotiations on oil exports and revenue sharing, the fifth such meeting since December 25. With passage of Iraq's 2014 budget delayed by the talks, all parties have a strong interest in striking a deal. Fortunately, such an agreement now stands a better chance of sticking than ever before.

NOT JUST ABOUT OIL

When discussing oil contracts and revenue sharing, Iraqi Kurds often begin by noting that the dispute with Baghdad "is not just about money." Kurds suffered decades of brutal oppression by the Iraqi government that far exceeded the cruel norms of internal repression in the Middle East. From the 1960s to the fall of Saddam Hussein's regime, many Kurdish areas witnessed complete destruction of all villages, with every structure demolished and all people and livestock removed from rural areas or killed.

This deep trauma was partially salved by the significant administrative and fiscal decentralization built into the 2005 Iraqi constitution, which committed to sharing national revenues on the basis of both population distribution and the level of damage inflicted on different parts of the country. Drawing on their interpretation of the constitution, Kurdish leaders in Erbil have since claimed the right to manage the development of KRG oil fields in northern Iraq and conduct sales through their embryonic Kurdistan Oil Marketing Organization (KOMO). They have also sought to keep the resultant revenues in accounts they control to ensure that international contractors receive their entitlements, since the KRG has signed fifty-plus production-sharing contracts that Baghdad does not endorse.

BAGHDAD'S LATEST OFFER

Late last year, culminating years of autonomous oil-sector development, the KRG threatened to export large volumes of oil via Turkey without Baghdad's involvement. The threat became more credible when Erbil signed a private agreement with Ankara in November to bring Turkish-backed companies into the Kurdish oil sector, and when an improvised pipeline became partially operational in December between KRG oilfields and Turkish export terminals at Ceyhan. These factors -- along with U.S. and Iranian encouragement of Baghdad-KRG reconciliation ahead of Iraq's April 30 elections -- have driven the Maliki government to propose a new mechanism for exporting and monetizing KRG oil. Key elements include:

- *Marketing.* The federal State Oil Marketing Organization (SOMO) and KOMO will jointly market KRG crude, with details such as price and end users preapproved by a joint high committee. Although this would represent a blow to Erbil's aspirations of independent marketing, it would have few tangible costs for the Kurds.
- *Revenue management.* The proceeds from the marketed crude will be processed using conventional accounting methods at the Federal Reserve Bank of New York (FRBNY). KRG crude revenues will enter the Oil Proceeds Receipt Account, with 5 percent remittance made to Kuwait via the UN Compensation Committee as required by UN Security Council Resolution 1511. Baghdad will then transfer the remainder of the KRG revenues each month to Erbil's control via a subaccount of the Iraqi Central Bank account at FRBNY, with the understanding that Baghdad would withhold this amount from its routine monthly transfers to the KRG (see below). This offer goes some way toward meeting Erbil's demand to maintain stewardship of KRG-derived oil revenues, even though the process would not be entirely under KRG control.
- *Revenue sharing.* The new upside for Erbil comes in the form of enhanced revenue sharing. Baghdad is offering to reduce strategic expenses by excluding $15 billion of federal petroleum costs incurred in the southern oil fields, thereby raising the value of the KRG's 17 percent "take" of monthly national revenues by an incremental $2.5 billion this year.
- *Budget revision.* The draft budget currently requires the KRG to produce 400,000 barrels of oil per day for the federal government or see deductions from its monthly transfer. This provision would be removed if the Kurds take the deal outlined above.

IMPLICATIONS FOR U.S. POLICY

Washington deserves significant credit for consistently pushing Baghdad toward compromise. Energetic U.S. engagement has helped keep the current negotiations on track, with Washington smartly leveraging its influence as a provider of intelligence, weapons, and diplomatic support in the fight against al-Qaeda affiliates in Iraq. U.S. officials need to keep up the pressure to get the current deal over the finish line.

Ongoing high-level lobbying is vital because a near-term deal is not assured. The latest proposal may give the KRG billions of additional dollars and a means of reassuring its international oil company partners, but Kurdish leaders would also have to explain to their constituencies why they are apparently taking a step backward from marketing oil with Turkey -- an important symbol of Iraqi Kurdistan's desire for economic independence. At this point in the negotiations, key Turkish and Kurdish stakeholders continue to argue against Baghdad's offer, either for parochial economic reasons or because they believe the KRG can get a better deal during the government formation negotiations after the April elections.

Meanwhile, the central government's current flexibility could disappear if the KRG withholds its assent too long. No amount of lawyering on Baghdad-KRG agreements or Iraqi laws will sustain the negotiations if political agreement breaks down: in reality, the airtight deal that the Kurds are seeking is unattainable, so they should not allow the perfect to become the enemy of the good. There are no real downsides if they take the current proposal as an interim agreement and monitor its implementation. This would secure the KRG's monthly allowances under the 2014 budget and head off a major financial crisis in the Kurdish region. And Erbil would have future opportunities to renegotiate the deal if it believes it has a better hand to play at a later point -- whether during post-April government formation, the 2015 budget negotiations, or the eventual debate over a permanent revenue-sharing law.

The United States should also continue to reassure the Kurds that taking this interim deal does not mean caving on longer-term issues such as disputed territories or revenue-sharing legislation -- two initiatives on which Washington can actively support the pursuit of a fair deal. In addition, the U.S. government should explicitly guarantee that it will respond sternly if Baghdad attempts to interfere with automatic fiscal transfers to the KRG. Delisting the Kurdistan Democratic Party and Patriotic Union of Kurdistan as Tier III terrorist groups would be another timely way to underline Washington's sincerity as an old friend and a true ally.

More broadly, success in the current Baghdad-KRG negotiations could improve Iraq's outlook in many ways. It would allow the Iraqi budget to pass and serve as the first step in bringing to market up to a million barrels per day of KRG oil. It could also defuse tensions in the run-up to the April elections and the months of government formation that will follow. Improvements in Iraq could in turn have potentially far-reaching geostrategic significance: a more united Iraqi effort against al-Qaeda affiliates and a tentative step toward a Baghdad-KRG-Turkey rapprochement would provide welcome relief from the generally negative trends visible across the region. Such a turn for the better under U.S. leadership would be widely appreciated and applauded.

Michael Knights is a Boston-based Lafer Fellow with The Washington Institute. ❖

RECOMMENDED

BRIEF ANALYSIS

Unpacking the UAE F-35 Negotiations

Feb 15, 2022

◆

Grant Rumley

(/policy-analysis/unpacking-uae-f-35-negotiations)

ARTICLES & TESTIMONY

How to Make Russia Pay in Ukraine: Study Syria

Feb 15, 2022

◆

Anna Borshchevskaya

(/policy-analysis/how-make-russia-pay-ukraine-study-syria)

BRIEF ANALYSIS

Bennett's Bahrain Visit Further Invigorates Israel-Gulf Diplomacy

Feb 14, 2022

◆

Simon Henderson

(/policy-analysis/bennetts-bahrain-visit-further-invigorates-israel-gulf-diplomacy)

TOPICS

Arab & Islamic Politics (/policy-analysis/arab-islamic-politics)

Energy & Economics (/policy-analysis/energy-economics)

REGIONS & COUNTRIES

Iraq (/policy-analysis/iraq)