

Iraq's Budget Threat Against the Kurds

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

In response to Iraq's troubling new budget, Washington should pressure Baghdad to leave the KRG's monthly funding intact and increase the allocation for oil cost recovery.

On March 7, the Iraqi parliament passed its annual budget law by a wafer-thin majority of 168 votes, just five seats over the threshold needed to pass legislation in the 325-seat Council of Representatives. After months of delay, the budget was finally rammed through the ratification process by a fleeting alignment of the main Shiite political blocs and defectors from the predominantly Sunni Arab and secular Iraqiya list. Kurdish parties were sidelined, resulting in the passage of post-Saddam Iraq's most anti-Kurdish budget. The episode has shown that majority rule in today's fragile Iraq has the potential to be ugly and dangerous.

Since 2003, successive Iraqi governments have (with U.S. backing) paid at least lip service to the idea of a unity government and national consensus. Although the country's political system allows for clear winners and losers, conventional wisdom holds that Iraq is too fragile to risk excluding any sizeable sectarian, ethnic, or political faction from government. Initially, such exclusions were exceptional and generally voluntary, such as cabinet boycotts and resignations by ministers from Iraqiya and Muqtada al-Sadr's blocs. Since 2010, Baghdad has gradually inched toward a government within a government, with all key institutions controlled by Prime Minister Nouri al-Maliki. But there was still one area where the government generally needed to foster a modicum of national consensus: the annual budget ratification vote in parliament.

The manner in which the latest budget crisis was resolved marks a dangerous nadir for post-Saddam unity and other U.S. interests in Iraq. In a blatant stiff-arm to the Kurds, the budget allocates just \$646 million to cost recovery for Kurdistan Regional Government oil contractors -- a figure that covers only around two months' worth of the crude that Erbil was slated to provide this year. In addition, the prospect of supplemental allocations of cost recovery funding was reduced by preemptive commitments to distribute surpluses caused by higher-than-budgeted oil prices

to social welfare projects. The net effect is that 250,000 barrels per day of KRG crude is now unlikely to hit world markets, a clear setback for U.S. efforts to maximize Iraqi production, offset Iran's declining exports, and generally cushion oil prices.

Article 10 of the new legislation also gives the central government numerous justifications to make deductions from the KRG's budget, most of which comes from Baghdad. For example, if the KRG does not provide its projected 250,000 barrels per day -- which would create a gaping hole in Iraq's budgetary revenue assumptions -- Baghdad reserves the right to withhold KRG funding. Funds may also be withheld if Erbil interferes with federal plans to use KRG airspace, communication frequencies, and power/phone lines.

If carried out, any such threats to economically strangle the KRG could drive Turkey to allow high-volume exports of KRG oil through its territory, independently of Baghdad; Washington hopes to prevent this. If tensions rise sufficiently high, and if the Kurds see further deterioration of their financial incentive for remaining part of Iraq, a hot war could erupt in the north between federal and KRG forces, with obvious negative effects for Iraqi unity.

It is too late to undo last week's budget move, which though ill advised was entirely legal. But Washington should put as much pressure as possible on the Maliki government to leave the KRG's monthly funding intact and shift money within the new budget to provide sufficient KRG cost recovery. The line to take is simple and convincing: helping the KRG will give Baghdad more revenue to fix its ailing electricity sector, which will be a key driver of antigovernment protests in the all-important Shiite provinces as summer power cuts begin. In contrast, threatening the KRG's funding would give the Kurds and Turkey an opening to justify closer bilateral ties.

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

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