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Low Oil Prices Complicate Iraqi Kurdish Independence

Mohammed A. Salih



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Iraqi Kurdish journalist Mohammed A. Salih explores the impact of low oil prices on Iraqi Kurdistan. Deepening economic and financial crises in Iraq's Kurdish region are likely to impose limitations on the semi-autonomous region's quest for statehood. However, this does not suggest that a rapprochement between the Kurds and federal authorities in Baghdad is imminent. If unaddressed, a prolonged state of economic crisis and budget deficits will also add more strain on the ability of the Kurdistan Regional Government (K.R.G.) to finance the costly war against the Islamic State, otherwise known as ISIS, which could potentially affect morale within Kurdish peshmerga ranks.

KEY POINTS

- ◆ Fluctuating levels of oil production coupled with a dramatic drop in oil prices starting in summer 2014 have led to economic crisis in Iraqi Kurdistan.
- ◆ The K.R.G. has severely mismanaged its few resources by failing to push for strategic development, invest in industry, and diversify the market.
- ◆ Economic crisis has curtailed the K.R.G.'s immediate hopes for independence.
- ◆ The United States should financially assist peshmerga fighters to ensure morale in war against ISIS does not drop.
- ◆ The United States should use its extensive leverage to pressure Kurdish authorities to carry out meaningful economic and political reforms.
- ◆ Cooperation between Baghdad and Erbil is essential to defeat ISIS, and the United States can play a significant role in bridging differences.

BACKGROUND TO THE K.R.G. FINANCIAL CRISIS

Since the ratification of the new Iraqi constitution in 2005, the K.R.G. has received from Baghdad around 17 percent of Iraq's national budget annually after certain sovereign and governance expenses were deducted. That amounted to around \$13 billion per year in 2012 and 2013 when oil prices were at their peak. The injection of such hefty sums in addition to at least \$37 billion¹ in private foreign and domestic investment generated rapid economic growth² and unprecedented signs of prosperity among Iraqi Kurdistan's approximately five million people. But this started to change when in November 2013 K.R.G. Prime Minister Nechirvan Barzani signed a "strategic" deal³ with neighboring Turkey to export Kurdish oil and gas to that country for the next 50 years. Although the deal was meant to cement Iraqi Kurdistan's position as a major energy exporter and assist its economic independence, the move backfired as Iraqi Prime Minister Nouri al-Maliki retaliated by suspending the K.R.G.'s budget share⁴ in February 2014.

Pressed hard for cash, the K.R.G. sought to step up its independent oil sales, but Baghdad's threats to sue buyers meant there was little willingness to purchase Iraqi Kurdish oil internationally. The war with ISIS, however, eased the pressures on the K.R.G.'s efforts to export its oil directly as it was in urgent need of cash to both finance a costly war against the jihadist organization and also provide for its population in addition

Mohammed A. Salih



Mohammed A. Salih is an Iraqi Kurdish journalist. He has written about Kurdish and Iraqi affairs for local and international media, and holds a master's degree from the Missouri School of Journalism. He is based in Erbil.

to nearly two million Syrian refugees and internally displaced Iraqis who had relocated to Kurdistan. But fluctuating levels of oil production coupled with a dramatic drop in oil prices starting in Summer 2014 meant that the K.R.G.'s total revenues from oil sales did not even reach \$6 billion per year in either 2014 or 2015.⁵

By the end of 2015, the K.R.G. was between three and five months behind in paying its nearly 1.4 million employees. Faced with grim economic and financial prospects, the K.R.G. has now slashed the salaries of its civil servants, ranging from 10 to 75 percent depending on rank and salary level.⁶ The salary cuts, however, have not included the security forces in an apparent attempt to maintain order and stability. The government has come under heavy criticism for not articulating a clear vision for serious reforms beyond the strict austerity measures it has introduced.

As a result of the economic crisis, much of Iraqi Kurdistan's public sector is now paralyzed as many government institutions, including at times the health and education

sectors, have gone on strike. The situation is particularly acute in Sulaimaniyah province and the nearby Garmiyah area where anti-establishment sentiments are stronger. Struggling to pay its dues, the K.R.G. is estimated to now be \$14 to \$20 billion in debt.⁷ This includes a \$1 billion loan from Turkey, entitlements owed to international oil firms and local companies and delayed payments to those on the K.R.G.'s payroll.⁸

ECONOMIC MISMANAGEMENT AND PUBLIC DISCONTENT

The K.R.G. failed to capitalize on the peak revenue years of 2012 and 2013 by investing in meaningful economic development and diversification. The current times of low oil revenue have, thus, exposed the K.R.G.'s severe mismanagement of the economy. "People were anaesthetized when the government had the money to feed them," said Sardar Aziz, a senior economic and energy advisor to the speaker of the Kurdish regional parliament.⁹ The K.R.G. lacked a clear vision to develop a productive economy by reviving agriculture or making a serious attempt to build industry. As a result, Iraqi Kurdistan was largely transformed into a consumerist, government-reliant society that had to massively import its basic food items and other essential goods.

In addition to failing to prioritize economic investment, the K.R.G. wove its economic fortunes within its political fabric, resulting

in an expanded patronage network to boost the standings of major political parties. The lucrative budget it received from Baghdad went mostly into paying the vast public sector that developed out of an unhealthy competition between the two major K.R.G. parties, the Kurdistan Democratic Party (K.D.P.) and the Patriotic Union of Kurdistan (P.U.K.), to buy political allegiance. Despite much ado about building a capitalist, free-market economy, the government failed to ensure fair competition in the various sectors of the market. The Kurdish private sector and key businesses such as telecom, energy and trade are monopolized by those with connections to the ruling political elite, mostly from the two dominant parties.¹⁰ Some of these major companies are also reportedly exempt from paying taxes.¹¹

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The siphoning of the country's wealth has been a particular source of discontent among ordinary Iraqi Kurds, who are now feeling the pinch from the plummet in oil revenues. Popular protests have been intermittent over the past few months as a result, and in some cases, offices of political parties have been attacked. Protesters are

demanding that individuals who, they accuse, have profited from their connections to the ruling parties return their “illegal” earnings to the public treasury. Regardless of the truth of such accusations or the extent of such ‘illegal’ practices, this has been a firm element in the public’s perception of the ruling powers in the K.R.G. and, as such, a major contributor to the ongoing protests and the raging sense of disgruntlement toward the elites.

“Now that there is no money, everyone feels there is money somewhere and that that money needs to be returned to the public economy or treasury and allowed to circulate,” is how Aziz described the current thinking among ordinary Iraqi Kurds.

Deep political divisions and the desire of the ruling elite to preserve their interests make any popular push for structural economic reforms difficult. However, failure to enact meaningful reforms that address the grievances of the population, especially young Kurds, will continue to undermine the K.R.G.’s stability in the years to come.

THE QUEST FOR STATEHOOD

The deteriorating economic conditions in Iraqi Kurdistan will likely restrict the K.R.G.’s maneuverability with regard to its declared efforts for independence and render it more susceptible to pressure from the outside world, in particular powerful neighboring countries such as Turkey and

Iran. Voices opposing Kurdish independence have also been rising in the international arena, with German and E.U. foreign policy chiefs expressing concern over such attempts.¹²

Struggling hard to pay people on its payroll and under heavy debt, it is difficult to foresee how the K.R.G. is going to administer an independent country given the risks that will arise as a result of it. None of the neighboring countries of Iraqi Kurdistan have voiced support for Kurdish statehood. Although many might pin their hopes on the region’s oil exports, the government’s levels of production are far behind declared targets. The K.R.G.’s energy minister stated in 2013 that oil production in the Kurdish region will hit one million barrels per day by 2015, but a recent report by his ministry put production level at the end of last year at around 436,000 barrels per day.¹³ The K.R.G.’s oil is largely exported through a pipeline to the Turkish port of Ceyhan on the Mediterranean Sea and the rest is shipped to Iran and Turkey by trucks. Iraqi Kurdish oil is believed to be sold at rates lower than the Iraqi national oil largely due to risks associated with purchasing it.¹⁴ Moreover, given that the pipeline passes through an area in Turkey that witnesses frequent clashes between Turkish forces and the Kurdistan Workers Party (P.K.K.), the K.R.G.’s exports are at the mercy of geopolitical events beyond its control. Oil exports have been currently on hold for several weeks due to an act of sabotage against

the pipeline, costing the K.R.G. a loss of around \$200 million in oil revenues.¹⁵ Such occurrences will further undermine the K.R.G.'s ability to meet its budget requirements.

“The K.D.P. might be using independence as a card for internal legitimacy”

The major proponent for the push toward statehood is the K.D.P. and its leader Masoud Barzani, who also serves as the president of the K.R.G. despite ongoing objections from rival Kurdish parties about the legitimacy of his tenure. He has called for a referendum to be held, but cautioned that it will not mean immediate independence.¹⁶

While many might find it perplexing that Iraqi Kurds would push for independence under such exigent circumstances, an important part of the K.D.P.'s calculation is that there is no longer a future for Kurds in an Iraq torn apart by sectarian strife.¹⁷ Some say that conditions for an independent Kurdish state have never been as favorable over the past century as they are now, as the traditional centers of power in Baghdad and Damascus are bogged down in internal conflicts and the Kurds' weight has grown in Iraq and Syria, partly due to their central role in fighting ISIS. But Ankara and Tehran remain strongly opposed.

The K.D.P. and its leader might also be using independence as a card for internal legitimacy, leverage over its domestic rivals such as the P.U.K. and Gorran Movement (a largely anti-establishment party), and to establish itself as the leader of Kurdish nationalist ambitions, particularly in the face of the P.K.K., which has seen its popularity soar among Kurds in the region as a result of their successes against ISIS in Syria.¹⁸

Without strong and reliable support from at least one of the big neighboring countries, Turkey for instance, any push for independence will likely be counterproductive to the interests of the Kurds, particularly in the short run.

THE FIGHT AGAINST ISIS

So far the economic strains have not had a noticeable impact on the K.R.G.'s military campaign against ISIS. Thanks partly to Western military aid and air support, Kurdish peshmerga forces have successfully fought the jihadist group for nearly two years, despite the government falling behind for three months in paying their salaries. However, if oil prices stay low and outside support is not provided, there may be serious repercussions with regard to the peshmerga's performance vis-à-vis ISIS. While mass desertions are unlikely, morale might be dampened if salaries continue to go unpaid.

With an annual cost of over \$2 billion, according to Kurdish officials,¹⁹ financing the war against the jihadists along a fault line of over 1,000 km has put a heavy burden on the K.R.G. Kurdish leaders have repeatedly appealed to Western countries for financial aid, pointing to the difficulty of paying their peshmerga forces numbering at around 150,000.²⁰ Some U.S. senators are trying to provide emergency financial aid to the Kurds,²¹ but this appears to be bogged down in continued debate over how to support the Iraqi Kurds—either directly or through the federal authorities in Baghdad.

As a major ground force in the fight against ISIS, peshmerga forces need financial aid from their Western backers—especially if the K.R.G.’s economic situation further deteriorates.

RELATIONS WITH BAGHDAD: DEAL OR NO DEAL

Iraqi Kurds have run their own affairs ever since a popular uprising against Saddam Hussein in 1991. After the fall of Saddam’s regime in 2003 and Kurds’ reintegration into Iraqi politics, the federal budget has been the major cord tying Kurdistan to Baghdad. When Maliki cut off the K.R.G.’s share of the budget as a punitive measure in February 2014, he also cut the main link between his government and the Kurds.

Regardless of whether it will declare independence, there is little common ground upon which the K.R.G. and Baghdad can re-establish their relations. The Kurdish

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attitude toward Baghdad is shaped by a deep sense of mistrust and they are determined to maintain their current degree of autonomy, including full control over their energy resources. The latest of a series of deals²² between Baghdad and Erbil in late 2014 collapsed in mid-2015 due to mutual accusations and recriminations—Baghdad accused the K.R.G. of not handing over the 550,000 barrels per day they agreed to deliver, while the Kurds accused the Iraqi government of not fully providing them their financial dues.²³

One key problem is the lack of clear incentives for either side to adhere to the terms of the agreement. For as long as oil prices are low, Baghdad has little incentive to take the K.R.G.’s oil and pay it an amount that is more than the K.R.G.’s oil output. However, if oil prices recover, the K.R.G. will have little incentive to hand its precious oil

to Baghdad because, as a prominent P.U.K. member of parliament said, selling oil above \$50 per barrel will be enough to cover the K.R.G.'s costs.²⁴ Whether or not they achieve formal independence, the Kurds will do their utmost to run their own affairs as independently from Baghdad as possible.

INTERNATIONAL GUARANTEES

For the federal government and the K.R.G. to be able to cooperate meaningfully again, high-level mediation and strong written guarantees from third parties such as the United Nations or the United States are needed. Without such international guarantees, any attempt at reaching new deals between Baghdad and Erbil will be short-lived at best. Given the mistrust between the two governments, the United States, which enjoys strong relations with both Baghdad and Erbil, might be the only interlocutor that can facilitate a binding agreement and use its leverage to ensure both sides adhere to the terms of their agreements.

Cooperation between Baghdad and Erbil is essential for the defeat of ISIS—a high priority shared by the federal government and the K.R.G., as well as the two main external influencers in the country, the United States and Iran. While oil has been a source of disagreement between Baghdad and Erbil, the war on ISIS can be utilized as a platform from which to build bridges, and the United States can help on this front. But this all has to be done within the

framework of a larger agreement, with solid international guarantees, that resets the relations between the K.R.G. and Baghdad and puts them on a positive path.

The dire financial situation of the K.R.G., and the direct impact it may have on the front lines, should peshmerga salaries continue to go unpaid, warrants a U.S. and/or international response. Despite the many shortcomings of the K.R.G., it has proven itself to be an element of stability and relative freedom in a region often seen or characterized as otherwise. It has also been a steadfast ally to the United States and the West. As the main guarantor of Kurdish security, Washington not only has a fundamental interest in preserving the K.R.G., but should also use its extensive leverage to pressure Kurdish authorities to carry out meaningful economic and political reforms before it becomes too late.

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