

Who Will Have the Upper Hand in the New Turkish-KRG Energy Alliance? *By Munir Chalabi **

1-Introduction

The Middle East is in a state of turbulence, politically as well as in terms of its position with regard to Energy, and Iraq would seem to be an apparent case of this turmoil.

The Kurdistan Regional Government (KRG) has begun to export crude oil directly to world oil markets through Turkey. The KRG began exporting its own very light oil, or condensate, independently to world markets in October 2012 by trucks to a Turkish port, where it was sold via an intermediary (1).

At the same time, Turkey, with its vibrant economy, lacks energy and is increasingly dependent on foreign oil and gas imports. The autonomous KRG is oil and gas rich but land-locked. With the new agreement with Turkey, it will be able to ship its oil and gas directly through pipelines. Turkey can be guaranteed that its energy needs are met for the foreseeable future, and KRG can ensure its economic independence from Baghdad.

A Kurdish-Turkish alliance could be a potential geo-political game changer.

The KRG signed the first barter trade agreement with Turkey on the 18th January 2013. The Ankara-based “Genel Energy” will be the first Turkish company to ship oil directly from Kurdistan to Turkey through a pipeline under an agreement between the Turkish government and the KRG.

Baghdad fiercely objected to the Turk-Kurd trade agreement, with Iraqi Oil Minister Abdul Kareem Luaibi threatening to sue Genel Energy and slash the central government’s allocation of 17 percent of oil and gas revenues to the region unless the KRG halts direct oil export to Turkey (Reuters, 18 January 2013).

Turkey and the KRG have now fully negotiated a final framework of the deal, including stakes in at least a half a dozen exploration blocks and terms for the direct pipeline export of oil and gas from the KRG, and various aspects of the energy deal will exist within a commercial, and not political, framework.

To facilitate the investment, Turkey is currently creating a new public-private energy company that will eventually assume the KRG portfolio; in the early stages, the Turkish counterparty will likely be the state company Botas or its newly acquired subsidiary, TPIC.

Whatever its precise composition, the Turkish company will ultimately sign production sharing contracts (PSCs) for several Kurdish exploration areas.

These pipelines would meet at the border, and the Turkish government – rather than concluding an agreement with the KRG – could simply approve a private company's application to import hydrocarbons from a third party.

The Turkish company Calik has already applied to build a crude pipeline that would run parallel to the existing Iraqi pipeline to the Mediterranean port of Ceyhan; another Turkish firm, Siyahkalem, has applied to build a gas pipeline.(2)

The Federal government in Baghdad is viewing such developments as an egregious threat to Iraqi sovereignty.

Amidst the domestic political deadlock, the KRG has looked to Turkey. And as Turkey has taken steps to grant an alternative export arrangement, they have also reduced the Kurds' incentives to compromise with Baghdad.

2– What does Turkey want to accomplish from this alliance?

The Turkish policy objective can be summed up in the following aims:

First, the Turkish policy is part of the plan to ensure the fragmentation of the neighbouring countries to the south of Turkey including Syria and Iraq. This can be achieved by promoting nationalist and sectarian differences which will result in the fragmentation of two countries. Thus Turkey could impose economic, political and military control on the southern axis of Turkey. *Therefore we should look at the Turkish intervention in Iraq and Syria as corresponding to one political scheme.*

Second, Turkey and Iran are the two largest economic and military powers in the region and therefore the Turkish policy depends mainly on the weakening of any Iranian influence and interests, which will result in the strengthening of the Turkish influence at the expense of that of Iran.(3)

Third, and most importantly, the Turkish economy is one of the few strong economies that are undergoing development despite the economic crisis experienced by most industrialized countries. However, an important economic factor in the Turkish economy, which is a major threat to this economic progress, is the urgent need of the Turkish industry for energy resources that are not available in Turkey, namely oil and gas.

The newly discovered enormous oil and gas fields in the KRG areas are estimated to have a reserve of more than 24 to 28 billion barrels of oil (bb) (and could reach up to 38 bb including the reserves of the so called “disputed areas”). (4)

This may make turkey’s foreign policy concentrate its economic and political power in the province in order to ensure its control of the economy of the province.

The KRG is an especially attractive alternative because Turkey holds so much leverage to negotiate prices. Only with access to Turkish ports can Kurdistan

develop its oil industry – and generate revenue – to a degree that will grant it economic power independent of Baghdad.

Turkish authorities have developed a plan to assume unprecedented control over revenues from Iraq's northern oil exports.

Under this arrangement, revenue from all Iraqi oil exports through Turkey – from both the KRG and federal entities – would flow into a Turkish-controlled account that would ultimately be divided proportionally between KRG and Baghdad.

Until now, export revenues have been controlled exclusively by the Iraqi central government, which considers the 50-plus deals signed by the KRG to be illegal. The new account mechanism would fundamentally change that dynamic by giving the KRG and its oil contractors, direct access to a portion of the revenue from Iraq's northern exports. Turkey would essentially act as a guarantor of the KRG's oil sector and its contracts.(5)

The deal represents a dramatic shift in Turkish foreign policy, away from Baghdad and toward a strategic alliance with Erbil.

The deal would also likely serve to guarantee payments to oil contractors who under the terms of the KRG's production sharing contracts could claim rights to a portion of the exports and the resulting revenue.

After those deductions are made, 17 percent of the remaining revenue would be transferred directly to the KRG. The remaining 83 percent could be claimed by Baghdad.

This policy appears to serve several purposes:

First, it represents an ultimatum to Baghdad, as the Federal government would have to accept the new mechanism or else cut off exports to Ceyhan - a prospect that would be financially costly and strategically painful.

Second, the policy would allow the KRG to begin exporting immediately through existing pipelines. Before it leaves Iraqi territory, the pipeline that runs from Kirkuk to Ceyhan passes through the KRG areas. Kurdish contractors could send oil - by truck or through prospective pipelines - to the Feyskabor metering station.(5)

3 – The concern over the Kurdish province breaking away from Iraq:

All Arabs in Iraq should recognise the national rights of Iraqi Kurds. Among these rights is the right to break away from the Iraqi state if the vast majority of the Kurdish people vote for separation.

But the Iraqi Arabs should have the right to express their opinions on this issue.

Such views can be summarised in the following points:

First, the Iraqi Kurds and Arabs have become socially and economically concurrent since Iraq established its current geographical borders in 1921, as determined by the Conventions of Sykes – Picot Agreement in 1916.

Second, Iraqi Kurds believe that their fate inevitably is unification with Turkey's, Iran's and Syria's Kurds because they are one nation. This could be true in theory, but the Kurds in these countries have become socially and economically coexisting parts of these three countries as was determined by the same Sykes – Picot agreement.

Third, the Iraqi Kurds believe that the Kurds in Turkey, Iran and Syria and their political leaders will accept the tribal leadership of Massoud Barzani to lead them as one nation. The Kurds should take lessons from the Arab world where Arabs suffered from the same treaty and at the same time were divided into more than 22 Arab countries, with 22 opposing rulers.

Why would the Iraqi Kurds believe that the leaders of the PPK and the Turkish Kurds be less hostile to Massoud Barzani, than the existing hostilities between

the Arab rulers? And how could the Iraqi Kurds forget the lessons of 1996 when Massoud Barzani signed a secret agreement with Saddam Hussain, in which Saddam attacked Erbil which was at that time under the control of Jalal Talabani's Peshmerga, and handed over the city to Barazani?

Fourth, if the Iraqi Kurds do go ahead and break away from Iraq at this time - with a population of less than 4 million people in the new KRG's state – by all accounts the new Kurdish state will be fully dependent economically and geographically on Turkey.

If the Iraqi Kurds wanted to be part of sovereign federal Kurdish province, they would be independent in name only and they will almost certainly be no more than a subsidiary under the full control of the Turkish government.

4 – What should be the shape of the “financial quota system” in any agreement between the federal government and the KRG?

First, the federal oil ministry should work to reach an “*interim*” agreement with the KRG by direct negotiations in respect to the percentage of the state budget which should be allocated to the KRG. The deal could be used as a provisional agreement which should give the province between 12.7 and 17%.

One way is that both sides should agree on middle figures, for example 15% and to agree between them to look again at the calculation of any difference (with interest) after a general census is carried out. The results of the census shall be considered as a “concluding reference” for the calculation of any differences.

Second, the federal ministry of oil should count every barrel of oil produced in the KRG areas, and should add gas production as “*oil equivalent*” (6000 cubic

feet of gas equivalent to 1 barrel of oil) as part of the total production in Iraq in each financial year.

If the quantity of production of "*oil equivalent*" in the KRG is equal to the number agreed upon between the two governments as being the KRG's share, then there shall be no additional payments to be made by the federal government to the KRG. This will be regardless of the amount of money the KRG received from the IOCs for each barrel of "*oil equivalent*" as a result of the production sharing contracts (PSCs) held between the KRG and IOCs.

Hence if what is produced in the KRG areas of "oil equivalent" (not what they actually sold or what they consumed internally or smuggled abroad) is less than the quota agreed above, then the federal government should pay the difference to the KRG.

However, if the amount of oil production by the province was more than the region's share agreed upon, then the federal government should ask the provincial government to pay them back the difference of "*oil equivalent*".

This will be the most sensible and fair method to both parties.

5 - The dilemma of the new energy law:

It has become apparent that no agreement will be reached between the federal government and the KRG on a new energy law, at least not in the near or medium future. This is due to the wide differences between both parties.

This will require the following steps to be carried-out:

First, it is quite obvious that the KRG will not agree to any changes to the oil and gas law of the region, which was passed by the KRG's Parliament in 2007, and which was based mainly on PSCs between the KRG and the IOCs.

Based on the above concept, the federal government should go ahead and seek to pass a new federal energy law in the federal parliament, away from the 2007 drafts.

The new federal law should disallow any privatisation of the oil and gas resources in Iraq, and therefore reject any models of contracts which will privatise the Iraqi state's resources, including all modules of PSCs.

The Federal government should also go ahead and pass such a law, but should take into consideration that the two Kurdish parties are likely to reject such a federal law, and they would reject its application in the KRG's areas.

Second, in addition the Federal Government should be watchful not to accept any of the PSCs which were signed by the KRG, because if they do accept any such PSC agreement then they will give international legitimacy to the PSC module of contracts.

All the existing PSCs signed by the KRG, are not legitimate under international law as the KRG is not an Independent state, and therefore any such type of agreement should first be accepted by the Federal Government if they are to become internationally accepted, as this is the only party which represents the Iraqi state.

6 – The predicament of the so called "disputed areas" between the federal government and the KRG:

The 2005 Iraqi constitution, stipulates in Article 140 that Kirkuk is the only governorate which will decide its fate with a referendum. This is due to the plurality of the population in this governorate.

The KRG did not allege in 2005 when they agreed on the Iraqi constitution, any Kurdish demands on any of what they later called "disputed areas" in the

governorates of Nineveh, Salahuddin and Diyala. It is only after 2007, when they discovered the oil and gas fields, that they sent the KRG armed forces - the "Peshmerga" - to take control of them by force.

What should be the policy of the federal government?

First, as the final resolution of the dispute over Kirkuk had been covered by Article 140 of the Constitution, and since the population census had not been carried out, as required by the Constitution, before any referendum can be called, and due to the sensitivities of the differences and the strong feeling of nationalism, it is necessary in this current situation that both parties should negotiate to make Kirkuk a "*governorate with special status with a supplementary power*".

All the Kurdish Peshmerga forces and the federal government army units should withdraw from Kirkuk and the elected local administration in Kirkuk should be given additional powers and become a "*special administration*".

Second, all oil and gas fields in Kirkuk must stay covered by the current federal laws, the laws which are in force on all fields since nationalisation in 1972. The Federal authorities should not accept any PSCs on any oil and gas fields in Kirkuk, as such agreements contradict the existing laws which were enforced since 1972. The existing oil and gas fields should stay managed by the "Iraqi North Oil Company".

Third, the federal government should rebuff any agreements made by the KRG on any oil or gas fields in the governorates of Ninewa, Salahdyen and DIALYA as the 2005 Iraqi constitution does not recognise any areas in the three provinces as disputed areas. This should include all the fields which the KRG's Kurdish Peshmerga occupied by force.

Article (111) of the Constitution states: "the oil and gas belongs to the people of Iraq in all the regions and provinces."

The KRG did not pay any compensation whatsoever to the Federal treasury, and did not share any financial burdens outside the KRG areas. They did not even provide to the so-called "disputed areas", any amount of financial obligation and only the Federal Government are covering all the costs. (6)

All these so called "disputed areas" were under the administration and control of the federal government, and remained so during the presence of American troops between 2003 and 2005. But starting from 2006, the American forces started to withdraw from these areas and were replaced by the Peshmerga forces, which then dominated and took complete control of them.

It is quite obvious that all the above points are closely linked together. The federal government and the KRG should negotiate to resolve all the above issues as a "single package". The Federal government in Baghdad should take a determined stand, as this is the most sensible way of providing a practical solution to the differences between the federal government and the KRG.

If the Federal Government continues to concede to the KRG's demands, then this will most certainly lead to the KRG's separation from the Iraqi state, as was the case in the break-up of Sudan.

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