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Iraq, the KRG, Oil, and the Revision of Borders

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Events taking place in northern Iraq, especially with regard to crude oil issues, are ominous when it comes to the territorial integrity of the country. The two Kurdish provinces that form the Kurdish Regional Government (KRG) and border Turkey and Iran have long said that they would declare independence. Much of this talk has been used to obtain advantages in negotiations with the central government in Baghdad.

The Kurds obtained assurances that they would receive 17 percent of the gross income of all of Iraq's oil sales. This is in line with their share of oil income when the UN managed Iraq's sales. They also obtained the right to self govern in all aspects except for foreign affairs and oil issues, and they have maintained their well-known militia, the peshmerga. However, since the post-Saddam constitution the Kurds have had disagreements with Baghdad. The two main bones of contention are the status of Kirkuk and the oil law.

The constitution of Iraq provided for the province of Kirkuk, which lies just south of the two Kurdish provinces, to vote by referendum on whether it should be attached to the KRG, but Iraq has failed to organize the vote. The Kurds believe that Kirkuk is the heart of Kurdistan and only lost its Kurdish population when Saddam physically expelled Kurds and replaced them with Iraqis from the southern provinces. Since the beginning of the Iraq War in 2003, the Kurds have repopulated Kirkuk. The Iraqis argue that Kirkuk is also the geographic center for the Turkmen, who are part and parcel of the Iraqi nation and should not be dominated by the Kurds. The refusal on the part of the Iraqis to implement the referendum is a sign that they expect Kirkuk to vote to join the Kurdish territories.

Kirkuk sits on the second largest oil field in Iraq. The Iraqi state-owned Northern Oil Company is presently exploiting the field and receiving approximately 250,000 barrels/day (b/d) from it. This amount is much lower than its potential, which could be as high as two million b/d. Iraqis fear that if the Kurds take back Kirkuk, they will claim the oil field—at least those parts that are not presently managed by the Northern Oil Company.

Immediately after the arrival of U.S. forces in 2003 the Kurdish parliament, in direct opposition to the Iraqi federal government, which deems itself fully responsible for natural resources, voted for an oil law that gave Kurds the right to sign production sharing agreements (PSAs) with foreign oil companies. PSAs give the oil companies a large share of production—over 40 percent—which allows them to write the oil reserves on their balance sheet as their own. In contrast, Iraq's oil law, which would give oil ownership to the provinces and was originally drafted by the Americans, has not been passed. Iraq's parliament has been wary that the proposed law could bring about the breakup of the country.

In the meantime, the Ministry of Oil has sought to redevelop Iraq's ample reserves of around 150 billion barrels by bringing in foreign companies' technology. The international oil companies (IOCs) working in Iraq are allowed to invest in the existing fields, but Iraq keeps full ownership and control of them. This arrangement was accomplished through technical services contracts (TSCs), which give the IOCs a small contribution per barrel. Most major oil companies bid on the Iraqi oil acreage, and enough contracts were signed to give Baghdad the potential to produce 12 million b/d.

However, the companies that signed the TSCs have been frustrated by bureaucratic tangles. Oil production in Iraq has not increased as quickly as it could. As a result, the large IOCs have not earned as much as expected and have been seeking to renegotiate or escape their contracts. ExxonMobil, for example, obtained the right to redevelop the West Qurna field in the south; it is now producing close to 500,000 b/d from it, on which it earns $1.9 per barrel. While this is a fairly substantial profit, it is far from the two million b/d that ExxonMobil would need to return 30 to 35 percent on its original investment—the usual requirement of most IOCs. ExxonMobil has very publicly spoken of its dissatisfaction with the Iraqi bureaucracy and of its desire to sell its stake in the field.

Such problems have led many oil companies to seek alternatives in the Kurdish territories. The Kurds have some fairly small fields that are presently exploited by smaller IOCs and produce around 200,000 b/d. This oil must be exported through Turkey. The only pipeline currently available for Kurdish export is one that links the Kirkuk field through non-Kurdish territory to Turkey. If the Kurds use this pipeline, the oil is sold by Iraq's State Organization for the Marketing of Oil (SOMO). SOMO receives the payments and in turn pays the companies in the Kurdish territories for their expenses and profit share, as stated in their Kurdish profit sharing agreements. The Kurds then get the 17 percent of SOMO's oil revenues.

There are major disputes between the Kurds and the Iraqis on the meaning of these oil laws. The Iraqis claim that the Kurds have no right to sign PSAs independently from the Iraqi oil ministry. Hence, payments from Iraq to the KRG are late, delayed, or not made at all, and the Kurds have often avoided shipping oil through the Iraqi pipeline. Indeed, they currently export by truck to Turkey. The Iraqis claim that trucking 200,000 b/d is in fact smuggling, as the payments for these barrels do not go through Baghdad.

In the midst of this acrimony, the Kurdish territories are developing rapidly, mainly due to trade between the Kurds and the Turks. Turkish firms have become the largest investors in the KRG. The tragic battles between the Turks and the PKK, the organization of Turkish Kurds that seeks independence for the Kurds in Turkey and that has claimed many thousands of both Turkish and Kurdish lives, has recently negotiated a settlement in which the Kurds have the right to teach Kurdish in schools and maintain their culture and identity while remaining within the Turkish nation.

Part of the growing relations between the Kurds of the KRG and the Turks consists of a one million b/d capacity pipeline being built by Turkish firms. The pipeline will bring Kurdish oil directly into Turkey, bypassing the need to use the existing Iraqi pipeline and giving the oil companies active in the territories the ability to not only export their existing production but to increase that production.

Due to this development, ExxonMobil, Chevron, and Total have signed TSCs with the KRG, to the great annoyance of Baghdad, who has threatened to cancel ExxonMobil's contract in West Qurna. Yet Iraq needs ExxonMobil's technology and capital, and ExxonMobil has masterly used its contacts with the Kurds to extract assurances from the Iraqis of fewer bureaucratic problems in the south and the possibility of increasing its fee per barrel.

The small oil field in the Kurdish territories in which ExxonMobil has taken a share has the potential to produce 200,000 b/d, which would almost double the KRG's present production. Why would ExxonMobil risk alienating Baghdad and potentially lose a contract in the south for a mere and uncertain 200,000 b/d in the north? One can surmise that ExxonMobil, as well as the other large IOCs, are willing to sign with the KRG because they smell the possibility in the medium term—if not the short term—that the KRG will take over Kirkuk and its subterranean wealth. If ExxonMobil, Chevron, or Total could use their advanced technology of oil recovery in the Kirkuk field, the field could likely produce one or two million b/d.

Such large production would make the KRG very wealthy, provide excellent reserves and income to the IOCs, and bring a large volume of crude oil through Turkey. The oil would allow the KRG to develop its economy for the benefit of Turkish traders and manufacturers and help Turkey and Europe diversify their sources of crude oil.

This scenario implies great cooperation between Turks and Kurds, a sea change from the past, but this is not as farfetched as it might seem. Undoubtedly, the KRG will continue to make its push for getting hold of Kirkuk while the Turks build the necessary pipeline and the IOCs provide the capital and technology necessary to increase production. Further, the presence of the IOCs could serve as a guarantee of non-intervention from the United States in a politically charged area in which, due to the Syrian tragedy, the Syrian Kurds are drawing closer to the PKK, the KRG, and ultimately Turkey.

Some argue that such an arrangement will be stymied by Iraq using military force against the Kurds to stop them from allocating the oil field of Kirkuk to the IOCs in defiance of the existing operations of the Northern Oil Company. In other words, the fear is that the Iraqis would use coercion to keep the federation together, thus marginalizing the KRG and limiting IOC investments. It seems, however, that the peshmerga may be able to fend off a weak Iraqi army preoccupied with the Sunni uprising in central Iraq. Further, in an interesting twist, the Turkish military could intervene on the side of the Kurds against the Iraqis.

The perhaps more compelling theory is that the Turks are using the Kurds to ultimately obtain contracts and oil rights in the south from the Iraqis. This mercantilist view of Turkey could indeed be accurate, but it does not necessarily negate the possibility that the Turkish government and businesses are seeking to both increase their influence in the KRG as well as in the south.

In conclusion, it appears inevitable that the KRG will move toward independence. Though it will use the wealth from its existing oil reserves, it will mainly use the promise of the Kirkuk field to attract the capital of the IOCs. Such a situation may not necessarily result in a military confrontation between Iraq and the Kurds, as Iraq may not currently favor defending a "sacred federation" or a union. KRG independence inclusive of Kirkuk and its oil would benefit the large IOCs, the existing KRG, and Turkey. However, it would change the border, which could serve as a negative precedent in which the Kurds then establish a similar state in Syria. Would Iraq's Arab Shiʿa in the south, also endowed with huge oil reserves, then shake loose from Baghdad? Would Syria break up into an Alawi state, a Kurdish state, a liberal Sunni state in Damascus, and a Salafi state in the east? The combinations appear to be countless.

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