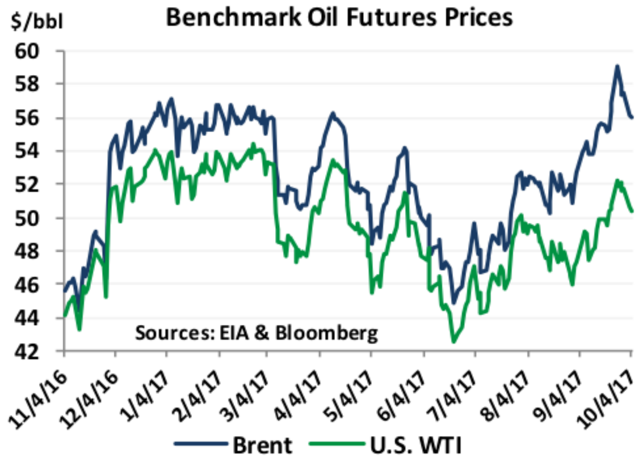
Kurdish Oil Exports under Threat after Independence Referendum. by Diane Munro

The Kurdistan Regional Government's (KRG) controversial referendum on independence has sparked fears of a disruption to Iraq's northern oil exports amid a firestorm of opposition from the central government in Baghdad, neighboring Turkey and Iran, as well as Western powers. Global oil prices scaled two-year highs last week on concerns that the backlash against the September 25 referendum may not only lead to a cutoff in Kurdish oil exports, but may also spark civil unrest in OPEC's second largest producing country.

Of immediate concern to the oil market are threats by Ankara to halt oil exports from the landlocked semiautonomous Kurdish region, which rely on a Turkish-controlled pipeline to the Mediterranean port of Ceyhan. Approximately 550,000-600,000 barrels per day (kb/d) of oil from the northern region of the country is exported via Ceyhan. Oil exports are the lifeline that provides 80-90 percent of KRG revenue.



Though the threat to cut off exports remains a major focus of the market, oil prices eased from their peak levels as a more tempered assessment of ample global crude supplies allayed initial concerns over a potential supply disruption, at least for the time being. The KRG's long-time economic partner Turkey is especially aggrieved Erbil moved forward with the contentious referendum over its strong objections amid fears the measure will spark further unrest among the country's own restive Kurdish population. Turkish President Recep Tayyip Erdogan described KRG President Masoud Barzani's decision to hold the referendum as a complete "betrayal." Turkey and the KRG have been allies for almost a decade with strong trade, economic, and military ties.

Inflammatory Rhetoric

A cauldron of contentious issues threatens to boil over at any time, injecting more volatility into oil markets. Concerns focus on retaliatory measures, including military action by Baghdad and Ankara, and fears that ethnic rivalries will erupt in the region and

a fractured Iraq will emerge. Iraqi Prime Minister Haider al-Abadi closed Kurdish airspace to international flights and asked international oil trading firms to cease buying crude from the region. In addition to cutting off export flows, Erdogan also threatened an ominous military response: “We may arrive one night, suddenly.”
The unusual and unlikely constellation of governments opposing independence for the Kurdistan region concurred that the referendum lacks legitimacy. Baghdad has been steadfast in its strategy to maintain unity while both Iran and Turkey see an independent Kurdistan as a threat given their own large Kurdish populations. Approximately 6 million Kurds live in Iraq with a further 30 million in Syria, Iran, and Turkey. Erdogan embraced Barzani as a model Kurdish leader compared to the outlawed Kurdistan Workers’ Party (PKK) that has waged an insurgency against Turkey for three decades. Iran has been especially alarmed by the sudden eruption of displays of Kurdish nationalism inside its own borders.

Even Washington, a long-time supporter of Iraq’s Kurdish minority, has condemned the vote, in large part due to concerns that the political fallout from the referendum will undermine and distract from international efforts to defeat the Islamic State in Iraq and the Levant. Within days of the vote, U.S. Secretary of State Rex Tillerson issued an official statement taking an unusually strong stance against Erbil: “The vote and the results lack legitimacy and we continue to support a united, federal, democratic, and prosperous Iraq.” At the same time, he urged “an end to vocal recriminations and threats of reciprocal actions.”

Long-Standing Battle Over Iraq’s Northern Oil Riches

Barzani appears to have underestimated the sharp backlash from both friends and foes alike. Ironically, amid all the potential flash points, few Middle East observers, including Kurdish experts, believe the “yes” vote on the referendum will lead to independence in the foreseeable future.

Nonetheless, with the end of the war with ISIL nearing, it was almost a foregone conclusion that the long-standing battle between the central government in Baghdad and the KRG for control of the country’s rich northern oil resources would be resurrected. Crucially, Iraq’s Kurdish region accounts for about one-third of the country’s total oil reserves, estimated at about 45 billion barrels. Both Baghdad and the KRG have claims to disputed oil provinces in the north.

While the referendum is not a legal declaration of independence, Erbil’s timing of the nonbinding vote appears designed to force Baghdad into negotiations over several key contentious issues, including the disputed control of the historic Kirkuk oil region, where Iraq first discovered crude in 1927, and a failed oil revenue-sharing agreement.

Raising the specter of Kurdish independence now may be a maneuver to try to consolidate territorial gains that the much-lauded northern military forces won back from ISIL, including the major oil rich province of Kirkuk, which the Kurdish peshmerga forces liberated in 2014. The giant Kirkuk oil fields contain an estimated 9 billion barrels in reserves and have a rated production capacity of 1 mb/d but output has been running at less than half that level due to a combination of damage sustained during the battle with ISIL and ongoing disputes over control by competing political groups.

Iraq: Disputed Territories as of September 11, 2017

Erbil Strikes Out on its Own

The central government in Baghdad and the KRG have been fighting over control of oil production rights, exports, and revenue for years. Erbil adopted a much more independent policy with its own hydrocarbons law in 2007 and development of oil production sharing contracts. In a major challenge to Baghdad's authority and control of the country's oil and gas resources, the KRG in late 2011 signed agreements with ExxonMobil for the development of projects in northern Iraq, including several fields located in disputed border areas. Despite Baghdad's strong objections, more contracts followed with both large and small international oil companies.

Ahead of the referendum, the KRG made long overdue payments and restructured debt to its international oil partners equal to more than $3 billion in a bid to restore its tarnished reputation for nonpayment to its international partners. Despite chronic payment problems, Russia's Rosneft entered the fray in the northern region, signing contracts for projects worth more than $3 billion since the end of 2016.
Baghdad's efforts to rein in Kurdish oil production and exports have so far come to naught. Abadi called for a de facto boycott of Kurdish crude by the international oil trading community ahead of the referendum vote but companies are unlikely to heed the request and jeopardize their contracts. Oil production is forecast to average around 600 kb/d in 2017. The disputed Kirkuk and surrounding oil fields under Kurdish control and guarded by peshmerga forces are reportedly producing 350-400 kb/d. The KRG has exported an estimated 585 kb/d via pipelines to Ceyhan so far this year, despite periodic disruptions to flows. Much to the dismay of Baghdad, Turkey reached an agreement in 2013 that allowed the KRG to sell its crude independent of Iraq's state oil company SOMO. Baghdad has long chafed at the arrangement but Kurdish oil trade has flourished under the deal.

Barzani may also be hoping to reopen negotiations over oil revenue and resolve the contentious dispute over the payment mechanism. Officials from Baghdad and Erbil reached a revenue-sharing agreement in December 2014 that called for the central government to pay the KRG a fixed 17 percent of the federal budget in return for the region supplying around 550 kb/d of oil exports for SOMO to market. That deal unraveled in 2015 after both sides failed to meet their commitments. Discussions have taken place since then but resolution of the issue has been impeded by Kurdish control of Kirkuk. Negotiations are not likely to resume in earnest anytime soon given the latest escalation in tensions.

Protracted Political Crisis Looms

The oil market for now is betting that Turkey will keep the pipeline open despite the alarming threats by Erdogan, and at the moment, that continues to be the case. Turkey's wide-ranging trade and economic relationship may ultimately outweigh the political furor over the KRG's insistence on holding the referendum. For all of its blustering, Turkey appears to be taking a go-slow approach as it weighs its options of cutting the KRG's access to the pipeline against not only the loss of revenue it receives in transit fees, but also its own domestic oil needs. Erdogan's son-in-law, Berat Albayrak, Turkey's minister of energy and natural resources, is no doubt also considering the potential reputational damage Turkey would suffer as it seeks to position itself as a reliable transit route for energy exports from the Middle East and Russia to Europe. That said, Turkey's mercurial president may yet surprise the oil market. The pro-government English-language Daily Sabah has suggested there is no turning back for Erdogan and that a normalization of relations with the KRG cannot take place until Barzani steps down.

While the initial inflammatory political brinksmanship has created a number of flash points for oil markets, a more measured approach to the crisis may prevail in coming months. Iraq's national elections are slated for April 2018, which will likely prompt Abadi to try to quell Parliament's anger and adopt a more tempered approach. Abadi needs the

Iraq's Oil and Natural Gas Infrastructure

support of the Kurdish bloc in Parliament to secure his re-election. Equally, the KRG's presidential and parliamentary elections are set for November 1 and a change in leadership may help pave the way for more pragmatic negotiating stances from all sides.

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Source: The Arab Gulf State institute in Washniton, 5 October 2017
http://www.agsiw.org/kurdish-oil-exports-under-threat-after-independence-referendum/