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Developing a Practical Model to Solve the Iraq-KRG Oil Crisis

by Yerevan Saeed (/experts/yerevan-saeed)

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ABOUT THE AUTHORS

Yerevan Saeed (/experts/yerevan-saeed)

Yerevan Saeed is a research associate at the Arab Gulf States Institute in Washington and a lecturer at the University of Kurdistan Hewler. He previously served as White House Correspondent for Kurdish Rudaw TV and has worked for news agencies including the New York Times, NPR, and the Wall Street Journal.

Brief Analysis

Baghdad should allow Kurdistan based oil operators to invest in the rest of Iraq as a part of a solution to the long-standing oil issue between Erbil and Baghdad, using a proven, practical model currently being implemented.

On October 16, 2023, Crescent Petroleum, a UAE-based company, and the Iraqi Oil Ministry officially enacted three oil and gas agreements that had been initially signed in February 2023, with the objective of exploring and developing oil and gas resources in the Diyala and Basra provinces. The significance of these contracts lies in their allocation to Crescent Petroleum within Iraq, a company that has made a substantial investment exceeding three billion dollars in the Kurdistan Region. Such an allocation is groundbreaking, particularly in light of the prior categorization by Baghdad of oil companies engaging in contracts with the Kurdistan Regional Government as "blacklisted."

Therefore, the contracts with Crescent Petroleum represent a pioneering approach that could potentially serve as a model for other oil companies based in the Kurdistan Region, offering them analogous opportunities throughout the rest of the country. This strategic approach holds promise in addressing the long-standing conflicts related to the utilization of natural resources and the operations of oil companies in the northern regions of the country.

The protracted and complex dispute over oil between the Kurdistan Region of Iraq and the central government in Baghdad is two decades old. Yet in recent years, this conflict over natural resources has reached new heights of complexity and tension. The situation took a notable turn when, in February 2022, the Iraqi Supreme Court declared the Kurdistan Region's oil and gas law as "unconstitutional." Furthermore, in March 2023, a Paris-based arbitration ruling sided with Baghdad in a case against Turkey, which pertained to the usage of the Iraq-Turkey Pipeline (ITP) through which the KRG had been exporting its oil. The upshot of these legal battles has been a disruption in the flow of approximately 500 thousand barrels of oil to date, preventing it from reaching the international market.

Although the volume of Kurdish oil may not be substantial enough to have a notable impact on global oil prices, it remains a significant resource for the European energy market. The interruptions in oil flow have already incurred substantial financial losses for the KRG, exceeding 7 billion dollars.

But urgency for Kurdish oil has been accentuated in the global market, particularly when considering the potential regional consequences of the ongoing Palestine-Israel conflict and the persisting Russia-Ukraine war. These geopolitical factors have already caused oil prices to skyrocket, making it all the more imperative to find a resolution to the conflict between Erbil and Baghdad.

Oil production in the northern fields has suffered a severe setback due to oil companies' reluctance to invest in these areas, primarily stemming from the pipeline closure and the uncertainty surrounding the recovery of their operational expenses. Nevertheless, the KRG has incrementally boosted oil production to 200,000 barrels per day, with the majority being allocated for domestic consumption.

Erbil and Baghdad have engaged in numerous discussions to address this issue, but a major point of contention has been the financial responsibilities of oil operators within the Kurdistan Region. Erbil contends that because the technical oversight of the oil sector now falls under the purview of the Iraqi Oil Ministry, Baghdad should bear the financial burden. Conversely, Baghdad asserts that the KRG should assume the costs and insists on a comprehensive renegotiation of contracts awarded to oil companies without prior authorization from the Iraqi government.

Amid these discussions, a promising avenue emerges that both parties should consider to safeguard the financial interests of oil companies in the Kurdistan region, prevent further damage to the Kurdish oil fields, and enable Iraq to release nearly half a million barrels of oil into the market. This opportunity entails extending an olive branch akin to Crescent Petroleum from Baghdad to other foreign oil companies operating in the Kurdistan Region, where they could be offered investment opportunities in the broader Iraq. Such a strategy could not only enhance cooperation but also potentially bolster Baghdad's negotiating power in endeavors to reactivate the ITP, which has been dormant for the past eight months. Iraqi Prime Minister Mohammed Shia al-Sudani hinted that Baghdad is heading that direction without elaborating on the mechanisms to restructuring the contracts of the International Oil Companies (IOCs).

The absence of diverse export routes for Baghdad's oil shipments has severely hampered its bargaining position with Turkey. Consequently, the Iraqi government has initiated efforts to reinvigorate defunct pipelines, such as the Iraq-Saudi pipeline to the Red Sea, and to launch new projects like the Basra-Aqaba pipeline. Recent reports suggest that, with backing from Tehran and Moscow, Baghdad is also striving to revive the 891-kilometer Kirkuk-Baniyas oil pipeline, inactive since 1982, largely due to Syria's support for Iran during the eight-year Iraq-Iran War.

However, the restoration of this pipeline—capable of transporting up to 300,000 barrels of oil per day to the Mediterranean—faces a series of significant challenges. Firstly, the U.S. Caesar sanctions on Syria have restricted Iraq's involvement in oil-related matters. Secondly, the financial expenses associated with repairing the pipeline could reach into the billions of dollars. Thirdly, the pipeline traverses extensive desert areas that may become vulnerable to sabotage by armed groups hostile to Damascus.

Nonetheless, the successful rehabilitation of this pipeline has the potential to substantially diminish Turkey's leverage in negotiations with Baghdad. Consequently, it may be in the Turkish government's best interest to expedite negotiations for the resumption of oil exports from the Kurdistan Region and Kirkuk. A timely agreement reached in the immediate future would prove considerably more advantageous for Ankara than one negotiated farther down the line, especially if Iraq proves successful in diversifying its oil export routes.

Should Iraq choose to foster stronger relationships with oil companies in the Kurdistan Region, it would effectively communicate a broader, more favorable message to the global business community: Iraq is committed to being open and receptive to foreign investments. Given Iraq's substantial reliance on oil exports and the overwhelming predominance of the public sector in its economy, there arises an urgent imperative to diversify the country's economic base and reduce its dependency on oil-generated revenues.

Iraq also is confronted with the formidable challenge of generating employment opportunities for its burgeoning population. In light of these circumstances, the government is well-positioned to leverage the expertise, resources, and capital offered by foreign investment, thereby facilitating the creation of job opportunities and ultimately mitigating unemployment concerns while concurrently bolstering economic stability.

Thus, extending the successful model implemented by Crescent Petroleum to other oil operators in Kurdistan holds the potential to establish a comprehensive conflict resolution framework, facilitating Erbil and Baghdad in their efforts to address one of the enduring conflicts between them. Such a resolution also sets the stage for the enactment of the country's hydrocarbon law, a pivotal step that will definitively delineate the respective powers of the federal government and the regional government concerning natural resources. Moreover, Iraq would be poised to finally surmount a divisive issue that has impeded its progress for decades. ❖

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