

The Balance Sheet of the Recent IFG-KRG Oil Deal in Iraq

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On 2 December the Council of Ministers-CoM website posted the decisions taken by the Cabinet including one approving the agreement concluded between the Iraqi Federal Government-IFG and Kurdistan Regional Government-KRG.

Soon after its announcement and due to lack of transparency an increasing sense of skepticism and growing opposition to the concluded agreement began to surface within Iraqi oil professionals, parliamentarians, politicians, economists, media and the general public. Obviously, we are heading toward difficult debate inside the federal parliament on both this agreement and the state budget for 2015. This intervention explains why.

To avoid any possible confusion I reviewed the Arabic text of the decision and its English translation done and posted by Iraq Oil Report-IOR.

IOR provides the following English translation of the above decision:

Cabinet endorses the agreement reached between the federal government and the Kurdistan Regional Government, which was attended by the President of the Federal Cabinet, Dr. Haider Abadi and the President of the Kurdistan Regional Government, Mr. Barzani, which states that the Iraqi oil belongs to all Iraqis, and the Kurdistan Region to deliver at least (250) thousand barrels of oil a day to the federal government, for the purpose of export, also the agreement includes the export of 300 thousand bpd by the federal government from the oil fields of Kirkuk province through the oil pipeline in the Kurdistan region, and an agreement to allocate a percentage of the federal ground forces allocations of the Iraqi army to the Peshmerga forces based on population ratio.

The Arabic and English texts indicate to two sets of principles and operational measures. The **principles** are “Iraqi oil belongs to all Iraqis”, which is in compliance with current Iraqi Constitution; and “the export” of KRG oil and Kirkuk oil is the prerogative of the Federal Government, also in compliance with the Constitution, which asserts trade policy and State budget, among others, are part of the powers of the Federal Government. This also complies with the Administrative and Customary Laws which give SOMO, federal state oil marketing (exporting) company, the sole authority to market Iraqi oil.

The **operational** measures are:

- 1- KRG is obliged to deliver no less than 250,000 barrels per day (bd) to the Federal Government for export purpose.

Latest information from IOR asserts that, “The KRG is currently exporting around 350,000 bd of oil by pipeline to Ceyhan, according to industry officials in Kurdistan.” The implication is either KRG deliver the extra 100,000bd to the federal government, or reduce its production or violate the current agreement by independently exporting this extra oil. In case of violation the current agreement does not provide a compliance mechanism. The expectation is that State Budget Law 2015 will address this issue similar to the provision introduced in 2013 budget law.

- 2- The federal government is committed to export 300,000 bd of oil produced from oilfields in Kirkuk Province through the oil pipeline in the Kurdistan region.

The implication is that federal Ministry of Oil through its North Oil Company hold the responsibility to deliver the crude for export. Daily oil production from NOC in 2013 was 265,000bd and almost zero in 2014, thus making it difficult to secure the 300,000 bd for export especially if Baiji Refinery resumes operations during the first half of 2015.

- 3- Allocate a percentage of the federal ground forces allocations of the Iraqi army to the Peshmerga forces based on population ratio.

To decide this percentage requires information on the budget allocation for the federal ground forces from the Ministry of Defense and information on the population ratio from the Ministry of Planning.

Different Interpretations

The full text of the signed agreement has not been published and according to the Minister of Finance, Mr. Hoshyar Zebari, it will not be published, without explaining why!!. This has raised very serious concerns and suspicions concerning the contents of the agreement, which CoM statement referred to above.

The Minister made few statements that add new very substantive financial items not mentioned in CoM decision. Moreover, the KMP Mr. Nechirvan Barzani and another Kurdish member of Parliament, Dr. Bakhtiar Shawees made further statements not mentioned in agreement.

In the absence of true, authentic and signed agreement it is difficult to assess the credibility of what the three Kurdish politicians have claimed.

Nevertheless, I will address below some of what they said.

The Sovereign Expenses

In answering IOR (4 December 2014) question on the Peshmerga portion and whether it will be deducted from the 17 percent, Mr. Zebari answered, “This will be paid by the Defense Ministry in Baghdad. The KRG will receive the entire 17 percent, and sovereign expenses will not be deducted from this.”

This statement caused immediate and strong reaction since no such thing was mention in the CoM decision but above all this would contravene both the Constitution and previous budget laws.

There are two interpretations to the raised issue.

The first one suggests that if the Peshmerga portion will be paid by the Defense Ministry, and the allocation for this ministry is covered by the Sovereign Expenses, which is deducted from the 17% KRG share in the annual budget, then what Zebari said is correct, otherwise there will be double-counting.

The second interpretation suggests that if what Zebari have said means KRG will be exempted from shouldering its share of the Sovereign Expenses then he is completely wrong, unless the signed agreement stated so clearly and emphatically.

Article 9-three of 2013 Budget Law lists many items that constitute the Sovereign Expenditures. The Arabic text of the said sub-article is as follows:

النفقات السيادية المتمثلة بـ (مجلس النواب ، رئاسة الجمهورية، مجلس الوزراء ، وزارة الخارجية، وزارة الدفاع ، اجور المفاوضات والمطالبات القانونية للديون ، اجور تدقيق ومتابعة وملاحقة الاموال في الخارج، اجور تدقيق شركة التدقيق الدولية ولجنة الخبراء الماليين ، المساهمة في كلفة انتاج النفط الخام المصدر ، عقود الشركات الاجنبية المنفذة لأقليم كردستان (في ضوء محضر الاتفاق بين ممثلي الحكومة الاتحادية وممثلي حكومة اقليم كردستان حول انتاج وتصدير النفط الخام في الاقليم المذكور بموجب قرار مجلس الوزراء رقم 333 لسنة / 2012) فوائد قروض البنك الدولي وفوائد قروض صندوق النقد الدولي وفوائد على القروض الاجنبية الاخرى، فوائد على سندات حوالات الخزينة العامة ، فوائد السندات على اطفاء الديون الخارجية للقطاع الخاص، مبالغ المساهمات العربية والدولية ، مبالغ تعويضات حرب الكويت ، نفقات مديرية السفر والجنسية وقيادة قوات الحدود وجهاز الامن الوطني، تسوية الديون في الخارج ، اجور نقل النفط الخام المصدر عبر تركيا ، اقساط الاتفاقيات الثنائية مع دول نادي باريس ودول خارج نادي باريس، المشاريع الاستثمارية للشركات النفطية الاجنبية، الفوائد المترتبة عن اقساط الاتفاقيات الثنائية مع دول نادي باريس ودول خارج نادي باريس، تسديد قيمة اصدارات حوالات الخزينة القديمة، التسوية النقدية للديون الصغيرة للقطاع الخاص في الخارج ونفقات التمويل المشترك ومشاريع الموانئ والسدود ومنظومة السكك الحديد المرتبطة بالشبكة الدولية وادارة الاجواء وتسوية ديون الخطوط الجوية الكويتية واقساط قروض صندوق النقد الدولي ومستحقات صندوق النقد العربي عن اتفاقية اعادة هيكلة مديونية العراق.)

The Ministry of Finance-MoF is the only entity capable of providing accurate and comprehensive accounts for these items. However, based on information on the consolidated accounts prepared by the said ministry (for the first half of 2013) and 2013 Budget Law I estimate Sovereign Expenditures of the following items only to be \$29.5billion. The covered

items are: Parliament; Presidency of the Republic; Council of Ministers; Ministries of Finance, Foreign Affairs and Oil; and the external obligations.

These are my estimates based on official data, which are in the Iraqi Dinnars and I converted them to \$ at exchange rate of \$=1167ID (for 2013, though currently it is 1160 as per MoF). If I assume that other items could come to \$500 million then total Sovereign Expenditures would be \$30 billion.

Thus, KRG share in the Sovereign Expenditures should be ca. \$5billion, and accordingly their 17% in the national budget for 2013 should be deducted by at least \$5billion.

Peshmerga Allocation

Media sources report that KPM Mr. Nechirvan Barzani said that the Federal Cabinet agreed to pay a \$1 billion annual allocation from the Iraqi Defense Ministry's budget specifically for the KRG's Peshmerga.

Again and as mentioned earlier the CoM decisions does not specify a specific amount for Peshmerga or it will be on annual base. Moreover, the process for deciding the “percentage” allotment to the Peshmerga will be based on two specific parameters: budget “allocation for the federal ground forces”, which is decided by the Ministry of Defense; and “the population ratio”, which should be available from the Ministry of Planning. Correct data on these two items were/are probably not available to support the above stated \$1 billion annual allocation. Finally, based on the consolidated accounts prepared by the Ministry of Finance for the first half of 2013 the entire budget allocation for the entire Ministry of Defense could come to \$4.6billion. This implies that the Peshmerga allocation comes to 22% of the whole MoD allocation, and since “allocation for the federal ground forces” is only part of the MoD, then the Peshmerga allocation would come to very much higher than 22% of the “allocation for the federal ground forces”.

Political Statements

Dr. Bakhtiar Shawees made the following statements:

- The Federal Government confirmed through this agreement that these areas [Kirkuk and the disputed territories] are under Kurdistan control;
- This agreement some sort of initial agreement regarding this important law [Oil and Gas law] which has been delayed for more than six years;
- Also the agreement include the “return” of all entitlements of the Region for previous period

Again none of the above was mentioned in CoM announced agreement. Probably this rhetorical statement is meant for local audience and consumption rather than true knowledge of the complexity of the involved issues. But he is a newly elected parliamentarian!

Dr. Haider AL-Ibadi Views

In a recorded lengthy interview with Al-Mayadeen TV (aired on 1-3 December 2014) PM Dr. Ibadi outlined his views on various issues. For those relating to oil and relationship with KRG he emphasized the followings:

- The government pays the Region's share in the budget and all produced oil in the Region should be delivered to the federal government; the base is no fund will be released without delivering the oil.
- The current official position of the Iraqi government is that KRG is not allowed to export Iraqi oil; this is Iraqi ownership, federal ownership. Therefore the Region cannot export this oil openly in international markets. All their oil sale deals are secret.
- Honestly, the paper I delivered to brothers Kurds is clear. All extracted oil in the Region is owned by the Iraqi government, not only the exportable, as some wants to talk about the exportable. I say no; extracted oil, this is in the Iraqi Constitution. If we want to deal fairly and transparently we have to be obeyed by this.
- During 2012 and 2013 KR exported millions barrels of oil and they did receive full entitlement from the state budget but the federal government did not receive a single barrel of oil from KR.
- During that period KR was not able to market the oil formally but only by giving probably 50% to 60% price discount, and that causes losses to them and to the entire Iraq since the federal government did not receive not even one barrel.
- I cannot tell the Kurds that Kurdistan oil is yours and tell those in Basra or Missan that your oil is not yours and you have to share it with others, as this would be injustice and I will not do it.
- I told the Kurd leaders that I am willing to take a strategic decision that I will export Kirkuk oil through the Kurdish pipeline then through Turkey. This is for our mutual benefit, but they have to make a strategic decision to be with Iraq and part of Iraq.
- Brothers Kurds pressed me to conclude agreement with them before forming the government but I refused. Any agreement that I will be part of has to be approved by the Federal Cabinet, KRG and the Federal Parliament.
- The interest of all Iraqis should not be politicised.

Clearly the above views of PM Ibadi contrast those mentioned by the three Kurdish politicians. But his deeds should confirm his words!

The Balance Sheet

- 1- According to PM Al-Ibadi, KRG received its 17% share in the budgets for 2012 and 2013 without delivering oil to the federal government. Under these budget laws KRG was committed to deliver 175000 bd and 250000bd respectively. The average actual

oil export price (based on SOMO data) for 2012 and 2013 was \$115,05/b and \$102,34/b respectively, thus KRG caused losses to the budget at a total of \$7.329 billion in 2012 and \$9.312 billion in 2013.

Legally and constitutionally these amounts totaling to \$16.641 billion are recoverable according to Article 10-one-b of Budget Law 2013.

- 2- Draft Budget for 2014 comprises commitment on KRG to deliver to the federal government 400,000bd from oil produced in the Region; none delivery prompts proportional reduction from KRG share in the budget. The Kurdish refused and the budget was not approved up to date. Consequently, the federal government did not make payments, and the Region sought independent export that was, by all counts, not successful and costly.

With the advancement of Da'esh (IS/ISIS/ISIL) since 6/10 June 2014 that threatens both KRG and the federal governments and escalates military activities and associated cost, coupled with crash in oil prices from over \$100/b in June to less than \$70 in November, the economic situation in Kurdistan Region almost near collapsed. Moreover, if oil price remains that low or declines further that could make Production Sharing Contracts, concluded by KRG, much more painful to Kurdish interests, since inflated development cost will drain most of the generated revenues leaving little to KRG. Also if KRG insist on the independent export it has to give even higher price discount on an already low oil price to counter the legal measures taken by the federal ministry of oil.

All the above, among other geopolitical reasons and leaving aside the fiery rhetoric that dominates KRG during the period between the fall of Mousil (9/10 June) and the attack on Sinjar Mountain early August, what actually had prompted KRG to seek resolution of its differences with Baghdad.

- 3- Back to the basic components of the agreement as posted on CoM website. The export revenues that would be generated from these additional volumes depend on oil prices in 2015 on one hand and the compliance by KRG to deliver the stated volumes.

November actual export price of Iraqi oil through SOMO was ca. \$70 a barrel, and assuming that this price prevails during 2015 total revenues from exporting KRG supplied 250000bd would be \$6.370 billion, and total revenues from exporting Kirkuk Province oil of 300,000bd would be \$7.644billion. This is rather optimistic since all information indicates that oil prices in 2015 could very well be lower than \$70 a barrel.

- 4- Now, if the Zebari-Barzani understanding, outlined above, prevails that KRG is exempted from sharing the Sovereign Expenditures and Peshmerga get \$1 billion that will come to minimum \$6 billion. If we assume further that Budget 2015 will be at \$100 billion (with not yet known deficit) then KRG will get the following: \$17 billion its share (at 17%); \$1 billion for Peshmerga and \$5 billion for Sovereign Expenditures exemption. That is \$23 billion or 23% of the national budget. In other words KRG will lose only \$370 million (6.370-6.000) to get \$17 billion, or deliver only 14.5 thousand barrel per day not 250,000 barrels per day.
- 5- Obviously there are very different interpretations and even more serious implications pertaining to this agreement. The lack of transparency by not disclosing true signed copy of the agreement has caused much confusion and strong opposition to the agreement especially if the Zebari-Barzani understanding prevails.

The Federal Prime Minister has to deliver what he had promised during his interview on Al-Mayadeen and he with the Federal Minister of Oil have to disclose the full text of the agreements to the public, the sooner the better.

The Parliamentarians have the responsibility to:

- Examine thoroughly the text of the agreement when it is presented to them;
- Maintain the related provisions in the previous state budget law especially those covered by articles 9 and 10;
- Strongly oppose and block any attempt to introduce the Zebari-Barzani understanding since such understanding is a disastrous proposition with dangerous ramifications when the country is already in deep fiscal crisis that could get worse in 2015.

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