

2019 Budget Law- Politics of Appeasement, Non-Compliance and Extortion

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Data from different sources indicates that KRG oil exports, so far in this year, ranged between 418.8 and 438 thousand barrels daily-kbd and KRG gross oil export revenues at end of May mounted to \$3.681billion.

Draft of the budget law was debated, amended and approved by the parliament; then endorsed by the President of the Republic and finally promulgated as a law when it was published on the official gazette. KRG, Kurdish politicians, parliamentarians and commentators praised the law as it favors them. Yet, so far and as it officially confirmed by the Minister of Oil and the Prime Minister, KRG did not deliver a single barrel of oil; this is the usual KRG' non-compliance extortion practice.

Such practice prompts a wave of criticisms and accusations against the Prime Minister, who is known for his appeasement towards KRG even at the expense of the rest of Iraq. KR leaders know too well how to exploit Prime Minister's weaknesses and his lack of resolve and leadership; KRG succeeded so far.

This article asserts that state budget law is clear enough regarding KRG entitlements and obligations; KRG not only renegades on its obligations but also causes "comparable" losses; thus intensifies state budget deficit. Both KRG and the PM are violating the law and they should be held accountable for such breach of legal obligations. Hence, any payment made by the federal government to KRG not only violates state budget law but also indicates government failure to protect the national interests and intensifies resentments and social divide; as evidenced by the magnitude and the sentiments expressed by many recent views and writings on the subject.

Different sources are used to compile data for this article and as this article is about oil export revenue, it does not cover KRG's obligations for other revenues mentioned in the law such as taxes, levies, and import duties costumes among others.

Brief review of the main and relevant provisions of the budget law is provided in part one. Part two demonstrates the actual against budgeted Oil Exports and Revenues, excluding KRG. Movement of export oil prices between January 2017 and May 2019 was addressed in part three using date relating to Brent, SOMO and KRG monthly average prices. KRG oil exports and revenue estimations are covered in part four. The article ends with a few concluding remarks.

Part one; Basic Provisions in 2019 State Budget Law-SBL

SBL was published on the official gazette *Al-Waaqae Aliraqiya* on 11 February 2019 and, thus, it became constitutionally effective and both federal and KR governments should adhere to and comply with it.

Budget planned expenditures and revenues were denominated in the Iraqi Dinar-ID with an exchange rate of 1182 ID per one USA Dollar, which is used for conversion in this article though I think the market rate is higher than this.

Budget planned expenditures-BPE is \$112.612billion, while Budget planned revenues-BPR is \$89.315billion, leading to budget planned deficit of \$23.3 billion (all figures rounded to three digits).

BPE is divided between current expenditures and investment expenditures at a rate of 75.2% and 24.8% respectively; similar tendency that prevailed during the last two decades!!

BPR is composed, primarily, of oil export revenues and non-oil revenues at a rate of 88.8% and 11.2% respectively; again similar magnitudes that intensify reliance on oil sector for generating revenues.

Oil export revenues-OER was estimated on an average oil price \$56 a barrel-B; an export of 3.88 million barrels daily-mbd including 0.250mbd from KRG oilfields; this implies that oil produced by Ministry of Oil companies that would be exported by SOMO is 3.63mbd.

SBL clearly outlines entitlements and obligations of both the federal government and KRG as follows:

- 1- KRG delivers “no less than 0.25mbd” of oil produced from its oilfields to be “marketed exclusively by SOMO”; this implies that at least 6.44% of the budgeted oil export should come from KRG!!!;
- 2- If KR Provinces-KRPs export more than 0.25mbd and/or MoO exports more than 3.63mbd, they should deliver all such additional “actual” export revenues to state coffers;
- 3- KRG share in state revenues is based on the percentage of KRPs’ population (no specific percentages were mentioned in the SBL);
- 4- The federal government pays all KR “entitlements, including KR employees”, but such entitlements will be deducted proportionally if KRPs fail to deliver all 0.25mbd. (This is very serious loophole as there is no punitive measure if KRG/KRPs delivers the 0.25mbd but keeps revenues if it exports more than that!!)
- 5- KRG delivers full details on its civilian and military employees no later than end June 2019 (Again, no provisions are stated on verifying the accuracy of provided information or if KRG do not deliver the data and how to deal with difference etc.).

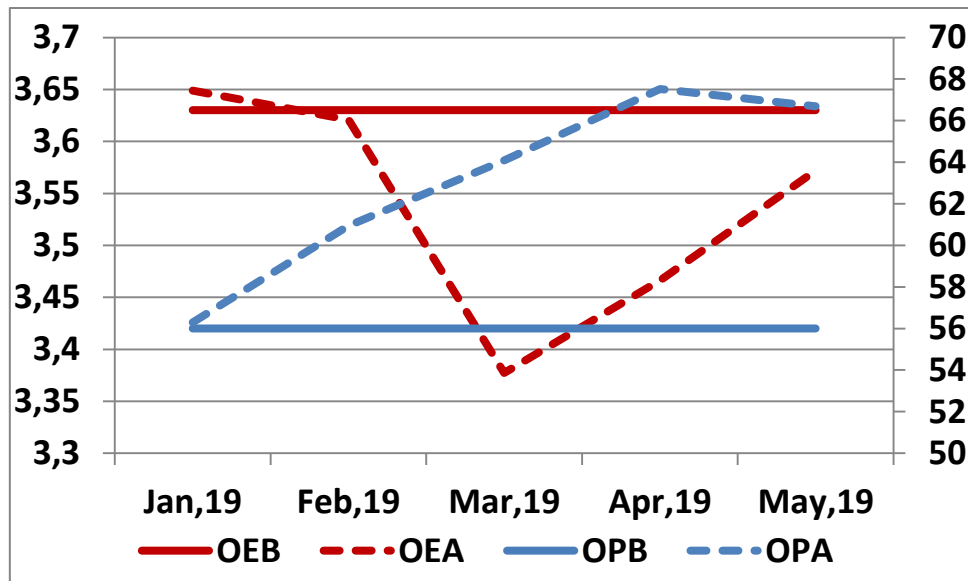
Part two; Oil Exports and Revenues: Actual vs. Budgeted Thresholds

Export performance on the part of federal government is analyzed based on the official monthly data provided by SOMO for the first five months of 2019. The data allows comparison between budgeted and actually realized four main parameters: export oil price (\$/b), volume of oil export (mbd), generated revenues and realized surplus or deficit.

For every month, actual oil export revenues exceeded the budgeted oil revenues leading to total surplus of \$2.965billion.

This surplus was attributed to oil price improvement, while export volume failed to meet budget target. On average, actual oil prices (OPA) was \$7.1/b higher than what was adopted by the budget (OPB); this improvement could be attributed to “OPEC+” accord on production. Actual export volume (OEA), on the other hand, was 923Kbd lower than budget threshold (OEB); this could be attributed to weather conditions impacting tankers’ loading from southern export terminals as well as water flooding that seriously impacted production operations in some southern oilfields as clearly indicated by OEA red dotted line below. The monthly movements of these four variables are exhibited in the following chart.

Chart 1
Actual vs. Budgeted Oil Prices & Exports (MoO-SOMO)



Source and notes: compiled by the author based on MoO-SOMO official data and BSL. Oil prices (\$/b) on right side while Export volume (mbd) on left side.

Part three; Export Oil Prices

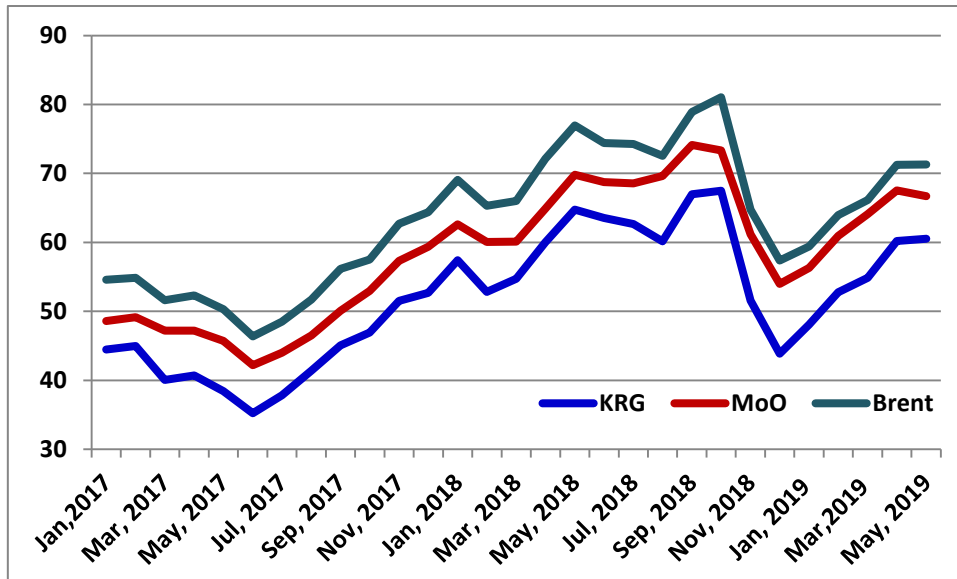
Very briefly, oil export pricing mechanisms are very different between SOMO, of the federal Ministry of Oil and those adopted by KRG. While much information is available about SOMO's monthly price setting mechanism including a ministerial committee that uses different pricing equations for three broad types of crude, Basra light, Basra Heavy and Kirkuk (and Qayara oil since August 2018) for three major market destinations, Asia, Americas and Europe, with three different marker crudes for each market; nothing is formally declared by KRG on such mechanism or market destinations, or types of crude among other things.

However, statistical data compiled from different sources makes it possible to trace the monthly movement of average oil export prices by both SOMO and KRG and also estimate the price differential between them and in comparison with the international benchmark crude- Brent.

Since this article is about budget law 2019, our estimates and assessment will be limited to the period from January 2017 for the purpose of showing the trend but the comparison will be made between the first five months of 2019 compared with the second half of previous year 2018.

The following chart clearly exhibits: first; there has a constant pattern of movement, up and down, between the three export oil prices: Brent (Green line), MoO (red line) and KRG (Blue line) and second; MoO prices has been all the way below Brent and KRG prices has been all the way below MoO, and accordingly, below Brent. This has led to a very high correlation coefficient for MoO price and KRG price with Brent price at 0.99041 and 0.99613 respectively.

Chart 2
Actual Oil Price Movement (\$/B) January 2017-May 2019



Source and notes: Compiled by the author. Brent oil price are from EIA-STEOM monthly reports; MoO oil price are from MoO-SOMO monthly reports posted on their websites; KRG oil prices are from Deloitte Reports for January 2017 to December 2018 and from IOR reports for January to May 2019.

Such pattern and strong correlation produces different magnitude in price differentials compared with Brent benchmark.

During the second half of 2018 SOMO-MoO export price was, on average, less than Brent by a margin of \$4.669 a barrel; that margin went down to \$3.309/b during the first five months of 2019. Similarly but at a much higher margin, KRG export price compared to Brent was lower by \$12.684/b and \$11.131/b respectively.

This implies that KRG lost \$8.014 for every barrel of oil it exported independently (from SOMO) during the second half of 2018 and \$7.822 for every barrel it exported so far in 2019; that inflicted huge losses and contributes to worsening the region itself and the national economy alike. It should be mentioned that price differentials could be attributed to many factors such as qualitative factors- API and contents; location factors; marketing efficiency and effectiveness; and legal ramifications among others.

Therefore, one could argue that had KRG complied with the budget law and delivered such oil to be exported by SOMO, Iraq could have generated more revenues to offset the realized deficit mentioned above.

Part four; KRG Oil Exports Estimates

Different sources used to estimate KRG oil and condensate exports since January 2017 until end May 2019. The results are summarized in the following table.

Table 1
KRG Oil Export Estimates by Different Sources

Source	Barrels Daily	Remarks
Deloitte	462244	Average for second half 2018

MoO	418750	Average first 4 months 2019
IOR	438000	Average first 5 months 2019
IOD	420000	Average Dec 2018 & January 2019

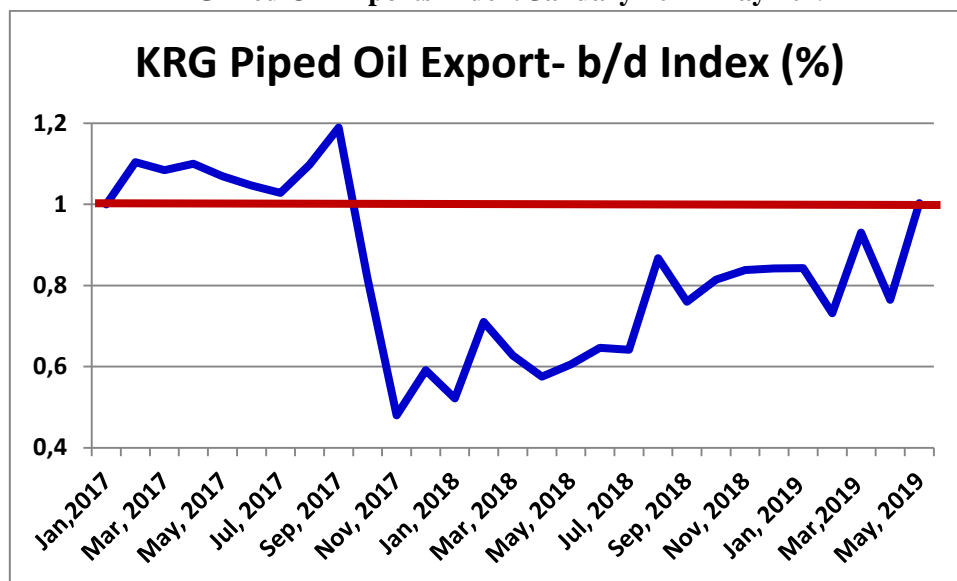
Source & Notes: compiled by the author from the mentioned sources. MoO: federal ministry of oil; IOR: Iraq Oil Report; IOD: International Oil Daily

The above data indicates that KRG daily exports of oil and condensates could not, on average, reach even 440kbd in this year so far.

The following chart exhibits the Index for KRG piped oil exports constructed on January 2017 data as the base for the index. From January to end September 2017, the value of the index was positive reaching its maximum value for the month of September; then declines sharply before recovering gradually.

During that period, KRG oil daily export was over 500kbd reaching its maximum of 609Kbd during September 2017. **That surge in KRG exports was primarily due to KRG seizer of many of NOC oilfields by taking advantages of Daesh effects on one hand and for the promotion of the ill-fated separatist referendum of 25 September 2017.**

Chart 3
KRG Pied Oil Exports Index: January 2017-May 2019



Source: compiled by the author; original data are from Deloitte Reports and IOR

After retaking Kirkuk by the federal government in October that year, oil exports dropped sharply to 246kbd in November 2017 then began recovering gradually to reach a new height by May 2019; but never reached the threshold of 600KBD since September 2017.

Estimation of KRG Oil Exports Revenues in 2019

Since KRG does not publish monthly oil export data on time I considered three sources to make the needed estimation. Deloitte reports latest information is related to December 2018, therefore, it was not considered. MoO website provides volumes of KRG oil exports based on data provided by SOMO but it does not provide data on KRG oil export revenues; MoO latest data covers months January-April 2019; therefore it was not taken as well. Finally, Iraq Oil

Report-IOR estimation of the KRG's monthly revenue is based on pipeline throughput and export data combined with historical government disclosures; IOR latest estimates cover January-May 2019.

Since IOR data covers volumes and revenues for the first five months of 2019, their data was used and then compared with SOMO's average export prices during the same five months; that produced the following:

- 1- According to IOR, KRG generated gross export revenues totaling to \$3.681billion;
- 2- Had KRG delivered all such exports to SOMO and exported as per SOMO actual export prices, KRG export revenues could have been \$4.199billion;
- 3- The difference in the above oil export revenues is \$518million- corresponding to 14.1% of actual KRG gross oil export revenues, which undoubtedly represents significant financial losses to both KRG and Iraq.

Concluding remarks

KRG continues in its known non-compliance and extortion policy and practice. But, this time, the current federal Prime Minister authorizes significant payments to KRG while he officially confirms that KRG did not deliver oil as required by the state budget law; this legally and constitutionally indicates that both KRG and the PM are violating the law and they should be held accountable for such breach of legal obligations.

Data from different sources indicates that KRG oil exports, so far in this year, ranged between 418.8 and 438 thousand barrels daily-kbd and KRG gross oil export revenues at end of May mounted to \$3.681billion. As the year approaching the end of its first half, there are no indications that KRG will fulfill its constitutional obligations.

The federal government should not make any more payment to KRG unless the latter comply fully and effectively with all related provisions of the state budget law. Any payment made by the federal government to KRG not only violates state budget law but also indicates government failure to protect the national interests and intensifies resentments and social divide; as evidenced by the magnitude and the sentiments expressed by many recent views and writings on the subject.

Norway

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