

THE TURKEY-KRG ENERGY PARTNERSHIP: ASSESSING ITS IMPLICATIONS

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Ten years after the U.S. invasion and two years after the complete withdrawal of American forces from its soil, Iraq faces a number of challenges to its long-term stability and development. These range from corruption to poor public services, from rising terrorist violence to ethnosectarian tensions in the context of a complex power-sharing system. An important, but often overlooked, aspect of Iraq's political scene concerns the dispute between the federal government and the Kurdish Regional Government (KRG) over the management of the country's and the Kurdish region's natural resources and over appropriate revenue-sharing mechanisms. The parties have been stuck in a costly political stalemate for the past few years, as the absence of a federal hydrocarbon law has discouraged international investment in Iraq's natural resources, and oil extracted from KRG-controlled fields has had only intermittent access to international markets.

Oil and gas pipelines currently under construction connecting Iraq's Kurdistan region and Turkey would provide an outlet to international markets for KRG-controlled resources beyond the existing

Baghdad-controlled export infrastructure, thus holding the promise of unlocking the Kurdish region's hydrocarbon wealth. However, U.S. policy makers have expressed concerns that the Turkey-KRG energy partnership could actually destabilize Iraq, starting a chain reaction that could lead to the violent breakdown of the country.

We take part in this policy debate by analyzing the ongoing dispute between Baghdad and Erbil through the lenses of bargaining theory. This allows us both to make sense of the costly negotiating stalemate between the federal government and the KRG and to assess the likely geopolitical impact of the new pipelines. Our analysis relies on information we have collected through interviews with KRG policy makers, Turkish officials, third-country diplomats and analysts as well as from newspaper articles and analytical pieces on Iraq and Turkey. We argue that the negotiating deadlock between Baghdad and Erbil is to a large extent due to the existence of serious commitment problems on both sides.

The KRG is concerned that the federal government may renege in the future on its

revenue-sharing promises; thus, it insists on maintaining control of the Kurdistan region's hydrocarbon industry and on adopting mechanisms for automatic revenue allocation to subfederal entities. On its part, Baghdad fears that Erbil's control of the region's hydrocarbon industry may enable it to extract further concessions on revenue-sharing and other pending issues, while also representing a preliminary step towards a Kurdish secessionist bid down the road. Moreover, Baghdad worries that other subfederal entities may feel emboldened by Kurdish success and advance similar requests for control of their hydrocarbon resources, thus weakening the central government and potentially even unleashing a process that could lead to the break-up of the country.

We expect that Ankara's decision to allow the creation of new pipelines will assuage Erbil's deep-seated fears of exploitation by Baghdad, which should eliminate a powerful motive for Kurdish secessionist aspirations and thus reduce the corresponding risk of war. On the other hand, the Turkey-KRG energy partnership would enhance Erbil's sway in Iraqi politics, which could generate incentives for Baghdad to use force to forestall this development. However, a government attack is highly unlikely; Baghdad's forces are stretched thin fighting a reinvigorated Sunni Arab insurgency and would thus be reluctant to open a second front. The United States could further reduce the short-run risk of violence by abandoning its current opposition to the Turkey-KRG partnership and clearly communicating to Baghdad that an attack on the country's Kurds would not be tolerated. This message should be coupled with a policy of withholding the transfer to Iraq of military equipment that could be used in a conventional offensive against

Kurdistan, while propping up Iraqi forces' counterinsurgency and counterterrorism capabilities to deal with the threat posed by al-Qaeda in Iraq (AQI). Moreover, once the new pipelines are in place and Turkey makes the investments in KRG-controlled exploration blocks that are supposed to accompany the new export infrastructure, Baghdad is likely to be deterred from resorting to force against Erbil by the sizable chance of Turkish intervention to protect the KRG (and its investments).

THE CURRENT SITUATION **Baghdad-Erbil Relations**

The toppling of Saddam Hussein in 2003 ushered in a federal democratic regime in Iraq. After a long history of Kurdish marginalization and victimization at the hands of the central government, the 2005 Iraqi constitution enshrined Kurdish rights and significant autonomous powers for the KRG, which had de facto ruled the Kurdish region of Iraq in the decade following the first Gulf war.¹ However, the constitution left unaddressed or ill-defined important aspects of the division of competences between federal and subfederal entities. These have been the focus of intense disputes between Baghdad and Erbil in recent years.

One key bone of contention concerns natural resources, which make up over 90 percent of the federal budget.² Negotiations over both the framework law for the oil and gas sector and the revenue-sharing law have stalled since 2007, due to unbridgeable disagreements between the federal government and the KRG.³ In the absence of federal legislation clarifying jurisdiction over hydrocarbon exploration and development, the KRG passed its own oil and gas law in August 2007, which it claims is consistent with the federal constitution. The KRG has since proceeded to

sign production-sharing contracts (PSC) with international oil companies — small companies at first, followed by larger ones and majors such as ExxonMobil, Chevron, Total and Gazprom.⁴ Baghdad disputes the KRG's right to sign contracts with oil companies without its approval. In particular, it claims that, by offering oil companies excessively favorable terms, the KRG's PSCs violate the constitutional requirement to develop "oil and gas wealth in a way that yields the greatest benefit to the Iraqi people."⁵ Besides the specific legal arguments, Baghdad is vocal in its opposition to decentralized development and management of natural resources, which it claims could bring about civil war and disintegration of the country.⁶

The KRG is adamant that, in light of a history of violence against the Kurds by government forces financed through oil revenues, centralization is unacceptable.⁷ Kurds' fears of creeping re-centralization are not limited to the hydrocarbon sector. They underlie the attempts in 2012 by KRG President Masoud Barzani to unseat Iraqi Prime Minister Nouri al-Maliki with a no-confidence vote.⁸

Revenues from all of Iraq's oil exports accrue to the federal budget.⁹ In accordance with a political agreement between Iraq's main political parties enshrined in the annual federal budget law, revenues are then distributed to governorates in proportion to their population, with the exception of the KRG, which receives a flat 17 percent (before deductions for federal expenditures from which the region benefits). The KRG complains that Baghdad provides it with a smaller share of revenues than agreed upon and that disbursement of the funds occurs capriciously through myriad small installments. Kurdish officials claim that this hinders Erbil's policy planning and imple-

mentation.¹⁰ Hence, the KRG demands the establishment of a mechanism for the automatic allocation to subfederal entities of their share of the federal budget; however, as noted, no progress has been made towards agreement on a revenue-sharing law over the past few years.

The natural resources issue is deeply intertwined with territorial disputes between the KRG and the federal government over areas of Kirkuk, Ninewa, Salahaddin and Diyala provinces. These territories are ethnically mixed (mostly inhabited by Sunni Arabs, Turkmen and Kurds) and rich in natural resources, including Kirkuk and its "super-giant" oil field, a major flashpoint between Iraq's Kurds and Baghdad.¹¹ Tensions in the disputed territories escalated following a shootout between Kurdish and federal security forces south of Kirkuk in November 2012, leading both sides to mobilize tens of thousands of troops in an ongoing standoff in the disputed territories.¹²

The Kurdistan region is landlocked, depending for exports of its oil to Turkey on Baghdad-controlled export infrastructure.¹³ Over the past three years, Baghdad and Erbil reached a series of stop-gap agreements for the export of Kurdistan's oil, by means of which revenues would accrue to the federal budget and Baghdad would compensate producing companies. The implementation of the agreements was marred by disputes over Baghdad's partial and delayed payments to the companies and over the KRG's compliance with agreed-upon export volumes.¹⁴ The last agreement, reached in September 2012, broke down within less than three months. Pressured by complaints from oil companies operating in Kurdistan about Baghdad's unreliable payments, the KRG essentially stopped its exports through

the pipeline. As of the time of this writing (November 2013), Kurdistan's oil is being sold within the region at significantly less than international market prices, but small amounts are being exported by truck to Turkey (there are also allegations of smuggling to Iran).¹⁵ Baghdad responded by threatening legal action, claiming that unauthorized exports to Turkey represent an unconstitutional infringement of the federal government's authority.¹⁶ A May 2013 agreement between Maliki and his KRG counterpart, Nechirvan Barzani, on a set of principles and procedures to solve several longstanding disputes between Baghdad and Erbil raised hopes of a breakthrough in the hydrocarbon deadlock, but no concrete development followed.¹⁷

Ankara-Erbil Relations

The deterioration of Baghdad-Erbil relations over the past few years stands in stark contrast to the deepening political and economic partnership between Turkey and the KRG. In 2011, Iraq was the second-largest export market for Turkey, with the Kurdistan region accounting for 70 percent of the flows. An overwhelming majority of goods sold in the region and about half of its foreign companies are from Turkey (Turkish investment has been especially prominent in construction and natural resources).¹⁸ Politics has proceeded hand in hand with economics. As Aydin Selcen, Turkish consul-general in Erbil, put it: "Our prime minister's vision is full economic integration. One day you won't notice the frontier between Turkey and Iraq."¹⁹ In October 2009, Turkish Foreign Minister Ahmet Davutoğlu visited Iraqi Kurdistan with a delegation of officials and businessmen and announced the opening of a consulate in Erbil.²⁰ In March 2011, Recep Tayyip Erdogan visited the

Kurdistan Region — a first for a Turkish prime minister.²¹ Iraqi Kurdish leaders also regularly visit Ankara; KRG President Massoud Barzani's October 2012 participation in the general congress of Erdogan's Justice and Development Party (AKP) was of special symbolic importance.²²

Relations between Ankara and Iraq's Kurds have historically been more tense. For a long time, the key driver of Turkey's policy vis-à-vis Iraq's Kurds was fear that any step towards enhanced Kurdish rights in Iraq would have negative repercussions for Turkey's own Kurdish "problem."²³ In 1984 (the year marking the onset of the insurgency of the Kurdistan Workers' Party, PKK), Turkey bullied Saddam Hussein into not signing an agreement on Kurdish autonomy that Baghdad had negotiated with the Patriotic Union of Kurdistan (PUK).²⁴ Throughout the 1990s, in spite of Turkey's contributions to Operation Provide Comfort and Operation Northern Watch in support of Iraq's Kurds after the first Gulf War, Ankara remained deeply suspicious of the experiment in Kurdish self-rule in Iraq. It feared that this example might somehow incite the Kurds in Turkey; besides, the ongoing PKK insurgency was benefiting from bases in Iraq.²⁵ Analogous concerns loomed large in Ankara's ambivalence about the U.S.-led invasion of Iraq in 2003 and motivated Turkish efforts to prevent recognition of the Kurdish region in the new Iraqi constitution.²⁶

The improvement in Erbil-Ankara relations of the past few years reflects both long-term trends in Turkish domestic politics and changes in the strategic environment faced by Turkey. Following the defeat of the PKK and the European Union's granting of accession-candidate status to Ankara in 1999, Turkey embarked on a process of political liberalization. This

entailed significant improvements in the human rights of the country's Kurds.²⁷ The victory of Erdogan's AKP in 2002 (with widespread support among Turkey's Kurds) led to an acceleration of reforms. Erdogan liberalized the political system through legislative and constitutional reforms enhancing freedom of the press, association and expression as well as lifting the state of emergency in several southeastern provinces and strengthening civilian control over the country's powerful military. Importantly, Erdogan amended Article 28 of the constitution, which banned the use of the Kurdish language in public.²⁸ These reforms contributed to the emergence of a climate conducive to the improvement of relations between Ankara and Erbil.²⁹ The recent ceasefire declaration by jailed PKK leader Abdullah Ocalan and the ongoing initiatives to amend Turkey's constitution to reduce its emphasis on Turkish ethnicity, expand Kurdish cultural and political rights, and increase administrative decentralization represent further significant steps in the same direction.³⁰

Turkey has experienced the fastest growth in energy demand among Organisation for Economic Co-operation and Development (OECD) countries over the past two years, and its energy use is projected to double over the next decade.³¹ The overwhelming majority of this growing demand is met with oil and gas imports, mostly from Iran and Russia.³² The KRG's natural resources represent a welcome opportunity to diversify away from these sources. Iranian gas supplies are unreliable, as they are often cut off during the winter in response to Iranian domestic demand peaks. Ankara has also experienced difficulties in paying for its gas purchases from Iran, due to the tightening of sanctions against the Iranian financial sector.³³ Turkey has long

expressed a desire to reduce its dependence on imports of gas from Russia so as to gain foreign-policy leeway.³⁴ KRG resources represent a source of energy security for Ankara because Turkey is their only plausible outlet. This makes them essentially captive sources of supply in the event of disruptions elsewhere, and it puts Turkey in a good position to extract a favorable gas price and reduce prices charged by other suppliers.³⁵ Moreover, access to Kurdish resources serves Ankara's goal of becoming a major energy hub, connecting the Middle East, Russia and the Caucasus to Europe and reaping both geopolitical advantages and economic benefits in the form of transit fees.³⁶ Finally, the geopolitical value of closer relations with the KRG has significantly increased for Ankara with the deterioration of its relationship with Baghdad in the past few years. Turkey sees Erbil as a counterweight to Iranian influence on the Shia-dominated government of Iraq.³⁷

The rapprochement between Turkey and the KRG recently culminated in a strategic energy deal, under which a Turkish parastatal company would acquire stakes in several exploration blocks in Iraqi Kurdistan, and pipelines would be built for oil and gas export to Turkey.³⁸ The new pipelines would provide an outlet to international markets for KRG-controlled natural resources, thus circumventing the present deadlock between Erbil and Baghdad over oil exports.³⁹ Turkish and KRG policy makers, however, have repeatedly stated that any export agreement between Ankara and Erbil would respect the existing revenue-sharing scheme, under which the KRG is entitled to 17 percent of the total hydrocarbon revenues bound for Iraq's federal coffers.

Baghdad has vehemently opposed the Turkey-KRG rapprochement, fearing that

it would increase the Kurds' leverage in Iraq's domestic politics and could represent a springboard for Kurdish independence down the road. While the United States initially encouraged warmer relations between Ankara and Erbil, it has campaigned against their new energy partnership, lest it intensify ethnic tensions and further destabilize Iraq.⁴⁰ As the joke in Turkish diplomatic circles goes, "The United States wanted Turkey and Iraq's Kurds to become friends, not to get married."

Ankara's willingness to allow natural-resource exports from KRG territory without Baghdad's permission (and in defiance of Washington's warnings) suggests that fears of enhanced KRG autonomy leading to more unrest among Turkish Kurds have largely subsided in Turkey's calculus. In fact, besides the economic and geopolitical considerations mentioned above, Ankara likely sees the pursuit of a closer relationship with the KRG as instrumental in solving Turkey's Kurdish "problem." On the one hand, Kurdish areas in the south of Turkey would handsomely benefit from deeper economic ties with the KRG, which in turn should reduce the Kurdish population's willingness to support armed struggle against the state. On the other hand, increasing KRG economic and political reliance on Turkey is likely to strengthen Ankara's leverage in the relationship, thus ensuring that Erbil will stick to positions on the PKK and the Kurdish issue that are to Ankara's liking.

BARGAINING LOGIC

The interaction between Baghdad and Erbil can be analyzed as a two-player bargaining game.⁴¹ Our objective is to assess the impact of Ankara's current and future policies towards Iraq on the prospects of cooperation and conflict between Baghdad

and Erbil. This analysis entails a major simplification of a complex reality, in order to shed light on ongoing developments in Iraq. In standard zero-sum bargaining games on the distribution of a surplus, the "pie" to be shared is a continuous variable. However, in weakly institutionalized political environments where the rule of law is weak or absent, the parties may not be able to credibly commit to specific divisions of resources. Whatever is agreed upon today could later be renegotiated in light of changes in relative power. Commitment problems can thus reduce the number of realistic negotiated solutions, making the surplus-share variable effectively discrete.

The existence of commitment problems goes a long way in explaining two facts: (1) Negotiations between Erbil and Baghdad have focused on the KRG's right to sign its own oil and gas contracts and on revenue-sharing procedures rather than the size of each side's shares; and (2) the gap between their positions has so far proven unbridgeable.⁴² Erbil sees as inherently suspect any revenue-sharing scheme that does not sanctify KRG's control of the region's hydrocarbon industry and does not include a mechanism for automatic revenue allocation to subfederal entities, as Baghdad could renege on any agreement.⁴³ For its part, Baghdad is likely concerned about the possibility that if the KRG gets its way in the ongoing disputes, Erbil would be in a better position to subsequently renegotiate its share of the federal budget or prevail in other disputes over distribution.⁴⁴ Baghdad may also fear that the KRG covets direct control of the region's hydrocarbon industry as a preliminary step towards outright Kurdish independence from Iraq. Moreover, there is evidence that Baghdad worries about some sort of "demonstration effect" associated

with concessions on control of the Kurdish region's natural resources industry: other subfederal entities may feel emboldened to advance similar requests, thus weakening the central government and, in the worst case scenario, paving the road to the country's disintegration.⁴⁵

Baghdad and Erbil have thus found themselves locked in a costly political stalemate. The absence of a comprehensive legal framework for Iraq's hydrocarbon sector is widely seen as a deterrent to international investment and therefore a hindrance to its development, while the breakdown of export deals between the federal government and the KRG has curtailed the country's revenues. Erbil and Baghdad have each pursued diametrically opposite strategies to overcome the stalemate in their own favor.

Erbil has attracted international investments in the natural resources under its control and lobbied Ankara to provide an alternative export outlet for the corresponding product. These two initiatives proved mutually reinforcing. On the one hand, attracting international companies required offering some guarantee of their right to monetize (sell in international markets the natural resources that they extract), demanding either a solution of the dispute between Baghdad and Erbil or the creation of an alternative export route through Turkey. On the other hand, Ankara's willingness to allow hydrocarbon exports from Iraq's Kurdistan without Baghdad's permission (and incur the corresponding political costs) has always been a function of the ability of KRG-controlled resources to satisfy a growing energy demand. This crucially depended on attracting international investments to the region. The KRG thus proceeded to create facts on the ground, so as to convince Baghdad

to soften up its negotiating position in the face of its ever-closer partnership with Ankara or, if no compromise is possible, to gain de facto financial independence from the federal government through oil and gas exports to Turkey.

The federal government has tried to undermine KRG initiatives towards international companies and Ankara with the ultimate objective of making Erbil capitulate to Baghdad's demands. The federal government has increased the legal-political risk to energy companies operating in Kurdistan by threatening legal consequences for signing PSCs with the KRG and exporting oil without federal government approval and by hinting at the possibility of resorting to force if Exxon-Mobil were to start its planned drilling activities in disputed territories.⁴⁶ The federal government likely used the rows over payments to KRG-contracted companies (which led to the breakdown of export agreements between Baghdad and Erbil) to punish companies working with Erbil and to try to discourage fence-sitters from following in their footsteps. Baghdad has also signaled to Ankara its displeasure at the deepening of relations between Turkey and the KRG through a variety of political and diplomatic channels and has lobbied the United States to persuade the Turkish government not to allow energy exports without federal-government approval.⁴⁷

With KRG oil expected to flow to Turkey through the new pipeline by the end of the year, Turkish officials hold out hopes of reconciliation with Baghdad and of a solution of the negotiating stalemate between the federal government and the KRG. This is not just wishful thinking. The operation of the new pipeline and the corresponding legalization of the Turkey-KRG energy partnership will signify the failure of Bagh-

dad's attempts to discourage Ankara from supporting Erbil in its dispute with the federal government and reassure international companies about the viability of the KRG's natural resources industry. As its residual hopes of undermining the KRG's initiatives with the current policy vanish, it is unlikely that Baghdad would want to stick to an increasingly costly failed strategy. (Besides the forgone investments due to investors' concerns for the absence of a federal hydrocarbon framework law, forgone revenues from KRG's oil production would grow fast, once investors are reassured about their right to monetize.) Baghdad would thus be faced with the alternative between making concessions to Kurdish demands on the hydrocarbon framework and revenue-sharing laws and escalating through a resort to force.

Baghdad's concessions could be coupled with Kurdish concessions on other pending issues so as to sweeten the pill. This would be particularly useful for Maliki to deflect likely accusations from his political rivals of having given in to the Kurds under duress. However, the fact would remain that, by making concessions on the key bones of contention — the hydrocarbon framework and revenue-sharing laws — Baghdad would be accepting to live with the commitment concerns mentioned above. In particular, when the new pipelines are actually operative, Baghdad would be dealing with a KRG with significantly more bargaining power. On the one hand, the new pipelines would allow Erbil to export oil (and gas at some point in the future) even in the case of continued stalemate with the federal government and to shield itself from the financial consequences of a possible decision by Baghdad to cut off federal budget transfers to the KRG.⁴⁸ On the other hand, Turkey's

investment in the pipelines and exploration blocks would represent a credible signal of Ankara's willingness to intervene on the KRG's behalf in case of violent confrontation with Baghdad (in particular, in case of unprovoked aggression by government forces). Both factors are likely to increase Erbil's bargaining power, and correspondingly decrease Baghdad's, on a range of domestic issues.

The federal government may be tempted to escalate the dispute with Erbil by resorting to force to forestall this increase in KRG's influence. To some in Baghdad, the gamble on preventive war now to coerce Erbil to capitulate may appear more appealing than having to acquiesce to KRG's demands in the future as the effects of the Turkey-KRG partnership fully materialize. Using force sooner rather than later may also make sense for Baghdad under the assumption that Turkey's commitment to intervene on the KRG's behalf in case of violent conflict would solidify over time as Ankara sinks more investment costs in the KRG's hydrocarbon industry. Baghdad may not be very optimistic about Ankara refraining from intervening if large-scale violence were to erupt in the proximate future, but it may think that its only hope lies with early use of force; the probability of Turkish intervention would increase with the passing of time.

These short-term destabilizing effects of the Turkey-KRG energy partnership stand in contrast to its long-term pacifying effects. In a sense, the partnership creates a window of opportunity for Baghdad to use force to forestall an unfavorable change in the balance of power vis-à-vis Erbil. Once this window closes, the probability of large-scale violence between Baghdad and Erbil should be lower, compared to a scenario in which Turkey had decided

not to invest in KRG-controlled exploration blocks and not to allow the creation of new pipelines. This reduction in war risk is a function of the attenuation of Erbil's commitment concerns over remaining part of Iraq and the deterrent effect on Baghdad represented by Ankara's increased stakes in the KRG's natural resources. The existence of an export outlet beyond Baghdad's control would have the important effect of assuaging Erbil's fears that at some point in the future Baghdad could renege on power and revenue-sharing arrangements and re-centralize political control. As noted, with new pipelines in Kurdish-controlled territory and a vibrant hydrocarbon industry, Erbil would be in a position to shield itself from the financial consequences of such a development by relying on the revenues deriving from its direct hydrocarbon exports to Turkey. The economic interdependence between Turkey and the KRG brought about by the new pipelines would work as a form of insurance for Erbil against worst-case-scenario behavior by an opportunistic Baghdad. This in turn should make the Kurds more comfortable with the idea of remaining part of Iraq. By removing an important motive for Kurdish secessionism, the creation of the new pipelines would reduce the probability of a civil war sparked by a KRG bid for independence. Moreover, as pointed out above, as Turkey actually sinks its investments into KRG-controlled exploration blocks and the new pipelines, the probability that Ankara would help Erbil in case of aggression by Baghdad (and thus protect its own investments) is likely to be sufficiently high to discourage Iraq's use of force to settle ongoing disputes.

A critical reader may point out that the creation of hydrocarbon export infrastructure outside federal control and prospects of Turkish political and military support

may embolden the KRG, which would then advance excessive demands to the federal government and perhaps even attempt secession, thus somehow provoking a war. The logic of our argument does, in fact, suggest that Erbil's demands *might* grow with its bargaining power. However, this is not necessarily the case. Inasmuch as our assessment that commitment fears are a key determinant of Erbil's negotiating position is correct, the reduction of those concerns associated with the creation of new pipelines (in a context in which the KRG maintains its hold on the region's hydrocarbon sector) could lead Erbil to be less intransigent in negotiations with the federal government. Even if an escalation of Kurdish demands does occur, we should not expect this to translate automatically into an increased risk of armed conflict between Baghdad and Erbil, but rather in a bargaining outcome more favorable to Erbil, as both are aware of the KRG's stronger position.⁴⁹ Moreover, Kurdish politicians have been explicit about their preference for overcoming the hydrocarbon deadlock with an agreement with Baghdad and in the framework of the existing 17-83 percent revenue-sharing formula, rather than by achieving de facto financial independence or even de jure independence. To be sure, they openly acknowledge the Kurdish people's historic aspiration to statehood, but they also clearly state that this is a long-term goal to be achieved by peaceful means under changed geopolitical circumstances — in particular, they consider Turkish and U.S. support for independence an absolutely necessary condition.⁵⁰

There is no indication that Ankara (let alone Washington) would back up a secessionist bid by Erbil. Turkey's position towards Iraq's Kurds has certainly dramatically changed over the past few years, but

it seems highly doubtful that Ankara would be willing to support the KRG all the way to statehood. Turkey is much more likely to accept a condition of *de facto* financial independence in which the KRG helps Ankara satisfy its growing energy demand and geopolitical ambitions, without the higher risks of war with Baghdad, the domestic nationalist backlash, and the potential “demonstration effect” among Turkey’s Kurds that *de jure* sovereignty would entail.⁵¹ The KRG’s complete reliance on Turkey for access to international hydrocarbon markets suggests that Ankara should be able to keep Kurdish secessionist aspirations at bay (if necessary) by threatening to shut down the pipelines. Carrying out this threat would be costly for Ankara, but the costs would be significantly higher for Erbil given its economy’s almost complete dependence on natural resources.

Our theoretical logic identifies competing short-term and long-term effects of the Turkey-KRG energy partnership on the prospects of conflict between Baghdad and Erbil. The key question from a policy point of view is this: are the long-term benefits worth the short-term risks? The answer hinges on whether Baghdad’s preventive-war incentives are sufficiently strong to push it to take a gamble. We argue that Baghdad is highly unlikely to consider the open use of force against Erbil in the short run as a realistic option. Baghdad is monitoring developments in neighboring Syria with great concern. A rebel victory (or even some sort of negotiated settlement that frees up insurgent resources) would have major political and military spillovers across the border in Iraq, strengthening and emboldening both the Sunni Arab protest movement and a resurgent AQI.⁵² The Iraqi government is unlikely to be willing to gamble on war against the KRG at a mo-

ment in which it faces a Sunni threat both across the border and at home. Moreover, even if the probability of Ankara’s intervention in a potential Baghdad-Erbil war would be highest when Turkish investments are fully sunk in and the new pipelines are in place, there would already be a non-negligible risk of Turkey’s providing military support to KRG forces, which should be a powerful deterrent to Baghdad’s decision to use force.

Baghdad is more likely to consider the use of more limited violent measures, in particular sabotage of the new pipelines; however, these are unlikely to pose major obstacles to hydrocarbon flows. Pipelines in northern Iraq are often targeted by armed Sunni groups, but these attacks tend to occur in areas under federal government rather than KRG control.⁵³ The federal government would have a hard time carrying out a sustained campaign of attacks on the new pipelines: the Shia groups that may be willing to help would probably experience serious difficulties organizing and executing operations in Sunni- and Kurdish-dominated areas, while the Sunni armed groups that may more easily operate in ethnically mixed areas are unlikely to offer their services to Baghdad, given the growing ethnosectarian tensions agitating the country.

In sum, the Turkey-KRG energy partnership offers the prospect of unlocking international markets for the Kurdistan region’s resource wealth. The corresponding significant economic benefits for both Iraq and Turkey (and probably energy-importing European countries) would be coupled with a net reduction in the probability of war between Baghdad and Erbil, in spite of the increased risk of preventive war by Baghdad in the short run. U.S. policy should reflect awareness of both the

opportunities and risks involved and thus abandon its current focus on discouraging Ankara and Erbil from pursuing closer energy ties for fear that Iraq may once again plunge into civil war. In fact, altering the trajectory of Ankara-Erbil relations may well be beyond Washington's power, given the importance of the stakes for both Turkey and the KRG. However, U.S. policy could help reduce the risk of short-term instability associated with the Turkey-KRG partnership by clearly stating that the United States will punish aggression by any side of the Ankara-Baghdad-Erbil triangle and that it expects the parties to solve their disputes peacefully. Moreover, Washington should withhold the transfer of military equipment to Iraq that could be used in a conventional offensive against Kurdistan, while providing Baghdad with support for counterinsurgency and counterterrorism activities. Finally, Washington should encourage Ankara to provide Baghdad with credible assurances that its partnership with Erbil will not affect Turkey's commitment to Iraq's sovereignty, territorial integrity and the existing revenue-sharing arrangement between the federal government and the KRG.

CONCLUSIONS

Due to deep-seated commitment problems, Baghdad and Erbil have been stuck in a political deadlock over the hydrocarbon framework and revenue-sharing laws. Erbil tried to attract international investments in hydrocarbons and persuade Ankara to provide an alternative export outlet, with the ultimate objective of mollifying Baghdad's negotiating position or to gain de facto financial independence from the federal government with hydrocarbon exports to Turkey in case of no agreement. Baghdad tried to undermine KRG initia-

tives by manipulating the legal-political risk faced by energy companies operating in Kurdistan and voicing to Ankara its unease at the tightening of relations between Turkey and the KRG.

The new Turkey-KRG energy partnership, with Ankara's decision to invest in KRG-controlled exploration blocks and allow the creation of new pipelines, signifies the success of Erbil's strategy and the failure of Baghdad's attempts to undermine it. Baghdad is likely to want to abandon a failing, costly strategy, in which case it will face a choice between making concessions to Kurdish demands on the hydrocarbon framework and revenue-sharing laws and escalating by resorting to force.

Baghdad's concessions would amplify the prospective strengthening of Erbil's hand deriving from Turkish investments and the new pipelines. The KRG would be in a position to bargain harder because the new pipelines would provide an alternative source of revenue, in case Baghdad threatens to suspend federal budget transfers. In addition, Turkish intervention on Erbil's behalf in case of aggression by Baghdad would be more likely after Ankara has sunk in its investment and the new pipelines are in place. This should also reduce the federal government's leverage vis-à-vis the KRG. Baghdad may thus be tempted to launch preventive war to forestall the unfavorable change in the balance of power, perhaps also in the hope of convincing Turkey to change course. However, we consider the probability of Baghdad's initiating war in the short-term to be low, in particular due to its concern with the civil war in Syria and the corresponding risks of spillover in Iraq, as well the ongoing unrest among Iraq's Sunnis and AQI's growing menace.

In any case, responsible policy making requires comparing the short-term increase

in the risk of war with the corresponding long-term benefits, which we argue are greater. Ankara's pipeline decision would offer the prospect of unlocking international markets for the Kurdistan region's resource wealth, with a strong potential of contributing to Iraq's and Turkey's socio-economic development (and probably to the wellbeing of energy-importing European countries). Moreover, Ankara's decision

would have the long-run effect of assuaging Erbil's entrenched fears of exploitation by Baghdad; this should eliminate a powerful motive for Kurdish secessionist aspirations and reduce the corresponding risk of war. Thus, U.S. policy on the issue should not aim at blocking the Turkish initiative (which, in any case, is unlikely to succeed) but rather attempt to contain the risk of conflict escalation in the short run.

¹ For good overviews of the recent history of relations between the central government and Iraqi Kurds, see, for example, Michael M. Gunter, *The Kurds Ascending: The Evolving Solution to the Kurdish Problem in Iraq and Turkey* (Palgrave Macmillan, 2008) and David McDowall, *A Modern History of the Kurds* (I. B. Tauris, 2004). For an analysis of the Iraqi constitution in comparative political perspective, see John McGarry and Brendan O'Leary, "Iraq's Constitution of 2005: Liberal Consociation as Political Prescription," *International Journal of Constitutional Law* 5, no. 4 (2007).

² In 2011, oil revenues accounted for around 95 percent of the federal budget. See International Energy Agency, "Iraq Energy Outlook," 2012, 19.

³ The package of hydrocarbon laws under consideration also includes the reorganization of the Iraqi Ministry of Oil and the creation of the Iraq National Oil Company (INOC).

⁴ Patrick Osgood, Ben Lando and Ben Van Heuvelen, "As Kurdistan Oil Booms, Deal-making Accelerates," *Iraq Oil Report*, December 3, 2012. Baghdad adopts technical service agreements. For a discussion of different types of contracts and their fiscal terms, see David Johnston, "How to Evaluate the Fiscal Terms of Oil Contracts," in *Escaping the Resource Curse*, eds. Macartan Humphreys, Jeffrey Sachs, and Joseph E. Stiglitz (Columbia University Press, 2007).

⁵ Article 112(2) of the Iraqi constitution states: "The federal government and the governments of the producing regions and governorates shall jointly formulate the necessary strategic policies to develop oil and gas wealth in a way that yields the greatest benefit to the Iraqi people and relies on the most advanced techniques of market principles and investment promotion," translated from Arabic in International Crisis Group, "Iraq and the Kurds: The High-Stakes Hydrocarbons Gambit," *Middle East Report* 120 (April 19, 2012). For an example of Baghdad's views, see Ben Lando, "Ten Deals Makes a Happy Minister," *Iraq Oil Report*, February 4, 2010, which reports an interview with Iraqi Deputy Prime Minister for Energy Affairs, Hussain al-Shahristani.

⁶ See, for example, Ben Van Heuvelen, "Q&A: Hussain al-Shahristani," *Iraq Oil Report*, December 22, 2011.

⁷ Interview with Minister Falah Mustafa Bakir, head of the KRG Department of Foreign Relations, Erbil, October 24, 2012; speech by KRG Prime Minister Nechirvan Barzani, CWC Kurdistan-Iraq Oil and Gas Conference, Erbil, December 4, 2012.

⁸ International Crisis Group, "Deja Vu All Over Again? Iraq's Escalating Political Crisis," *Middle East Report* 126 (July 30, 2012).

⁹ Iraq does not yet export gas.

¹⁰ Interview with Minister Falah Mustafa Bakir, October 24, 2012; interview with Qubad Talabani, KRG Presidency of the Council of Ministers, head of Department of Coordination and Follow Up, Erbil, December 2, 2012; interview with KRG natural resources ministry official, Erbil, December 2012; Christopher M. Blanchard, "Iraq: Oil and Gas Legislation, Revenue-sharing, and U.S. Policy," CRS Report for Congress, March 3, 2010.

¹¹ There are six other super-giant oil fields in Iraq, five in the south near Basra and one in the center near Baghdad; International Energy Agency, 2012, 52.

¹² Patrick Osgood and Kamaran Al-Najar, "In Disputed Territories, a Thin Line between Politics and Violence," *Iraq Oil Report*, January 24, 2013.

¹³ In principle, Iran and Syria represent alternative export routes. In practice, several geopolitical factors undermine their viability. Iran plays an important economic role in Iraq's Kurdish region but is under oil sanctions and the United States has been pressuring third parties to stop purchasing its gas. In addition, Tehran has much closer relations with the Shia-dominated government in Baghdad (which has been opposing KRG's natural resources initiatives) and in any case has less of a powerful incentive than Turkey to tap into Kurdish resources due to its own resource wealth. The ongoing civil war rules out Syria as an export outlet for KRG's resources; moreover, Syria is an oil exporter and thus has less of a thirst for Kurdish crude than Turkey (the country imports gas but KRG's gas exports are unlikely to start before a couple of years).

¹⁴ For a concise overview of Baghdad-Erbil export deals, see International Crisis Group, "Iraq and the Kurds: The High-Stakes Hydrocarbons Gambit," *Middle East Report* 120 (April 19, 2012): 6-7.

¹⁵ Patrick Osgood and Kamaran Al-Najar, "Kurdistan Exports Nearly Zero as Payment Hopes Thin," *Iraq Oil Report*, December 20, 2012.

¹⁶ Patrick Osgood and Kamaran Al-Najar, "Analysis: Legal Conflict Looms as Oil Politics Deteriorate," *Iraq Oil Report*, February 1, 2012.

¹⁷ Patrick Osgood and Ben Lando, "Barzani-Maliki Deal Sets Process, Again, for Agreement," *Iraq Oil Report*, May 3, 2013.

¹⁸ Interview with Turkish diplomat, Ankara, January 14, 2013.

¹⁹ Quoted in Abigail Fielding-Smith, "Turkey Finds a Gateway to Iraq," *Financial Times*, April 14, 2010.

²⁰ M. Alihan Hasanoglu, "Arbil Prepares Enthusiastic Welcome for Davutoğlu," *Today's Zaman*, October 30, 2009.

²¹ Shamal Araqi, "Turkey's Erdogan in First Visit to Iraq Kurd Region," Reuters, March 29, 2011.

²² Aziz Barzani, "AKP and Iraqi Kurds: The Participation of Massoud Barzani in the AKP General Congress," *Today's Zaman*, October 2, 2012.

²³ Mustafa Kemal Atatürk provided an early articulation of the Kurdish "domino effect" theory: "Mosul is extremely important for us. Firstly, as an oil-rich region... Secondly, [because of] the equally important issue of Kurdistan (*Kütçülük*), Britain tries to create a Kurdish state there. If it does so, the [idea of Kurdistan] will also get spread out among the Kurds inside our borders," Uğur Mumcu, *Kürt İslam Ayaklanması 1919-1925/Kurdish Islamic Revolt 1919-1925* (Istanbul: Tekin Yayinevi, 1991), 47.

²⁴ Interview with Adel Murad, Secretary of the PUK Central Council, Sulaimani, November 15, 2012.

²⁵ David L. Phillips, "Confidence Building between Turks and Iraqi Kurds," Atlantic Council of the United States, 2009, 9-10.

²⁶ International Crisis Group, "War in Iraq: What's Next for the Kurds?" *Middle East Report* 10 (March 19, 2003): 7-9; M. Hakan Yavuz and Nihat Ali Özcan, "The Kurdish Question and Turkey's Justice and Development Party," *Journal of Middle East Policy* 13, no. 1 (2006).

²⁷ By 1999, with a series of Turkish military thrusts against PKK bases in northern Iraq and the interruption of Syrian support to the PKK (leading to the arrest of its leader, Abdullah Öcalan), Turkey managed to significantly weaken the insurgent group, which announced it was laying down its arms in 2000; Svante E. Cornell, "The Land of Many Crossroads: The Kurdish Question in Turkish Politics," *Orbis* 45, no. 1 (2001). Significant PKK operations in Turkey resumed in 2011; International Crisis Group, "Turkey: The PKK and a Kurdish Settlement," *Europe Report* 219 (September 11, 2012).

²⁸ Phillips, "Confidence Building," 2009, 7-8.

²⁹ Iraqi Kurdish politicians often stress this point; interview with Saadi Pirah, PUK Politburo member, Erbil, October 23, 2012; interview with Jafaar Ibrahim, KDP spokesperson, Erbil, November 20, 2012.

³⁰ F. Stephen Larrabee, "Why Erdogan Wants Peace with the PKK: The End of an Insurgency," *Foreign Affairs*, March 27, 2013, accessed April 7, 2013, <http://www.foreignaffairs.com/articles/139081/f-stephen-larrabee/why-erdogan-wants-peace-with-the-pkk>.

³¹ U.S. Energy Information Administration, "Turkey," February 1, 2013, 1.

³² U.S. Energy Information Administration, 2013. Turkey's existing plans for nuclear energy would meet only a small fraction of the country's energy demand; Volkan Özdemir, "Turkey's Role in European Energy Security," in *Europe's Energy Security: Gazprom's Dominance and Caspian Supply Alternatives*, eds. Svante E. Cornell and Niklas Nilsson (Central Asia-Caucasus Institute and Silk Road Studies Program, 2008), 100.

³³ Robin M. Mills, "Northern Iraq's Oil Chessboard: Energy, Politics and Power," *Insight Turkey* 15, no. 1 (2013): 58; and "Exclusive: Turkey-Iran Gold Trade Wiped Out By New U.S. Sanctions," Reuters, February 16, 2013.

³⁴ Ahmet Evin et al., "Getting to Zero: Turkey, Its Neighbors and the West," Transatlantic Academy, 2010, 15. Tapping into Kurdistan's resources would more generally provide Turkey with increased leverage in its neighborhood; Mills, "Northern Iraq's Oil Chessboard," 58.

³⁵ Mills, "Northern Iraq's Oil Chessboard," 57-59; Shwan Zulal, "Survival Strategies and Diplomatic Tools: The Kurdistan Region's Foreign Policy Outlook," *Insight Turkey* 14, no. 3 (2012): 152. Mills also notes that Turkish demand for oil could be fully satisfied by the amount of oil that the KRG claims it would be able to export by 2015 (1 million barrels per day), while projected gas exports would be sufficient to entirely replace Iranian exports.

³⁶ Mills, "Northern Iraq's Oil Chessboard," 58.

³⁷ Baghdad's and Ankara's contrasting positions vis-à-vis the ongoing Syrian crisis have been a major source of tension between the two countries. The deepening of Ankara-Erbil political and economic relations as disagreements between the KRG and the federal government festered has also played a role (interview with Turkish diplomat, November 2012).

³⁸ Humeyra Pamuk and Orhan Coskun, "Exclusive: Turkey, Iraqi Kurdistan Clinch Major Energy Pipeline Deals," Reuters, November 6, 2013.

³⁹ A new oil pipeline in KRG-controlled territory is about to be completed and is supposed to be connected near the Turkish border with the existing Iraq-Turkey (Kirkuk-Ceyhan) pipeline, which has significant spare capacity. A second oil pipeline and a gas pipeline are in the works, but gas exports will not take place for a few years. Ben Van Heuvelen, "New Pipeline Reinforces KRG-Turkey Ties," *Iraq Oil Report*, October 6, 2013; "Kurds, Turkey Edge Towards Oil Deal," *Wall Street Journal*, October 31, 2013.

⁴⁰ Semih Idiz, "U.S. Tries to Reconcile Ankara and Baghdad," *Al-Monitor*, April 9, 2013.

⁴¹ The classic reference is James D. Fearon, "Rationalist Explanations for War," *International Organization* 49, no. 3 (1995): 379-414.

⁴² To be sure, some aspects of the dispute between Baghdad and Erbil can be thought of as bargaining over the share of federal revenues allocated to the KRG. In particular, members of the Iraqi parliament aligned with Maliki have repeatedly tried to reduce from 17 to 12 percent the KRG's share of the federal budget. Moreover, the amount of federal payments to the companies under KRG's contracts pumping oil through the existing pipeline was a central focus of the negotiations for the 2013 federal budget. However, both of these issues are connected with the broader negotiations over the degree of decentralization of the natural resources sector, with Baghdad trying to use the threat of reducing federal transfers to the KRG and the stalled payments to the oil companies as tools for leverage; Ben Van Heuvelen and Ben Lando, "Baghdad Targets KRG Budget Priorities," *Iraq Oil Report*, December 17, 2012; Patrick Osgood, "Budget Passes despite Kurdish Boycott," *Iraq Oil Report*, March 8, 2013.

⁴³ KRG officials are explicit about the fact that the history of violence perpetrated by the Iraqi government against its Kurdish citizens makes them distrustful of centralized control of natural resources and of revenue-sharing arrangements that leave room for the central government's discretion. Interview with Minister Falah Mustafa Bakir, October 24, 2012; interview with Qubad Talabani, December 2, 2012; interview with KRG natural-resources ministry official, December 2012.

⁴⁴ There is, for example, a longstanding dispute between Erbil and Baghdad about whether the KRG's peshmerga forces should be financed via the central government's or the KRG's budget.

⁴⁵ For example, Maliki has argued that the KRG's oil policy threatens to unravel Iraq's fragile federal structure by tempting its other oil-rich regions to strike their own independent deals. Similarly, Abdullah al-Amir, a personal advisor to Hussein al-Shahristani, Iraq's deputy prime minister for energy affairs, argued: "If you have one part of the country producing and exporting and selling the oil, then Basra, the southern part, will do the same, and the other governorates will do the same, and this will have no government planning"; Roxana Saberi, "No End in Sight for Iraq Oil Dispute," *Al-Monitor*, February 27, 2013. Baghdad's fear of setting a precedent represents a different kind of commitment concern from those associated with Erbil's behavior after concessions: here the focus is on the lessons that third parties may draw by observing interactions between the federal government and the KRG.

⁴⁶ Ben Van Heuvelen, "In Iraq, Exxon Oil Deal Fosters Talk of Civil War," *Washington Post*, December

18, 2013; Ben Lando, "Exxon Leads Exodus from Basra to Kurdistan," *Iraq Oil Report*, October 19, 2012; and "Chevron Undeterred by Baghdad Blacklist," *Iraq Oil Report*, July 25, 2012. Baghdad has threatened to blacklist companies signing agreements with the KRG, but the policy has been inconsistently applied. Baghdad has told ExxonMobil that it needs to choose between its investments in southern Iraq and in the Kurdistan region, while Chevron has been banned from investing in the rest of Iraq after signing a contract with the KRG. By contrast, the federal government has warned Total and Gazprom that their contracts with the KRG are illegal but has not asked them to choose between investing in southern and northern Iraq.

⁴⁷ Joe Parkinson, "Iraq Turns Back Turkish Energy Minister's Plane," *Wall Street Journal*, December 4, 2012.

⁴⁸ Back-of-the-envelope calculations suggest that the KRG could offset the loss of federal budget transfers by exporting about 500,000 barrels of oil per day (bpd) in 2015. Assuming that the federal budget grows in 2014 and 2015 at the same speed at which it has been growing since 2009 (17 percent a year) and that the KRG would be allocated the same percentage as in 2013, federal transfers to Erbil in 2015 would amount to approximately \$17 billion, which would require 500,000 bpd at \$90 per barrel for Erbil to break even (this calculation does not take into account federal expenditures on services that the Kurdish areas benefit from). There is wide variation in estimates of KRG's oil production in 2015: the KRG estimates 1 million bpd, while the International Energy Agency considers this estimate too high and expects between 800,000 and 1 million bpd of overall northern production (including both KRG and non-KRG oil). The International Energy Agency does not provide a breakdown of estimated northern Iraqi production for 2015 but only for the years 2020 and 2035. Given that for those two years KRG and non-KRG northern production are approximately equal and the KRG production is expected to grow faster, we can identify 400,000 bpd as the high bound of the International Energy Agency's estimate of KRG oil production in 2015. Thus, 500,000 bpd can be considered as an intermediate estimate of the KRG's export potential in 2015.

⁴⁹ Baghdad may be concerned about the prospect of negotiating from a position of weakness with Erbil and having to make concessions down the road and may thus prefer to fight in the present; this is, however, the short-term preventive war incentive that is already part of our argument.

⁵⁰ One could question the reliability of these kinds of statements by pointing out that they are likely tailored to international audiences with the objective of projecting an image of moderation. However, history suggests that minority leaders' moderate political claims should not be automatically dismissed as "cheap talk" because they sometimes adopt hardline positions. The case of Kosovo offers a useful illustration. Several analysts consider it a clear-cut example of an ethnic minority emboldened by the prospect of external intervention (Kuperman, "The Moral Hazard of Humanitarian Intervention"; Grigoryan, "Third-Party Intervention and the Escalation of State-Minority Conflicts"), but its leaders did not try to underplay their aspiration to independence. In 1992, Serbian Prime Minister Milan Panic offered Kosovo Albanians' leader Ibrahim Rugova to reopen schools and hospitals in Kosovo, as well as to restore the province's autonomy, but Rugova insisted on Kosovo's outright independence as the only possible solution to the conflict (Miranda Vickers, *Between Serb and Albanian: A History of Kosovo* [Columbia University Press, 1998], 266; Diana Johnstone, *Fools' Crusade: Yugoslavia, NATO, and Western Delusions* [Monthly Review Press, 2002], 226). In 1996, shortly after the Dayton agreement put an end to the war in Bosnia, Slobodan Milosevic expressed willingness to negotiate a compromise, but the Kosovo Albanians' response was the dismissal of any settlement short of Kosovo's full independence and the insurgency launched by the Kosovo Liberation Army, which eventually led to the NATO intervention in 1999 and the Serbian retaliatory ethnic cleansing; (Steven Burg, "Coercive Diplomacy in the Balkans: The U.S. Use of Force in Bosnia and Kosovo," in *The United States and Coercive Diplomacy*, eds. Robert Art and Patrick Cronin [The United States Institute of Peace, 2003], 73; Grigoryan, "Third-Party Intervention and the Escalation of State-Minority Conflicts.")

⁵¹ International Crisis Group, "Crying 'Wolf': Why Turkish Fears Need Not Block Kurdish Reform," *Europe Report* 227 (October 7, 2013).

⁵² See, for example, Ernesto Londoño, "Syrian Conflict's Impact Is Felt across Border in Iraq," *Washington Post*, March 27, 2013; Jane Arraf, "A Wary Iraq Weighs Its Options As Syrian Civil War Deepens," *Christian Science Monitor*, December 6, 2012; Tim Arango, "Rising Violence in Iraq Spurs Fears of New Sectarian War," *New York Times*, April 24, 2013; and Jessica D. Lewis, "AQI's 'Soldier Harvest' Campaign," Institute for the Study of War Backgrounder, October 9, 2013.

⁵³ See, for example, Kamaran Al-Najr, "New Pipeline Bombing Adds to Kirkuk Field Woes," *Iraq Oil Report*, September 18, 2013.