Oil, Federalism, and Third-Party Intervention: An Assessment of Conflict Risk in Iraqi Kurdistan

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1. Introduction

Ten years after the US invasion and one and a half year after the withdrawal of all American forces from the country, Iraq faces a number of challenges to its long-term stability and development, ranging from corruption, poor public services provision and persistent terrorist violence to ethno-sectarian tensions in the context of a complex power-sharing system. In this chapter, we focus on one important aspect of the country’s contemporary political scene – the dispute between Iraq’s 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 mechanisms to allocate between the federal government and sub-federal entities revenues from hydrocarbon exports. The parties have been stuck in a costly political stalemate for the past few years. Recent signs that Turkey may allow the creation of new pipelines, thus offering an outlet to international markets for KRG-controlled resources beyond the existing export infrastructure under federal control, offer some hope of ending the stalemate and unlocking the Kurdish region’s hydrocarbon wealth. However, some analysts and US policymakers have expressed concerns that Turkey’s move could actually have destabilizing effects for Iraq, starting a chain reaction that could lead to the violent breakdown of the country.
With this chapter, we take part in this policy debate by attempting to make sense of the ongoing dispute between Baghdad and Erbil and to assess the likely impact on the prospects of its resolution and escalation of Ankara’s possible decision about the new pipelines. We do this by combining an informal bargaining model of Baghdad-Erbil interactions and information collected through about thirty interviews with KRG’s policy makers, Turkish officials, third-country diplomats and analysts as well as from newspaper articles and analytical pieces on Iraq’s politics. We argue that the negotiating stalemate between the federal government and the KRG is to a large extent due to the existence of serious commitment problems on both sides. We expect Ankara’s decision to allow the creation of new pipelines to assuage Erbil’s long-run fears of exploitation by Baghdad, which should eliminate a powerful motive for Kurdish secessionist aspirations and thus reduce the corresponding risk of war. Moreover, once the new pipelines are in place (and Turkey has made the investments in KRG-controlled exploration blocks that are likely to accompany the new export infrastructure), Baghdad is likely to be deterred from resorting to force against Erbil due to the sizable chance of Turkish intervention on KRG’s behalf. On the other hand, Ankara’s decision should lead to a strengthening of Erbil’s bargaining hand vis-à-vis Baghdad, which could generate incentives for the latter to launch a preventive attack before the effects of the Turkish initiative fully materialize. However, we deem the probability of Baghdad initiating war in the short-term low, due to the federal government’s concern with the ongoing civil war in Syria and the corresponding risks of spill-over in Iraq as well as ongoing unrest in Sunni areas. Thus we argue that the United States should abandon its current opposition to a possible Turkish initiative about new pipelines but rather focus its efforts on convincing the relevant actors (in particular Baghdad in the short-term) not to resort to force to resolve disputes.
Our theoretical argument is relevant to a set of intersecting literatures in International Relations on war as bargaining breakdown\(^1\), the effects of natural resources on the risk of different forms of political violence\(^2\), and the impact of third-party intervention in relations between states and their ethnic minorities.\(^3\) The closest existing works are a book chapter by James Fearon (“Commitment Problems and the Spread of Ethnic Conflict”) and a working paper by Arman Grigoryan (“Commitment Problems, Third Parties and State-Minority Conflicts”), which identify commitments concerns, respectively, by the minority and the government as the driver of violent conflict.\(^4\) We combine elements of the two models by assuming that both the government and the minority are haunted by commitment fears when engaged in negotiations

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\(^4\) See note 3 above.
over natural resources. Like in Grigoryan’s model, we assume that third-party intervention in support of the minority can intensify government’s commitment fears by prospectively strengthening the minority’s bargaining hand, which can prompt the government to preventively attack the minority. However, unlike in Grigoryan’s model, our argument suggests that short-term preventive war incentives associated with third-party intervention can be offset by a corresponding long-term reduction of the minority’s fears of exploitation and by the deterrent effect towards the government of third-party support for the minority.

The applicability of our finding goes beyond the case of Iraq. As the case study presented in chapter 1 of this volume points out, Austria played the stabilizing role of an international guarantor for the agreement between the Italian government and the South-Tyrolean community. By contrast, international intervention in Bosnia and Kosovo contributed to the escalation of violence. Our argument can help make sense of these divergent dynamics by showing that third-party intervention in government-minority disputes may have competing destabilizing and pacifying effects in different phases of the intervention. When considering the merits of intervention in a specific case, policymakers should carefully weigh the probability of both positive and negative effects on the risk of conflict escalation and design strategies to mitigate the latter.

The remainder of this paper is structured as follows. Section 2 discusses the current state of relations between Baghdad and Erbil and the ongoing deepening of Turkey-KRG ties. Section 3 presents an analysis of the strategic interaction between Baghdad and Erbil and assesses the likely impact on this interaction of Turkey’s possible decision to allow the creation of new pipelines. Section 4 concludes by summarizing our findings.

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2. Snapshot of the Current Situation

2.1. Baghdad-Erbil relations

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

One key bone of contention concerns natural resources, which contribute for over 90 percent to the federal budget. Negotiations over the oil and gas sector framework law and the revenue sharing law have stalled since 2007 due to unbridgeable disagreements between the federal government and the KRG. 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

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8 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).
proceeded to sign production-sharing contracts (PSC) with international oil companies – small companies at first, followed by larger ones and majors such as Exxon Mobile, Chevron, Total and Gazprom.9 Baghdad disputes the KRG’s right to sign contracts with oil companies without its approval and in particular claims that, by offering oil companies excessively favorable terms, the KRG’s PSCs violate the constitutional requirement of developing “oil and gas wealth in a way that yields the greatest benefit to the Iraqi people.”10 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.11 On its part, the KRG is adamant in saying that, in light of a history of violence against the Kurds by government forces financed with oil revenues, centralization is unacceptable.12 Kurds’ fears of creeping re-centralization of political power are not limited to the hydrocarbon sector and underlay attempts by KRG President Masoud Barzani to unseat Iraqi Prime Minister Nouri al-Maliki with a non-confidence vote last year.13

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10 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, 19 April 2012). For an example of Baghdad’s views, see Ben Lando, “Ten deals makes a happy minister”, *Iraq Oil Report*, 4 February 2010, which reports an interview with Iraqi Deputy Prime Minister for Energy Affairs, Hussain al-Shahristani.


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

Revenues from all of Iraq’s oil exports accrue to the federal budget. 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 a myriad of small installments, which hinders Erbil’s policy planning and implementation. Hence the KRG demands the establishment of a mechanism for the automatic allocation to sub-federal entities of their share of the federal budget, but, as noted, no progress has been made towards the 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, Turkmens and Kurds) and rich in natural resources, including Kirkuk and its “super-giant” oil field, an historic flashpoint between Iraq’s Kurds and Baghdad. Tensions in the disputed territories have recently escalated following a shootout between Kurdish and federal security forces south of Kirkuk.

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14 Iraq does not yet export gas.
15 Interview with Minister Falah Mustafa Bakir, 24 October 2012; interview with Qubad Talabani, KRG Presidency of the Council of Ministers, Head of Department of Coordination and Follow Up, Erbil, 2 December 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, 3 March 2010.
16 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, p. 52).
Kirkuk in November 2012, leading both sides to mobilize tens of thousands of troops in an ongoing standoff in the disputed territories.\textsuperscript{17}

The Kurdistan region is landlocked and depends for exports of its oil to Turkey on Baghdad-controlled export infrastructure.\textsuperscript{18} Over the past three years Baghdad and Erbil reached a series of stopgap agreements for the export of Kurdistan’s oil by which revenues would accrue to the federal budget and Baghdad would compensate producing companies. The implementation of the agreements was marred by disputes over partial and delayed payments to the companies by Baghdad and over KRG’s compliance with agreed export volumes.\textsuperscript{19} The last agreement, reached in September 2012, broke down within less than three months: under pressure from oil companies operating in Kurdistan complaining about Baghdad’s unreliable payments, the KRG essentially stopped its exports through the pipeline. At the time of this writing (April 2013), Kurdistan’s oil is being sold within the region (at a significantly lower price than in the international market) but small amounts are being exported via truck to Turkey (there are also allegations of smuggling to Iran).\textsuperscript{20} Baghdad has responded by threatening legal action, claiming

\begin{itemize}
\item \textsuperscript{17} Patrick Osgood and Kamaran Al-Najar, “In disputed territories, a thin line between politics and violence,” \textit{Iraq Oil Report}, 24 January 2013.
\item \textsuperscript{18} In principle, Iran and Syria represent alternative export routes. In practice, several geo-political 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 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).
\item \textsuperscript{19} For a concise overview of Baghdad-Erbil export deals, see International Crisis Group, “Iraq and the Kurds: The High-Stakes Hydrocarbons Gambit,” \textit{Middle East Report} 120, 19 April 2012, pp. 6-7.
\item \textsuperscript{20} Patrick Osgood and Kamaran Al-Najar, “Kurdistan exports nearly zero as payment hopes thin,” \textit{Iraq Oil Report}, 20 December 2012.
\end{itemize}
that unauthorized exports to Turkey represent an unconstitutional infringement of the federal government’s authority.\textsuperscript{21}

2.2 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.\textsuperscript{22} 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.”\textsuperscript{23} 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.\textsuperscript{24} In March 2011, Recep Tayyip Erdogan visited the Kurdistan Region – the first time for a Turkish prime minister.\textsuperscript{25} Iraqi Kurdish leaders also regularly visit Ankara; KRG president Massoud

\textsuperscript{22} Interview with Turkish diplomat, Ankara, 14 January 2013.
\textsuperscript{23} Quoted in Abigail Fielding-Smith, “Turkey finds a gateway to Iraq,” \textit{Financial Times}, 14 April 2010.
\textsuperscript{25} Shamal Aqraqi, “Turkey’s Erdogan in First Visit to Iraq Kurd Region,” \textit{Reuters}, 29 March 2011.
Barzani’s participation to the AKP’s general congress in October 2012 was of special symbolic importance.26

Relations between Ankara and Iraq’s Kurds were historically much tenser. For 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 on Turkey’s own Kurdish “problem”. In 1984 (the year marking the onset of the PKK insurgency), Turkey bullied Saddam Hussein into not signing an agreement on Kurdish autonomy that Baghdad had negotiated with the Patriotic Union of Kurdistan (PUK).27 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, both for fear that its example could somehow incite the Kurds in Turkey and because of the ongoing PKK insurgency, which benefited from bases in Iraq.28 Analogous concerns loomed large in Ankara’s ambivalence vis-à-vis the US-led invasion of Iraq in 2003 and motivated Turkish efforts to prevent recognition of the Kurdish region in the new Iraqi constitution.29

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 grant of accession candidate status in

27 Interview with Adel Murad, Secretary of the PUK Central Council, Sulaimani, 15 November 2012.
1999 to Ankara, Turkey embarked on a process of political liberalization, entailing significant improvements in the human rights treatment of the country’s Kurds. The victory of Erdogan’s Justice and Development Party (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 Kurdish language in public. These reforms contributed to the emergence of a climate conducive to the improvement of relations between Ankara and Erbil. The recent ceasefire declaration by PKK’s jailed leader Abdullah Ocalan and the ongoing initiatives to amend Turkey’s constitution so as to reduce its emphasis on Turkish ethnicity, expand Kurdish cultural and political rights, and increase administrative decentralization, represent further important steps in the same direction.

Turkey has experienced the fastest growth in energy demand among OECD countries over the past two years and its energy use is projected to double over the next decade. The

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30 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 its leader’s, Abdullah Ocalan, arrest), 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 (1), 2001). Significant PKK operations in Turkey have resumed since 2011 (International Crisis Group, “Turkey: The PKK and a Kurdish Settlement,” Europe Report 219, 11 September 2012).


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


overwhelming majority of this growing demand is met with oil and gas imports, mostly from Iran and Russia. KRG’s natural resources would 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. Turkey has long expressed a desire to reduce its dependence on imports of gas from Russia so as to gain foreign policy leeway. KRG’s resources represent a source of energy security for Ankara because Turkey is their only plausible outlet, which makes them essentially captive sources of supply in the event of disruptions elsewhere; this fact also puts Turkey in a good position to extract a favorable gas price and/or reduce prices charged by other suppliers. Moreover, access to Kurdish resources serves Ankara’ goal of becoming a major energy hub connecting the Middle East, Russia and the Caucasus to Europe, with both geopolitical advantages and economic benefits in the form of transit fees. Finally, the geopolitical value of closer relations with the KRG has significantly increased for Ankara with the deterioration of its

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37 Ahmet Evin et al., “Getting to Zero: Turkey, Its Neighbors and the West,” Transatlantic Academy, 2010, p. 15. Tapping Kurdistan’s resources would more generally provide Turkey with increased leverage in its neighborhood (Mills, “Northern Iraq’s Oil Chessboard,” p 58). Mills, “Northern Iraq’s Oil Chessboard,” p. 57-59; Shwan Zulal, “Survival Strategies and Diplomatic Tools: The Kurdistan Region’s Foreign Policy Outlook,” Insight Turkey 14 (3), 2012, p. 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.

38 Mills, “Northern Iraq’s Oil Chessboard,” p. 58.
relationship with Baghdad in the past few years, as Turkey sees Erbil as a counterweight to Iranian influence on the Shia-dominated government of Iraq.\footnote{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).}

At the time of this writing, the rapprochement between Turkey and the KRG seems set to climax in an imminent major energy deal based on which a Turkish state company would acquire stakes in several exploration blocks in Iraqi Kurdistan and gas and oil pipelines would be built for export of natural resources under KRG’s control to Turkey. 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.\footnote{Ben Van Heuvelen, “Turkey, Kurdistan Advance Energy Ties,”\textit{ Iraq Oil Report}, 29 March 2013; “Turkey PM confirms talks with Iraqi Kurds on energy deal,”\textit{ Al Arabiya}, 30 March 2013; Aymenn Jawad Al-Tamimi, “Turkey, Iraq, and Oil,”\textit{ The American Spectator}, 5 April 2013.} Ankara’s willingness to allow natural resources exports from KRG’s territory without Baghdad’s permission and in defiance of Washington’s warnings seems to suggest that fears that enhanced autonomy for the KRG could lead to more unrest among Turkish Kurds have largely subsided in Turkey’s calculus. In fact, it is quite likely that, besides the economic and geopolitical considerations mentioned above, Ankara sees the pursuit of a closer relationship with the KRG as instrumental to 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’s economic and political reliance on Turkey is likely to strengthen Ankara’s

\textsuperscript{40} Baghad’s and Ankar’a’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).

\textsuperscript{41} Ben Van Heuvelen, “Turkey, Kurdistan Advance Energy Ties,”\textit{ Iraq Oil Report}, 29 March 2013; “Turkey PM confirms talks with Iraqi Kurds on energy deal,”\textit{ Al Arabiya}, 30 March 2013; Aymenn Jawad Al-Tamimi, “Turkey, Iraq, and Oil,”\textit{ The American Spectator}, 5 April 2013. Turkish and KRG policymakers have repeatedly stated that any export agreement between Ankara and Erbil would respect the existing revenue sharing scheme by which the KRG is entitled to 17 percent of revenues.
leverage in that relation, thus ensuring that Erbil stick to policy positions on the PKK and the Kurdish issue in Turkey to Ankara’s liking.

3. The Strategic Interaction

In this section, we informally analyze the interaction between Baghdad and Erbil through the lenses of a two-player bargaining game. 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 very complex reality. However, this stylization is warranted because our goal is not thick description but rather developing a simple analytical framework that can shed light on ongoing developments in Iraq and that could be used to help us understand other cases with similar characteristics.

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 be renegotiated in the future in light of changes in bargaining 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 the fact that negotiations between Erbil and Baghdad have focused on the KRG’s right to sign its own oil and gas contracts and on procedures for the sharing of national resources revenues rather than the size of each side’s shares, and the fact that the gap between their positions has so far proven
unbridgeable. Erbil sees as inherently non-credible any revenue-sharing scheme that does not enshrine KRG’s control of the region’s hydrocarbon industry and does not include a mechanism for automatic revenue allocation to sub-federal entities, as Baghdad could renege on any agreement. On its part, Baghdad may be 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 with distributional implications. 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 some evidence that Baghdad worries about some sort of demonstration effect associated with concessions on control of the Kurdish region’s natural resources industry: other sub-federal entities may feel emboldened to advance similar requests, thus weakening the central government and, in the worst case scenario, paving the road to the disintegration of the country.

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, 17 December 2012; Patrick Osgood, “Budget passes despite Kurdish boycott,” Iraq Oil Report, 8 March 2013).

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

44 There is, for example, a long standing 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.
Baghdad and Erbil have thus found themselves locked in a costly political stalemate, as the absence of a comprehensive legal framework for Iraq’s hydrocarbon sector is widely seen as deterrent for international investment and therefore a hindrance to its development, while the breakdown of export deals between federal government and KRG has curtailed the country’s revenues. Erbil and Baghdad have been pursuing diametrically opposite strategies to overcome the stalemate in their favor. Erbil has been attracting international investments in natural resources under its control and lobbying Ankara to provide an alternative export outlet for the corresponding output. These two initiatives are mutually reinforcing. On the one hand, attracting international companies requires offering some guarantee of their right to monetize (i.e., sell in international markets the natural resources that they extract), which necessitates 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 would be a function of KRG-controlled resources’ ability to satisfy its growing energy demand, which crucially depends on attracting international investments to the region. The KRG’s ultimate objective seems to be to create facts on the ground so as to convince Baghdad to soften up its negotiating position or, if no compromise is possible, to gain de facto financial independence from the federal government with oil and gas exports to Turkey.

The federal government’s strategy aims to undermine KRG’s initiatives towards international companies and Ankara with the ultimate objective of making Erbil capitulate to

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, 27 February 2013).
Baghdad’s demands. Baghdad has increased the legal-political risk of energy companies operating in Kurdistan by threatening legal consequences for signing PSCs with the KRG and exporting oil without federal government’s approval and by hinting at the possibility of resorting to force if Exxon Mobile were to start its planned drilling activities in disputed territories.\(^{46}\) The rows over payments to KRG-contracted companies, which led to the breakdown of export agreements between Baghdad and Erbil, may also serve the purpose of punishing companies working with Erbil and discouraging “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’s approval.\(^{47}\)

Ankara has signaled its interest in investment in KRG-controlled exploration blocks and in the creation of new pipelines but has apparently not made a final decision on these issues.\(^{48}\) A substantial amount of ambiguity remains about the extent of Ankara’s willingness to defy Baghdad’s wishes, in particular by importing large volumes of oil through a new pipeline without authorization from Iraq’s federal government. The emergence of clear evidence that Turkey has made a final decision to invest in KRG-controlled blocs and allow the creation of

\(^{46}\) Ben Van Heuvelen “In Iraq, Exxon oil deal foments talk of civil war,” *The Washington Post*, 18 December 2013; Ben Lando, “Exxon leads exodus from Basra to Kurdistan,” *Iraq Oil Report*, 19 October 2012; “Chevron undeterred by Baghdad blacklist,” *Iraq Oil Report*, 25 July 2012. Baghdad has threatened to blacklist companies signing agreements with KRG, but the policy has been inconsistently applied. Baghdad has told Exxon Mobile 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 the south and he north of Iraq.


\(^{48}\) See sources cited in note 36 above.
new pipelines (for simplicity’s sake henceforth we refer to this as the “pipeline decision”) would be a major game changer.\textsuperscript{49} Turkey’s decision would signify the failure of Baghdad’s attempts to discourage Ankara from supporting Erbil in its dispute with the federal government and would reassure international companies about the viability of the KRG’s natural resources industry. Any hope for Baghdad to undermine the KRG’s strategy with the current policy would be dashed once it becomes apparent that the Turkish government has made up its mind on the issue, while the KRG would likely be emboldened by its success. At that point it is unlikely that Baghdad would want to stick to a failing strategy whose costs would be increasing (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 likely be growing faster once investors are reassured about their right to monetize). Baghdad would thus be faced with an alternative: make concessions to Kurdish demands on the hydrocarbon framework and revenue sharing laws or escalate by resorting 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 rivals of having made concessions to the Kurds under duress. The fact, however, would remain that, by making concessions on the key bones of contention of 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 in

\textsuperscript{49} It should be noted that for a variety of reasons Ankara may abstain from making a crystal clear announcement about its pipeline decision and may instead continue to make statements to the effect that unlocking the KRG’s energy potential is in Turkey’s national interest and that there is no provision in the Iraqi constitution that bars the regional government from signing export agreements. However, the emergence of evidence that the pipelines are in fact being constructed and that Turkey has invested in KRG-controlled exploration blocks would likely drastically reduce Baghdad’s uncertainty about Ankara’s intentions.
place Baghdad would be dealing with a KRG with a significantly stronger bargaining hand. On the one hand, the existence of new pipelines would allow Erbil to export oil (and at some point in the future gas) even in 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. 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. Both factors are likely to increase Erbil’s bargaining power and correspondingly weaken Baghdad’s.

Baghdad may be tempted to escalate the dispute with Erbil by resorting to force to forestall the increase in KRG’s bargaining power implied by Ankara’s pipeline decision. The basic logic here is that Baghdad may anticipate that, once the new pipeline is in place, Erbil will be in a stronger bargaining position, which would allow it to prevail in negotiations on the hydrocarbon framework and revenue sharing laws. Baghdad may thus decide to take the gamble of preventive war to coerce Erbil to capitulate now rather than waiting to find itself in the

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50 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.
position of having to acquiesce to KRG’s demands in the future.\textsuperscript{51} Using force sooner rather than later may also make sense from Baghdad’s point of view under the assumption that Turkey’s commitment to intervene on the KRG’s behalf in case of violent conflict would solidify over time as Turkey sinks more investment costs in the KRG’s hydrocarbon industry. Baghdad may not be very optimistic about Turkey not intervening if large-scale violence erupts, but it may think that its only hope of military success lies with early use of force.

These short-term destabilizing effects of Ankara’s pipeline decision stand in contrast to its long-term pacifying effects. In a sense, Ankara’s pipeline decision creates a window of opportunity for Baghdad to use force to forestall an unfavorable change in the balance of power between the federal government and the KRG. Once this window closes, the probability of large-scale violence between Baghdad and Erbil should be lower compared to a scenario in which Turkey decides 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 about remaining part of Iraq and the deterrent effect on Baghdad represented by Ankara’s increased stakes in KRG’s natural resources. Ankara’s pipeline decision has the important effect of assuaging Erbil’s fears that at some point in the future Baghdad could

\textsuperscript{51} It should be noted that the meaning of successful use of force in this context is less straightforward than in the typical bargaining game, in which it is assumed that victory automatically gives access to the good under dispute (e.g., Fearon’s model in “Rationalist Explanations for War”). This conceptualization makes intuitive sense when the dispute is over territory and victory enables territorial grabs. By contrast, we assume that Baghdad and Erbil are negotiating over institutional arrangements rather than the physical control of some asset. Thus it makes more sense to think of military victory in terms of coercion. For example, victory for the federal government could be represented by a scenario in which the Iraqi army manages to seize KRG-controlled oil fields, essentially forcing Erbil to accept Baghdad’s position. Alternatively, a more limited use of force by Baghdad signaling its ability to take control of KRG-controlled oil fields could discourage further investments by international companies in the Kurdish region, thus undermining the KRG’s strategy for development of its hydrocarbon industry and prompting Erbil to accept Baghdad’s requests. By contrast, a scenario in which Baghdad proves unable to make any headway in Kurdish territory would amount to a Kurdish victory.
renege on power and revenue sharing arrangements and re-centralize political control. 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 a worst case scenario opportunistic behavior by Baghdad (i.e., a naked power grab), which 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 war provoked by a KRG’s bid for independence. Moreover, as noted, once Turkish investment in KRG-controlled exploration blocks and the new pipelines are actually in place, the probability that Ankara would help Erbil in case of military confrontation with 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 prospect 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: in as much as our assessment that commitment fears are a key determinant of Erbil’s negotiating position with Baghdad 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 actors are aware of the KRG’s stronger position. (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.) Moreover, there is no evidence that Ankara would back up a potential 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 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 risks of war with Baghdad and demonstration effect among Turkey’s Kurds that de jure sovereignty would likely entail.

Our theoretical argument identifies competing short-term and long-term effects of Turkey’s pipeline decision on the prospects of conflict between Baghdad and Erbil. The key question from a policy point of view is: are the long-term benefits worth the short-term risks? This is an empirical, rather than theoretical, question. The answer hinges on whether Baghdad’s preventive war incentives are sufficiently strong to push it to take the gamble of war. We argue that Baghdad is highly unlikely to consider the use of force against Erbil in the short-run as a realistic option. Baghdad is monitoring with great concern developments in neighboring Syria. A victory by Sunni rebels in the civil war there would mean a significant risk of political and military spillovers in Iraq, in particular strengthening and emboldening the Sunni protest
movement and terrorist groups. The Iraqi government is unlikely to be willing to gamble on war against the KRG in a moment in which it faces a mounting Sunni challenge both across the border and at home. Moreover, even if the probability of Ankara’s intervention in a Baghdad-Erbil war would be highest when Turkish investments and the new pipelines are in place, there would be a non-negligible risk of Turkey providing military support to KRG’s forces in the aftermath of Ankara’s pipeline decision, which should be a powerful deterrent for Baghdad’s decision to use force.

In sum, Ankara’s pipeline decision would offer 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 of the probability of war between Baghdad and Erbil, in spite of the increase in the risk of preventive war by the Baghdad in the short-run. US policy on this issue 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 plunge once again in civil war as a consequence. In fact, altering the trajectory of Ankara-Erbil relations may well be beyond Washington’s power, given the importance of the


53 Baghdad may feel in a better position to wage war against Kurdish forces after the planned delivery of M1A1 tanks and F-16s (Marisa Sullivan, “Maliki’s Authoritarian Regime,” Middle East Security Report, Institute for the Study of War, April 2013, p. 36). However, it is unclear whether this increase in Baghdad’s military power would be sufficient to prevail over the factors, discussed above, that make war against the KRG unpalatable in the short-run. In addition, the military equipment may well be delivered after the new pipelines are in place, in which case the increase in Baghdad’s military power would likely be dwarfed by the increase in the probability of Turkey – the regional powerhouse – intervening on the KRG’s behalf in case of aggression by the central government.
stakes for both Turkey and the KRG. However, US policy could help reduce the risk of short-term instability associated with Ankara’s pipeline decision by clearly stating that the United States will punish aggression by any party in the Ankara-Baghdad-Erbil triangle and that it expects the parties to solve their disputes in a peaceful manner. Moreover, Washington should carefully time the delivery of military hardware to Iraq’s federal government so as to make sure that the corresponding increase in Baghdad’s military power occurs only after Turkish investments and the new pipelines are in place, i.e., when Baghdad has no longer an incentive to launch preventive war. Finally, Washington should pressure Ankara to provide credible assurances to Baghdad that the pipeline decision will not affect Turkey’s commitment to Iraqi sovereignty, territorial integrity and the existing revenue sharing arrangement between Baghdad and Erbil.

4. Conclusions

Due to deep-seated commitment problems, Baghdad and Erbil are in a political deadlock over hydrocarbon framework and revenue sharing laws. Erbil has tried to attract international investments in hydrocarbons and to 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 if no agreement emerges. Baghdad has tried to undermine KRG’s initiatives 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.

Ankara’s future likely decision to invest in KRG-controlled exploration blocks and allow the creation of new pipelines would be a major game changer, as it would signify the failure of
Baghdad’s attempts to discourage Ankara from supporting Erbil in its dispute with the federal government and would reassure international companies about the viability of the KRG’s natural resources industry. In that event, Baghdad would likely abandon a failing, costly strategy and would thus face a choice between making concessions to Kurdish demands on the hydrocarbon framework and revenue sharing laws or 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 revenues in case Baghdad threatens to suspend federal budget transfers. In addition, Turkish intervention on Erbil’s behalf would be more likely, in case of armed confrontation with Baghdad, after Ankara has sunk in its investment costs and the new pipelines are in place, which also should reduce the federal government’s leverage with the KRG. With the emergence of evidence that Turkey has made a final pipeline decision, Baghdad may thus be tempted to launch preventive war to forestall the unfavorable change in the balance of power, perhaps also in the hope that Turkey may change its mind. However, we consider the probability of Baghdad 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 spill-over in Iraq as well ongoing unrest among Iraq’s Sunnis. 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 larger. 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 well-being 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, which should eliminate a powerful motive for Kurdish secessionist aspirations and reduce the corresponding risk of war. Thus US 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.