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The debate over Iraqi Kurdistan’s share of the federal budget

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About

Al-Bayan Center for Planning and Studies is an independent, nonprofit think tank based in Baghdad, Iraq. Its primary mission is to offer an authentic perspective on public and foreign policy issues related to Iraq and the region.

Al-Bayan Center pursues its vision by conducting independent analysis, as well as proposing workable solutions for complex issues that concern policymakers and academics.

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"Each side has its narrative, based on history, accumulated grievances and strong sense of entitlement. For now, neither is inclined to settle the conflict peacefully through serious, sustained negotiations, as each believes its fortunes are on the rise, and time is on its side." – International Crisis Group 2012

Introduction

The current debate over the interpretation of the 2019 budget that governs the Kurdistan Regional Government's (KRG) share of the federal budget in return for contributing 250,000 bbl/d[1] to federal oil exports has echoes of the first conflict in April 2012 on the issue. The adept quote above by the International Crisis Group (IGC)[2], in its description of the relationship between the two sides leading to that conflict, is as applicable today as it was then, and over the many repeats of similar conflicts in the intervening years.

The current flare up[3] is initiated by members of the federal parliament against the Government of Iraq (GoI) over its continuing payments to the KRG, under the terms of the 2019 budget, while the KRG has not or refused to honour its obligations under the terms of the same budget. The internal and external dynamics of the players on both sides, the federal politicians and the regional Kurdish politicians, follow the same trajectory that led to countless struggles over this issue and others since 2003. Each side is not only blind and deaf to the other side's needs and motives but views it with suspicion and mistrust. Unless something breaks the mould, either an intervention by Iraq's international stakeholders or a change in the balance of relative power between the two, both

1. bbl/d is an abbreviation for barrels per day, /bbl for per barrel in quoting oil prices, bbls for barrels.

2. "Iraq and the Kurds: The High-Stakes Hydrocarbons Gambit", International Crisis Group, April 19th 2012,
https://www.crisisgroup.org/middle-east-north-africa/gulf-and-arabian-peninsula/iraq/iraq-and-kurds-high-stakes-hydrocarbons-gambit

3. Kamal Chomani, "Oil dispute reignites Baghdad-Erbil tensions", Al-Monitor, May 29th, 2019, https://www.al-monitor.com/pulse/originals/2019/05/iraq-kurdistan-oil-kirkuk.html

will continue to think and act in the same manner that each had acted in the past, while still expecting a different outcome for the conflict or a different response form the other side.

The literature on the history of the Iraqi state and aspirations of the Iraqi Kurds is rich in political and social analysis of the powerful centrifugal forces rooted in the desires of the Kurds for independence or at least for autonomy versus the equally powerful centripetal forces of the central authority of the Iraqi state for a unified country[4]. However, this literature seldom considers economic realities or investigates the economic underpinnings of the positions of either side in the conflict. That was evident in the events that led to the independence referendum of 2017 -in that the architects of that movement and their international backers failed to take these underpinnings[5] into account.

Ignoring the economic underpinnings of both sides of the conflict over the share of the federal budget vs. contributions to oil exports has led to the inevitable breakdown of all prior agreements. It is this same failure in bargaining that led in the past to drafting and approving unworkable agreements, that are not mutually advantageous, non-enforceable and unsustainable, which ultimately lead to a cycle of mutual recriminations over the failures of such agreements.

This paper reviews the KRG's finances for 2019 and 2020 taking into account its oil exports and expenditures, as well its share of the federal budget and the federal salary transfers since March 2018. It concludes that the current debate misses some major economic realities, and argues that the GoI and the KRG need to embark on comprehensive re-write of the relationship and the contribution of

4. " … this dynamism is not limited to China. The Scottish referendum and waves of secession movements — from Spain's Catalonia to Turkey and Iraq's ethnic Kurds — are working in different directions." Taken from: "Stratfor: Geopolitical Weekly", September 23rd, 2014, https://worldview.stratfor.com/article/centripetal-and-centrifugal-forces-work-nation-state

5. A prior study of the author looked into the independence question from an economic view point and concluded that the Kurdistan Region of Iraq (KRI) "did not have the economic capacity to become an independent state" by analysing the region's "Oil assets and exports, the creation of a central bank and currency, trade, debt and a balanced budget are all essential features of a future independent Kurdish state, without which no amount of political will, nationalistic messaging or international support could lead to a viable, let alone successful, secession from Iraq." Ahmed Tabaqchali, "Statehood in the Kurdistan Region of Iraq through an Economic Lens", The Institute of Regional and International Studies (IRIS), March 2018,

https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pdf each party to the federal budget. This re-write needs to be in a such way that both parties believe that the benefits of the new relationship far outweigh the benefits of not having it.

Fresh thinking by both sides, as well as by Iraq's international stakeholders, is needed for such a re-write to happen. It would entail that the GoI takes into consideration the region's dynamics, expenditures and current functioning; while on the KRG's part this requires a realization that it cannot operate as a separate state, setting up its own infrastructure and at the same time claim its share of the federal budget in absence or in excess of its own contributions to the said budget[6]. That a full autonomy and relying solely on its own resources would mean accepting significantly less economic prosperity for its peoples.

This paper makes use of the Deloitte reports on the KRG's oil production, export, consumption and revenue for 2017 and 2018[7]. It will use these reports to estimate and explain the dynamics of the KRG finances for 2019 and 2020.

Looking at 2019 and 2020

This section looks at the KRG's finances in 2019 and 2020 by considering two scenarios, the current state of affairs versus the theoretical one envisaged by the budget. Under the current state of affairs, the KRG's income is made up of revenues from independent oil exports, and salary transfers from the GoI, while under the theoretical one, the KRG's income is made up of its share of the federal budget as defined by the 2019 budget in return for exporting a minimum of 250,000 bbl/d[8] through the State Oil Marketing Organization (SOMO) as well

6. "KRG risks 2020 budget cuts if it fails to send oil to Baghdad: MP", June 25th, 2019

https://shafaaq.com/en/kurdistan/kurdistan-prepared-to-send-oil-if-baghdad-meets-obligations-krg-source/

7. The Deloitte reports for H1/2017, H2/2017, Q1/2018, Q2/2018, Q3/2018, & Q4/2018 are available at: http://cabinet.gov.krd/a/d.aspx?s=010000&l=12&a=56305

http://cabinet.gov.krd/a/d.aspx?s=010000&l=12&a=56996

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57041

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57395

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57589

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57842

8. Final Budget Law 2019, article 9-1, article 10-2 points a, b, c &d.

http://mof.gov.iq/obs/_layouts/obsServices/DownloadObs.aspx?SourceUrl=%2fobs%2fObsDocuments%2fEnacted+Budget+Folder+-+%2المعتمدة+الموازنة+مجلدfFederal+Budget+Law+2019.pdf transferring the income from sales above this minimum.

The Deloitte audits of the KRG's oil exports, consumption and sales for 2017 and 2018, provide valuable information, however incomplete, on the operating dynamics of its oil exports, their costs and net revenues. The information for 2018 is extrapolated into 2019 and 2020, as well other sources, to arrive at the KRG finances in 2019 and 2020 under the two scenarios. Due to the opaqueness of the KRG's budget, as the last budget passed was in 2013[9], as well other incomplete information, the analysis portrays the operating dynamics of the KRG's finances rather than depicting an accurate picture. It is the operating dynamics that are required for understanding the economic dilemmas and to point to an economically viable and sustainable future path.

The dynamics of the current state of affairs is given in table 1 below. The first column is based on the Deloitte audits for 2018, the second is an extrapolation of the 2018 numbers taking into account the KRG's exports for the first four months of 2019 and uses the Brent crude price of these months as an estimate for the whole year. The final three columns look at three possible cases of oil prices for 2020 (a pessimistic case assuming a year average price of $50/bbl for Brent, neutral case assuming an average price of $65/bbl, and an optimistic case assuming an average price of $80/bbl). It also assumes flat oil exports from the current elevated levels[10], year-over-year increases of 10 percent in other revenues (customs, taxes) and a 20 percent increase in expenditures (see appendix one for a full explanation of the assumptions used)

9. Bilal Wahab, "Iraqi Kurdistan Chooses a New President, But Internal Rifts Deepen", The Washington Institute, May 30th, 2019,

https://www.washingtoninstitute.org/policy-analysis/view/iraqi-kurdistan-chooses-a-new-president-but-internal-rifts-deepen

10. The KRG has been exporting about 414,000 bbl/d for the first four months of the year (sources: Ahmed Mehdi, a petroleum consultant for IOCs and oil traders in the region, Alan Mohtadi of T&S Consulting Energy and Security, Ben Van Heuvelen of the Iraq Oil Report, and Robin Mills of Qamar Energy) and about 530,000 bbl/d for May (Bloomberg). However, this is against an oil production of 450,000 bbl/d and local refinery consumption of about 55,000-75,000 bbl/d (source: discussion with Alan Mohtadi of T&S Consulting Energy and Security). This has been enabled by selling from oil held in storage at Ceyhan to meet the strong demand for oil in Europe due to the expiry of the US waivers on Iranian oil exports, and such it is highly unlikely that the KRG can sustain this level of exports, even with likely increasing oil production of 20,000-35,000 bbl/d in 2020.

Table 1: The KRG's budget with revenues from direct oil sales and GoI salary transfers

			2020 e		
Direct oil sales + GoI salary payments	**2018**	**2019 e**	**Pessimistic case**	**Neutral case**	**Optimistic case**
Total sales bbl	135,424,801	151,284,000	151,284,000	151,284,000	151,284,000
Days	365	365	365	365	365
Exports bbl/d	371,027	414,477	414,477	414,477	414,477
Oil sales revenues (A) $	**7,914,746,875**	**7,953,582,456**	**5,655,578,496**	**7,924,838,496**	**10,194,098,496**
Avg price $/bbl	58.44	52.57	37.38	52.38	67.38
Brent average price $/bbl	71.06	65.19	50.00	65.00	80.00
Discount to Brent $	12.62	12.62	12.62	12.62	12.62
IOC payments $	2,407,136,306	2,418,947,491	1,720,048,480	2,410,205,502	3,100,362,524
IOC payments as % of oil revenues	*30%*	30%	30%	30%	30%
Turkish Energy Company "TEC" tariffs $	436,249,206	449,430,634	319,578,032	447,806,408	576,034,784
Tariffs % of export revenues	6%	6%	6%	6%	6%
Forward oil sales charges $	19,677,501	19,677,501	19,677,501	19,677,501	19,677,501
Legal fees $	24,587,158	24,587,158	24,587,158	24,587,158	24,587,158
Oil operating expenses (B) $	**2,887,650,171**	**2,912,642,784**	**2,083,891,171**	**2,902,276,569**	**3,720,661,967**
Electricity related payments $	411,417,041	411,417,041	411,417,041	411,417,041	411,417,041
Other payments (inc. debt payments) $	112,493,684	112,493,684	112,493,684	112,493,684	112,493,684
Non-oil expenses (C) $	**523,910,725**	**523,910,725**	**523,910,725**	**523,910,725**	**523,910,725**
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $	690,000,280	690,000,280	138,000,056	138,000,056	138,000,056
Forward oil sales repayments $ (Negative = over-draft)	316,921,410	316,921,410	316,921,410	316,921,410	316,921,410
Forward oil sales interest payments $	20,777,732	20,777,732	20,777,732	20,777,732	20,777,732
Oil financing & debt expenses (D) $	**1,027,699,422**	**1,027,699,422**	**475,699,198**	**475,699,198**	**475,699,198**
Total expenses (E = B + C + D) $	**4,439,260,318**	**4,464,252,931**	**3,083,501,094**	**3,901,886,492**	**4,720,271,890**
Net proceeds from oil sales (F = A- E) $	**3,475,486,557**	**3,489,329,525**	**2,572,077,402**	**4,022,952,004**	**5,473,826,606**
Additional net proceeds from PSC / pipeline licensing agreements (G) $	868,254,693	868,254,693	868,254,693	868,254,693	868,254,693
Additional forward sales (H) $	190,598,002	190,598,002	190,598,002	190,598,002	190,598,002
Total proceeds (I = F + G + H) $	**4,534,339,252**	**4,548,182,220**	**3,630,930,097**	**5,081,804,699**	**6,532,679,301**
Other revenues (J)	914,885,714	1,143,607,143	1,257,967,857	1,257,967,857	1,257,967,857
US government payments for Peshmerga (K)	262,184,874	277,915,966	138,957,983	138,957,983	138,957,983
GoI salary payments (L)	2,397,478,992	4,578,151,261	4,578,151,261	4,578,151,261	4,578,151,261
Total revenues (M = I + J + K + M) $	**8,108,888,832**	**10,547,856,590**	**9,606,007,198**	**11,056,881,800**	**12,507,756,402**
KRG salary expenses $	6,668,363,816	8,608,403,361	8,884,033,613	8,884,033,613	8,884,033,613
KRG debt repayments $	500,000,000	690,000,000	432,000,000	432,000,000	432,000,000
KRG goods, services and maintenance $	1,339,574,790	1,607,489,748	1,928,987,697	1,928,987,697	1,928,987,697
KRG investment spending $	268,072,269	321,686,723	386,024,067	386,024,067	386,024,067
KRG expenditures (N) $	**8,776,010,875**	**11,227,579,832**	**11,631,045,378**	**11,631,045,378**	**11,631,045,378**
Net (O = M -N) $	**-667,122,043**	**-679,723,242**	**-2,025,038,180**	**-574,163,578**	**876,711,024**
Net without GoI salary tranfers	**-3,064,601,035**	**-5,257,874,503**	**-6,603,189,441**	**-5,152,314,839**	**-3,701,440,237**

For sources and assumptions see Appendix 1[11]

11. For the sake of legibility of the paper these were moved to appendix 1 given the extensive number and nature of sources, assumptions and explanations.

A number of observations, irrespective of the unknown variables, are clear from the above table.

The first is the budget's singular dependence on the GoI salary payments for its smooth functioning, the absence of which would result in the deficits increasing meaningfully as can be seen from the last row in the table above. Given the impossibility of borrowing to cover such deficits[12], the only option would be to significantly cut salaries, sharply cutting any spending on goods, services and maintenance, as well an almost total cut in investment spending on infrastructure. These would need to be in the order of 50 percent cut in expenditures in 2019 and under the neutral case for 2020, which is next to impossible to implement without considerable social unrest.

However, even without these cuts, the only way for the KRG's budget to function is to use the savings made by delaying salary payments by one to two months and to use these funds for other purposes instead. In fact, that has been the way the KRG had operated from 2016 to the present time; and it is still the most likely way to operate going forward, even with continued salary transfers from the GoI, given both the sensitivity of revenues to oil prices and the variability of other sources of income. This has the been the route that enabled the beginning of repayments of the region's debts over the last 18 months; however, it is an unsustainable route as the treatment of the debts needs a full accounting of the debt and its servicing, repayments and interest payments, and their separate budget allocations[13].

The second observation is that the KRG's resumption of full salary payments has only been possible with the recommencement of salary payments from the GoI from March 2018 onwards, however, that has not been accompanied by

12. These were discussed at length in the author's 2018 report in the section on "Debt: Arrears & Borrowings" pages 25-30, in particular the second paragraph on page 28 explains this near impossibility. Ahmed Tabaqchali, "Statehood in the Kurdistan Region of Iraq through an Economic Lens", The Institute of Regional and International Studies (IRIS), March 2018,

https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pdf

13. There is considerable opaqueness in debt repayments in that some debts are paid on behalf of the KRG's Ministry of Natural Resources (MNR), most likely by oil traders, and some by the MNR directly, also the identity of the debtor sometimes is revealed and sometimes it's not, while other debt is payed directly by the KRG's Ministry of Finance.

the KRG fulfilling its full or partial[14] obligations to the GoI in return for these payments. Moreover, the federal budget allocates $4.6bn[15] towards salaries for the KRG, or about 12.5 percent of the total federal allocation for salaries. But the KRG's actual salary payments are at $8.8bn, which raises this share from 12.5 percent to 21.7 percent of the total federal allocation of salaries. This is too high a figure as a percentage of the total, but incredibly high considering the federal budget's own essential flaw of a high percentage allocation for salaries. Thus, the KRG's budget amplifies the core flaws of the federal budget's chronic investment spending deficit[16], in that its own allocation to its salary payments eclipses those of the federal budget.

The third observation is that the table assumes only modest amounts of spending on goods, services and maintenance as well as investment spending on infrastructure, both of which have seen almost no spending since the crisis in late 2014. The high allocation to salaries versus infrastructure spending has led to a growing cumulative deficit in spending on the region's non-oil infrastructure, a deficit that has gotten worse as a result of the cuts during the years of crisis. This shortage coupled with high allocation to salaries is not only unsustainable, but it is the greatest obstacle to the region diversifying its economy away from oil – a deficit that it shares with federal Iraq but on a magnified scale.

The fourth observation is the relatively high cost of the region's oil production and exports, partly due to the different IOC oil production agreements of the KRG to those of the GoI, but mostly due to the convoluted routes the KRG pursued in the past to establish its direct oil exporting capability[17].

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14. Partial is considered as these payments do not constitute the KRG's full share of the budget allocations.

15. The Federal Budget Law 2019 is available at the Ministry of Finance website: http://mof.gov.iq/obs/ar/Pages/obsDocuments.aspx

http://mof.gov.iq/obs/_layouts/obsServices/DownloadObs.aspx?SourceUrl=%2fobs%2fObsDocuments%2fEnacted+Budget+Folder+-+%2المعتمدة+الموازنة+مجلدfFederal+Budget+Law+2019.pdf

16. Ahmed Tabaqchali, "Iraq's Investment Spending Deficit: An Analysis of Chronic Failures", The Institute of Regional and International Studies (IRIS), December 2018,

https://auis.edu.krd/iris/latest-iris-publications/iraqs-investment-spending-deficit-analysis-chronic-failures

17. These were discussed at length in the author's 2018 report in section on "Oil: Assets, Liabilities, Production and Exports" pages 4-15, while the Appendix looked at these costs in more detail at pages 38 & 39. See link at footnote 12.

The fifth observation is the issue of other revenues, taxes and custom fees as detailed in appendix one. The analysis in the table assumes that the KRG would levy these and keep the revenues, however, this is not the view of the GoI and is an added source of conflict between the two. Obviously, the absence of this income or a lower level of such income would increase the deficit.

These observations and others argue that the current state of affairs, even if it were to continue for some time, is unsustainable and that a budgetary crisis would emerge at some stage. Although, the crisis might be precipitated by external shocks such as shifts in the global price of oil or a risk to oil exports[18], or by internal shocks such as a cut in the GoI's salary transfers or a loss of control of oil production fields[19]. Yet, the crisis is inherent in the current structure of the KRG's revenues versus expenditures but can be only be solved by a new thinking from the KRG and the GoI. It should be noted, that this analysis applies to the official borders of the Kurdistan Region of Iraq (KRI), however, the inclusion of the disputed territories would only exasperate the unsustainability of the KRG budget[20].

18. The current dispute in the International Chamber of Commerce (ICC) between Iraq and Turkey over the Iraq-Turkey Pipeline (ITP) agreement has been going for years, but it seems the ICC is close to a ruling by year end as this article suggests. Iraq claims that Turkey violated the terms of the agreement by allowing direct KRG oil sales. Michael Knights, "Iraq-Turkey Pipeline Arbitration: Avoiding a Policy Train Wreck", The Washington Institute, March 8th, 2019, https://www.washingtoninstitute.org/policy-analysis/view/iraq-turkey-pipeline-arbitration-avoiding-a-policy-train-wreck

19. The latest of which is the GoI's North Oil Company decision to take legal action to reclaim the Khurmala Dome, under the KRG's control since 2008, and which accounts for about a third of KRG oil production. An older case, ongoing for years is the GoI's legal challenge of the KRG's independent oil policy.
"Iraq's North Oil Co. sues to take Khurmala back from KRG", Iraq Oil Report, May 29th, 2019, https://www.iraqoilreport.com/news/iraqs-north-oil-co-sues-to-take-khurmala-back-from-krg-41268
"Court signals skepticism in Baghdad-KRG oil case", Iraq Oil Report, February 27th, 2019 https://www.iraqoilreport.com/news/court-signals-skepticism-in-baghdad-krg-oil-case-37537/

20. This was discussed throughout the Author's 2018 report "Statehood in the Kurdistan Region of Iraq through an Economic Lens", https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pdf

The theoretical case, which includes the KRG's share of the federal budget as defined by the 2019 budget law in return for exporting a minimum of 250,000 bbl/d through SOMO as well the transfer of all actual revenues[21] from export sales above this minimum, which for the period January to April 2019 were 164,500 bbl/d. The theoretical case makes use of the same information and makes the same assumptions of the prior case.

Table 2: The KRG's budget with revenues from share of GoI budget

		2020 e		
GoI budget payments + transfering all oil exports to SOMO	**2019 e**	**Pessimistic case**	**Neutral case**	**Optimistic case**
GoI budget payments $	8,221,030,093	8,221,030,093	8,221,030,093	8,221,030,093
Other revenues $	1,143,607,143	1,257,967,857	1,257,967,857	1,257,967,857
Additional net proceeds from PSC / pipeline licensing agreements $	868,254,693	868,254,693	868,254,693	868,254,693
US government payments for Peshmerga $	277,915,966	138,957,983	138,957,983	138,957,983
Total revenues $	**10,510,807,896**	**10,486,210,627**	**10,486,210,627**	**10,486,210,627**
Oil operating expenses (IOC payments) $	2,418,947,491	1,720,048,480	2,410,205,502	3,100,362,524
Other non-oil expenses $	523,910,725	523,910,725	523,910,725	523,910,725
KRG salary expenses $	8,608,403,361	8,884,033,613	8,884,033,613	8,884,033,613
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $	690,000,280	138,000,056	138,000,056	138,000,056
KRG debt repayments $	690,000,000	432,000,000	432,000,000	432,000,000
KRG goods, services and maintenance $	1,607,489,748	1,928,987,697	1,928,987,697	1,928,987,697
KRG investment spending $	321,686,723	386,024,067	386,024,067	386,024,067
Total expenditures $	**14,860,438,328**	**14,013,004,639**	**14,703,161,661**	**15,393,318,683**
Net $	**-4,349,630,432**	**-3,526,794,012**	**-4,216,951,034**	**-4,907,108,056**

For sources and assumptions see Appendix 1[22]

In sharp contrast to the prior case, the impossibility of the budget functioning under this scenario is beyond dispute, and it explains why the KRG is not able, even if it wanted to, to comply with its obligations, whole or partial, under the budget.

While, the GoI, and the federal parliament, might argue that the KRG is at fault for allowing such a large public sector payroll to grow in the first place, and to resume full salary payments so soon. However, successive GoI administrations, with parliament's approval, are equally at fault for the same reasons, albite with lower excess. The democratic deficit in both cases necessitates an oversized allocation to salary payments to ensure the continued support or the acquiescence by their respective constituents.

21. Article 10.D of the budget states "… transferring the actually received revenues …" (author's translation) when it discusses any sales, but without stating if this means gross revenues or revenues net from expenses such as IOC fees or transit fees. The table will assume that budget law means gross revenues given the impossibly of determining the meaning or which expenses are accepted if the meaning was net revenues. Also, this thinking is consistent with the positions taken in the past by the GoI on the region's oil contracts. While, the figures would change the numbers, it would not alter the basic dynamics of the table.

22. These are the same as for the first table, but with certain modifications to certain assumptions as discussed in appendix 1.

Moreover, the continued difference between the GoI and the KRG over the nature and terms of the region's oil production contracts, means that the GoI does not accept the liabilities arising from the KRG oil contracts, and thus leaves the KRG to settle these directly from its share of federal revenues. Also, this applies to the full KRG oil exports, which for January to April of 2019 were about 414,500 bbl/d. As the table shows these are considerable, would grow with increasing oil prices but the KRG's share of the budget does not increase similarly, and therefore reduces the funds available for the functioning of the region.

Finally, the requirement on the KRG for contributing a minimum of 250,000 bbl/d through SOMO, as well as any direct revenues from exports above this minimum, has many contradictions. For instance, asking for revenues from exports in excess of 250,000 bbl/d implies an acceptance of the KRG's established export routes in spite of all the GoI's reservations and objections. Also, the budget does not take into account the dynamics of different treatments of the two amounts, as 250,000bbl/d would be exported by SOMO, while the balance of 164,5000 bbl/d by the KRG's Ministry of Natural Resources (MNR). Finally, no consideration is made of the difference between the income generated from full KRG oil exports and the transfers to the KRG which the table below looks at.

Table 3: Revenues from KRG oil sales vs the KRG's share of the federal budget

		2020 e		
Oil revenues from KRG oil exports	2019 e	Pessimistic case	Neutral case	Optimistic case
Total sales bbl	151,284,000	151,284,000	151,284,000	151,284,000
Days	365	365	365	365
Exports bbl/d	414,477	414,477	414,477	414,477
Oil sales revenues under current KRG oil discount to Brent (A) $	7,953,582,456	5,655,578,496	7,924,838,496	10,194,098,496
Oil sales revenues under narrower KRG oil discount to Brent (B) $	8,748,940,702	6,221,136,346	8,717,322,346	11,213,508,346
GoI budget payments (C) $	8,221,030,093	8,221,030,093	8,221,030,093	8,221,030,093
Net effect (D = A - C) $	-267,447,637	-2,565,451,597	-296,191,597	1,973,068,403
Net effect (E = B - C) $	527,910,609	-1,999,893,747	496,292,253	2,992,478,253

For sources and assumptions see footnote[23]

The analysis suggests that the share of the budget in return for oil sales does not add up, in that it does not take into account the effects of the difference between the two amounts, i.e. the share of the KRG of the federal budget versus revenues of

23. The table makes same assumptions as the other tables. The table basically shows the gross income generated from the KRG's oil sales. Case (A) the oil exports would be sold at the same prices as if the KRG was directly exporting the oil, while (B) assumes that sales through SOMO would lower the discount of the KRG's oil to Brent and that gross revenues would be 10 percent higher. This is a simplified assumption as the case (B) would raise the KRG's payments to its IOC among other things.

its contributions in oil exports. As can be seen the figures almost cancel each other under a Brent price of $65/bbl, but the KRG would receive substantially more that it contributes in the pessimistic case of lower oil prices, while the reverse is true under the optimistic case of higher oil prices.

The Way forward[24]

In order to go forward both the KRG and the GoI need to recognize a few essential economic realities. The first would be a mutual recognition that though the KRI's share of revenues was determined according to its share of the overall population, and the contribution of 250,000 bbl/d first emerged in the December 2014 agreement based on the KRG's production then, yet this structure, is unworkable as the analysis argues.

The second would be for the KRG to recognize that its economic prosperity, or at the least the prosperity it is pursuing, is not compatible with its quest for full autonomy or independence, without a share of the federal budget that is in far in excess of its own contributions[25]. Moreover, that its prior economic prosperity up to 2014 was only made possible, or at a minimum the extent and the wide spread prosperity, by such an asymmetrical share of the federal budget. Furthermore, that such a share, was not a gift of successive GoI administrations, but an essential element of the KRI being an integral part of a federal Iraq. Also, the pursuit of its current independent path on oil exports, without the federal salary transfers would come with painful economic consequences to the population of the KRI. Finally, a rethink that the KRI's economic prosperity can be pursued by integrating the region deeply into Iraq's economy[26].

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24. Much of the ideas on source of conflict, bargaining failures and ideas to ensure self-enforcing agreements and so on based on the study below.

Matthew O. Jackson and Massimo Morelli, "The Reasons for Wars – an Updated Survey", December 2009. https://web.stanford.edu/~jacksonm/war-overview.pdf

It was published as a chapter in "The Handbook on the Political Economy of War", first published 2011, https://www.e-elgar.com/shop/the-handbook-on-the-political-economy-of-war

25. Zhelwan Z. Wali, "Indicators signal Kurdistan Region's return to economic boom in 2019", April 14th, 2019, http://www.rudaw.net/english/analysis/14042019

26. This was argued by the author in a conference on the "The Future of the Kurds". Ahmed Tabaqchali, "The Economic Future of the Kurds", Summary of a presentation at "The Future of the Kurds", October 9th-10th, 2018:

http://www.hennerbichler.info/futurekurds/ahmed-tabaqchali-msc.html

The third would be for the GoI to take into account the KRI's dynamics, expenditures and current functioning, as well as fully recognizing that the region is a full part of the county; and to emulate or at least learn from its more business-friendly environment. That being part of a federal structure is a two-way process and requires dialogue between the centre and the regions, and not driven by the centre.

While, a great deal of the fault for the failure of successive agreements between the KRG and GoI's lie squarely with Iraqis, yet Iraq's international stakeholders have played a part in this failure. That is because their interactions and commitments with both entities, especially with the KRG, carried enough ambiguities or at least allowed false understandings to persist, that contributed to bargaining failure between the two, and to failures to commit to agreements. These ambiguities carried the belief that these international stakeholders would provide support that made it more attractive to the KRG to break these agreements than to hold on to them. Such ambiguities provided some of the rationale behind the independence referendum of September 2017, in that its cost was believed to be lower than its expected rewards.

Such an agreement would need to be mutually advantageous, self-enforceable and sustainable so that both parties both can believe that the benefits of the new agreement far outweigh the benefits of not having it. That this would be possible by pursuing an integrated approach approach to this agreement by taking into account the region's gas and oil production, refining, electricity generation, and water resource sharing as essential components in drafting the budget sharing/ agreement.

The need for a comprehensive approach

The development of KRG gas sector[27] was pursued, in-line with that of its oil sector, to further the KRG's quest for establishing the financial wherewithal to enable securing political independence from Iraq. This meant a focus on developing the sector to export gas to Europe through Turkey. However, choices made came with significant logistical, financing, and political challenges[28] in addition to the commercial obstacles of marketing the gas in the extremely competitive European gas market[29] –all of which would have huge effects on the economics of the KRG's gas exporting plans.

27. Most of the KRI's gas reserves are of the non-associated gas type, i.e. not a by-product of oil production unlike most of Iraq's gas production. This means that their development can be pursed independently of that of oil, with its own economics of development, production and marketing.

The nature of the sector and the associated challenges are covered below:

"Kurdistan Gas: The Key to Easing Iraq's Chronic Power Shortages?", MEES, Volume: 62 issue: 07, February 15th, 2019

https://www.mees.com/2019/2/15/oil-gas/kurdistan-gas-the-key-to-easing-iraqs-chronic-power-shortages/474cb250-3144-11e9-b8bc-6b92dd7b2b1c

The essential differences between the associated gas and free (non-associated) gas are provided by PetroWiki below:

https://petrowiki.org/Associated_and_nonassociated_gas

28. Ahmed Tabaqchali, "Rosneft in the Kurdish Region: Moscow's Balancing Act", Iraq in Context, November 3, 2017, https://www.iraqincontext.com/single-post/2017/11/03/Rosneft-in-the-Kurdish-Region-Moscows-Balancing-Act

29. Alex Barnes, "Competitive European gas markets are a reality", EURACTIV Network, September 11, 2018, https://www.euractiv.com/section/energy/opinion/competitive-european-gas-markets-are-a-reality/

However, these challenges would be on a much smaller scale and far more economically feasible if the focus was turned towards developing the sector with the aim of satisfying the fuel needs of the power generating plants for the rest of Iraq[30]. The long-term viability of such a change in focus is enhanced by considering that the competition in the intended markets is very expensive imported Iranian gas and an insufficient amount of captured flared gas. A situation that would persist even if Iraq were to capture all current and future flared gas, as Iraq's future needs for electricity[31] far outstrips its potential gas production. The benefits for Iraq would be establishing its energy security, a cheaper supply of gas, and in the process enhancing the country's national cohesion.

An integrated approach by the KRG and the GoI to developing the KRI's gas sector for exports to Iraq, would be pursued jointly with the related development of selling electricity to the rest of Iraq after satisfying local demand. The electricity generation sector in the KRI is not only well developed, but its generating capacity far exceeds local demand, but suffers from lack of feedstock in the form of gas[32]. This as explained above is hindered by development challenges for a gas sector focused on exports to Europe. The economic benefits to both the KRI and the rest of Iraq from an integrated approach to gas development should be obvious to both parties.

Similar dynamics hold for the KRI's refining sector's capacity to satisfy the needs of the region as well as the rest of Iraq. The focus of the KRG on maximizing oil exports came with the unintended consequences of undersupplying the domestic refining market. A coordinated GoI-KRG oil export strategy would address both the need of maximizing exports as well supplying the KRI's well developed refining

30. Much of the work on the KRG's using the KRI's gas reserves to integrate itself within federal Iraq owes the concept to Robin Mill's work in February 2018, as well covered by MEES in February 2019 (both below)

Robin Mills, "A New Hope: Iraq Oil's Way Forward", Al-Bayan Center, February 15th, 2018, http://www.bayancenter.org/en/2018/02/1435/ "Kurdistan Gas: The Key to Easing Iraq's Chronic Power Shortages?", MEES, Volume: 62 issue: 07, February 15th, 2019

https://www.mees.com/2019/2/15/oil-gas/kurdistan-gas-the-key-to-easing-iraqs-chronic-power-shortages/474cb250-3144-11e9-b8bc-6b92dd7b2b1c

31. Robins Mills "A New Hope: Iraq Oil's Way Forward" (above), pages 78-85.

32. "Iraq Power Generation Hits New Heights Despite Stalled KRG Deal", MEES, Volume: 62 issue: 22, May 31st, 2019
https://www.mees.com/2019/5/31/power-water/iraq-power-generation-hits-new-heights-despite-stalled-krg-deal/adf63b10-83a7-11e9-a109-03fdad0554ef

sector, which would include developing optimized oil supply pipelines as part of a national oil pipeline network. While, KRI refinery operators would gain financially, which in the process develops the region's private sector, but come with the benefit of suppling the rest of Iraq with much needed refined products that its refining sector has not been able to supply. This is because while Iraq's total refining capacity, in theory, meets domestic demand, yet the issue is the mismatch in the demand of refined products versus their supply due to Iraq's outdated refining sector- a situation that forces Iraq to import a number of refined products[33].

The final benefit within the energy sector comes with the future development plans of the Kirkuk related fields[34], by building upon the late 2018 GoI-KRG agreement to resume partial exports from these fields[35]. These would be to jointly boost the production capacity of the Kirkuk super giant field (not only the GoI controlled Avana and Baba Domes, but also the KRG controlled Khurmala Dome) to about 1,000,000 bbl/d [36] from about 450,000 bbl/d in 2017 for the benefit of both sides. This would also mean improving the utilization and thus the profitability of the upgraded KRG oil export pipeline.

The two sides can work on other sectors in the same way such as water, trade, transport routes and tourism to name a few. Water for instance, is a crucial area that has been pursued independently for the deterrent to both sides.

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33. Robins Mills "A New Hope: Iraq Oil's Way Forward" (above), pages 75-78.

"Iraq's Downstream Dreams: Back to Square One?", MEES, Volume: 62 issue: 15, April 12th, 2019 https://www.mees.com/2019/4/12/refining-petrochemicals/iraqs-downstream-dreams-back-to-square-one/449f90d0-5d32-11e9-8650-6b44ae3501ef

34. Huda Majeed & Ahmed Rasheed, "UPDATE 2-Iraq and BP sign deal to boost Kirkuk crude output -oil ministry", Reuters, January 18, 2018, https://www.reuters.com/article/iraq-oil-kirkuk/update-2-iraq-and-bp-sign-deal-to-boost-kirkuk-crude-output-oil-ministry-idUSL8N1PD28U

35. David Sheppard, Chloe Cornish and Anjli Raval, "Iraq resumes oil exports from Kirkuk", November 16, 2018, https://www.ft.com/content/1b3347de-e99e-11e8-885c-e64da4c0f981.

36. "Iraq oil: Upstream ambitions undimmed, infrastructure remains key", APICORP Energy Report, December 2018, http://www.apicorp.org/Research/EnergyReseach/2018/APICORP_Energy_Research_V03_N15_2018.pdf

The KRG[37] has pursued its water security independently of the rest of the country, exposing the rest of Iraq to the added danger of water security from the region's plans for dams on the Tigris river to those that are pursued by its neighbours on the Tigris and the Euphrates. In the process weakening Iraq's negotiating power with its neighbours over their own dam plans, by arguing that Iraq is doing to itself what it is accusing them of doing to it. The end result is that both parties have a much weaker position viz-a-vis these neighbours. Working together on the country's overall water security and challenges has an obvious benefit of cost savings and countrywide linked developments. But an additional benefit would be combing the water dialogue with Turkey as part of an overall dialogue on oil exports via Turkey as well as Turkish exports to Iraq.

Conclusion

In conclusion the spirit of the "dialogue of the deaf", involving the KRG, the GoI and Iraq's international stakeholders, has led to the development strategies on crucial sectors such as energy and water that faced significant challenges of commercial and financial viability, as well as political challenges of a contiual KRG-GoI conflict. A conflict, that is made worse by the debate over aflawed and forever breaking budget arrangements.

The current environment, in spite of the political noise and recrimination, is right for the a comprehensive GoI-KRG agreement that not only covers the KRI's share of the federal budget, but includes a join development plan for energy, water and other resources. Its only in taking this overall joint development approach that a mutually advantageous, self-enforceable and sustainable agreement can be drafted.

37. Kosar Nawzad, "Official: Kurdistan Region needs more dams to ensure 'water security'", Kurdistan 24, January 17th, 2019, https://www.kurdistan24.net/en/news/64cc9204-c991-4810-a95f-df383b9955ba

"Water crisis: Kurdish authorities ignore Iraqi call to cut water intensive crops", Rudaw, June 19th, 2018 http://www.rudaw.net/english/business/19062018

Baxtiyar Goran, "Kurdistan considers cutting water supplies to Iraq", Kurdistan 24, June 21st, 2016

https://www.kurdistan24.net/en/news/66faa943-6947-4143-9df3-fba0aea86dcf/Kurdistan-considers-cutting-water-supplies-to-Iraq-

"KRG Minister: Flow of Water into Iraq Shall Be Reduced", Basnews, July 1st 2017, http://www.basnews.com/index.php/en/news/360888

Intra-Kurdish conflict[38] over the formation of the new KRG administration, while perceived as negative, yet like the current intra-Shia and intra-Sunni conflicts means that the political elite in the country are forced to seek agreements based on issues and not on identity as in the past. Coupled, with the current Iraqi leadership[39] that does not seek a zero-sum game over the dispute on the salary allocations for the KRI, the environment is ripe for the GoI-KRG to strike a new deal that is shepherded by the country's international stakeholders.

38. Bilal Wahab, "Iraqi Kurdistan Chooses a New President, But Internal Rifts Deepen", The Washington Institute, May 30th, 2019, https://www.washingtoninstitute.org/policy-analysis/view/iraqi-kurdistan-chooses-a-new-president-but-internal-rifts-deepen

39. "PM: KRG has not transferred a single barrel as manded by the budget" (author's translation), Al Summaria TV, June 2nd, 2019.

https://www.alsumaria.tv/news/سياسة/306405/عبد-المهدي-اقليم-كردستان-لم-يسلم-بغداد-برميل-نفط-و

Appendix 1: The 2019-2020 Tables with full explanations

This section reproduces the tables provided earlier in the main body of the piece and provides full explanations and sources of the assumptions made.

Table I: The KRG's budget with revenues from direct oil sales and GoI salary transfers

			2020 e		
Direct oil sales + GoI salary payments	**2018**	**2019 e**	**Pessimistic case**	**Neutral case**	**Optimistic case**
Total sales bbl	135,424,801	151,284,000	151,284,000	151,284,000	151,284,000
Days	365	365	365	365	365
Exports bbl/d	371,027	414,477	414,477	414,477	414,477
Oil sales revenues (A) $	**7,914,746,875**	**7,953,582,456**	**5,655,578,496**	**7,924,838,496**	**10,194,098,496**
Avg price $/bbl	58.44	52.57	37.38	52.38	67.38
Brent average price $/bbl	71.06	65.19	50.00	65.00	80.00
Discount to Brent $	12.62	12.62	12.62	12.62	12.62
IOC payments $	2,407,136,306	2,418,947,491	1,720,048,480	2,410,205,502	3,100,362,524
IOC payments as % of oil revenues	*30%*	30%	30%	30%	30%
Turkish Energy Company "TEC" tariffs $	436,249,206	449,430,634	319,578,032	447,806,408	576,034,784
Tariffs % of export revenues	6%	6%	6%	6%	6%
Forward oil sales charges $	19,677,501	19,677,501	19,677,501	19,677,501	19,677,501
Legal fees $	24,587,158	24,587,158	24,587,158	24,587,158	24,587,158
Oil operating expenses (B) $	**2,887,650,171**	**2,912,642,784**	**2,083,891,171**	**2,902,276,569**	**3,720,661,967**
Electricity related payments $	411,417,041	411,417,041	411,417,041	411,417,041	411,417,041
Other payments (inc. debt payments) $	112,493,684	112,493,684	112,493,684	112,493,684	112,493,684
Non-oil expenses (C) $	**523,910,725**	**523,910,725**	**523,910,725**	**523,910,725**	**523,910,725**
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $	690,000,280	690,000,280	138,000,056	138,000,056	138,000,056
Forward oil sales repayments $ (Negative = over-draft)	316,921,410	316,921,410	316,921,410	316,921,410	316,921,410
Forward oil sales interest payments $	20,777,732	20,777,732	20,777,732	20,777,732	20,777,732
Oil financing & debt expenses (D) $	**1,027,699,422**	**1,027,699,422**	**475,699,198**	**475,699,198**	**475,699,198**
Total expenses (E = B + C + D) $	**4,439,260,318**	**4,464,252,931**	**3,083,501,094**	**3,901,886,492**	**4,720,271,890**
Net proceeds from oil sales (F = A- E) $	**3,475,486,557**	**3,489,329,525**	**2,572,077,402**	**4,022,952,004**	**5,473,826,606**
Additional net proceeds from PSC / pipeline licensing agreements (G) $	868,254,693	868,254,693	868,254,693	868,254,693	868,254,693
Additional forward sales (H) $	190,598,002	190,598,002	190,598,002	190,598,002	190,598,002
Total proceeds (I = F + G + H) $	**4,534,339,252**	**4,548,182,220**	**3,630,930,097**	**5,081,804,699**	**6,532,679,301**
Other revenues (J)	914,885,714	1,143,607,143	1,257,967,857	1,257,967,857	1,257,967,857
US government payments for Peshmerga (K)	262,184,874	277,915,966	138,957,983	138,957,983	138,957,983
GoI salary payments (L)	2,397,478,992	4,578,151,261	4,578,151,261	4,578,151,261	4,578,151,261
Total revenues (M = I + J + K + M) $	**8,108,888,832**	**10,547,856,590**	**9,606,007,198**	**11,056,881,800**	**12,507,756,402**
KRG salary expenses $	6,668,363,816	8,608,403,361	8,884,033,613	8,884,033,613	8,884,033,613
KRG debt repayments $	500,000,000	690,000,000	432,000,000	432,000,000	432,000,000
KRG goods, services and maintenance $	1,339,574,790	1,607,489,748	1,928,987,697	1,928,987,697	1,928,987,697
KRG investment spending $	268,072,269	321,686,723	386,024,067	386,024,067	386,024,067
KRG expenditures (N) $	**8,776,010,875**	**11,227,579,832**	**11,631,045,378**	**11,631,045,378**	**11,631,045,378**
Net (O = M -N) $	**-667,122,043**	**-679,723,242**	**-2,025,038,180**	**-574,163,578**	**876,711,024**
Net without GoI salary tranfers	**-3,064,601,035**	**-5,257,874,503**	**-6,603,189,441**	**-5,152,314,839**	**-3,701,440,237**

Sources, assumptions and estimates:

- Oil exports: The KRG has been exporting about 414,500 bbl/d for the first four months of the year[40], and about 530,000 bbl/d for May[41]. However, this is against an oil production of 450,000 bbl/d and local refinery consumption of about 55,000-75,000 bbl/d[42]. This has only been possible by additionally selling oil held in storage at Ceyhan to meet the strong demand for oil in Europe due to the expiry of the US waivers on Iranian oil exports, and such it is highly unlikely that the KRG can sustain this level of exports, even with expected increase in oil production of 20,000-35,000 bbl/d in 2020[43]. The analysis assumes that the KRG will maintain this level of production for 2019 and 2020.
- The KRG's oil discount to Brent crude of $12.62 for 2019 & 2020 is the average discount for 2018. The discount has widened considerably since 2017 due to the lower quality crude oil (heavier and more sour crude) due to the loss of the Kirkuk related fields in October 2017, as well as likely higher pipeline transport fees charged by Rosenft following its investment of $1bn to increase the capacity of the pipeline from 700,000 bbl/d to about 1,000,000 bbl/d. It is likely that this discount might narrow in 2020 given the new dynamics of the oil market in which there is a developing shortage of heavy-sour crudes due to production issues in Venezuela and sanctions on Iran[44]. Oil operating expenses (B) for 2018 are assumed to be the same for 2019 and 2020. This means the same ratios of oil revenues for IOC payments and TEC tariffs .
- Non-oil expenses (C) and Oil financing & debt expenses (D) for 2018 are assumed to be the same for 2019 and 2020.
- Note on debt payment to Turkish Energy Company (TEC), Turkish Petroleum

40. Discussions with industry sources: Ahmed Mehdi, a petroleum consultant for IOCs and oil traders in the region, Alan Mohtadi of T&S Consulting Energy and Security, Ben Van Heuvelen of the Iraq Oil Report, and Robin Mills of Qamar Energy.

41. Bloomberg.

42. Source: Discussion with Alan Mohtadi of T&S Consulting Energy and Security.

43. Source: Discussion with Alan Mohtadi of T&S Consulting Energy and Security.

44. Source: Discussion with Ahmed Mehdi, a petroleum consultant for IOCs and oil traders in the region.

International Company (TPIC) and to Turkey: The author's 2018 report[45] (footnote 80) noted arrears to TEC of $0.514bn as of December 2016. The Deloitte audit report for July 2017-Decemebr 2018 showed debt payments to TEC and TPIC of $0.234bn in 2017, $0.690bn in 2018. The table assumes a continuation of the payments of $0.690bn for 2019, and $0.138bn for 2020 for a total of $1.62bn. While is figure is much higher than the debt to TEC of $0.514bn as of end of 2016, it would cover any growth in that figure (including interest) plus the unknown debt to TPIC. The same author's 2018 report (footnote 80) estimated debt to the Turkish government of $1.4bn by end of 2017, parts of which might have been on behalf of TPIC.

- Payments for "Additional net proceeds from PSC / pipeline licensing agreements (G)" and "Additional forward sales (H)" for 2018 are assumed to be the same for 2019 and 2020.
- Additional net proceeds from PSC / pipeline licensing agreements (G) and Additional forward sales (H) for 2018 are assumed to be the same for 2019 and 2020.
- Other revenues (J). The last reported figure was an annualized rate of $4.7bn for 2014 (World Bank report showing the figures for H1/2014[46]) which would have been made up of tax revenues and custom fees. Given the severe economic contraction from 2014, collapse in oil prices and the loss of trade routes following the ISIS conflict, the table assumes that these would be at 20 percent of the annualized 2014 levels in 2017 and 2018, increasing by 25 percent in 2019 and a further 10 percent in 2020.

45. Ahmed Tabaqchali, "Statehood in the Kurdistan Region of Iraq through an Economic Lens", The Institute of Regional and International Studies (IRIS), March 2018,
https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pd

46. "The Kurdistan region of Iraq: assessing the economic and social impact of the Syrian conflict and ISIS", World Bank Report, April 16th, 2015.
http://documents.worldbank.org/curated/en/579451468305943474/The-Kurdistan-region-of-Iraq-assessing-the-economic-and-social-impact-of-the-Syrian-conflict-and-ISIS, table 1.1 page

- GoI salary payments. The GOI resumed salary transfers in March 2018[47] at an annualized rate of $3.2bn, and raised this to annualized rate of $4.6bn in March 2019 which the table assumes to hold for 2020.
- US payments towards the Peshmerga's salaries which were IQD 26bn per month in 2018, are assumed to have increased by six percent in 2019 with the increase in overall aid to the Peshmerga, and cut by 50 percent for 2020 in-line with a similar cut to the Peshmerga as part of their integration within the Iraqi Security Forces (ISF). The US did not renew the payments in the summer of 2017 due to unhappiness with the plans for the referendum[48].
- KRG Salary expenses. By the end of 2016, the KRG introduced the salary savings scheme which included significant salary cuts across the board. In March 2018, it reversed part of these cuts and assumed payments at an annualized rate of $7.23 bn verus a prior annualized rate of $5.9bn from 2016 onwards. In March 2018 it removed all of these cuts to assume an annualized payment rate of $8.9bn[49]. The report assumes the new rate is paid from April of each year-which explains the difference between the above figures and the corresponding ones in the table. The figure assumes the full annualized rate

47. Raya Jalabi and Ahmed Rasheed, "Iraq sends money to pay Kurdish salaries for first time since 2014", Reuters, March 19th, 2018, https://www.reuters.com/article/us-mideast-crisis-iraq-kurds/iraq-sends-money-to-pay-kurdish-salaries-for-first-time-since-2014-idUSKBN1GV0T1

"Baghdad-Kurdistan oil disputes flare up in Parliament", Iraq Oil Report, May 24th, 2019 https://www.iraqoilreport.com/news/baghdad-kurdistan-oil-disputes-flare-up-in-parliament-41105/

48. Jack Detsch, "US stops paying Peshmerga amid Kurdish Independence Backlash", Al-Monitor and reproduced in Iraq Business News, October 11, 2017,

http://www.iraq-businessnews.com/2017/10/11/us-stops-paying-peshmerga-amid-kurdish-independence-backlash/ "US to send Erbil $365 million to pay Peshmerga salaries, KRG minister confirms", Rudaw, February 24th, 2018
http://www.rudaw.net/english/kurdistan/240220181

Kurt T, "Peshmerga to receive $290 million from the US in 2019", May 26th, 2018 https://thenewsrep.com/103759/peshmerga-to-receive-290-million-from-the-us-in-2019/ Jack Destch, "Iraqi Kurdish fighters dealt setback in Pentagon budget", Al Monitor, April 2nd, 2019

https://www.al-monitor.com/pulse/originals/2019/04/iraq-kurdistan-region-peshmerga-fighters-setback-pentagon.html

49. "KRG abolishes salary cuts for low-earners, to end it for all ‹soon›", Rudaw March 28th, 2018,
http://www.rudaw.net/english/kurdistan/280320181
Hiwa Jamal, "KRG owes $10 billion in back pay to public sector employees", Rudaw, March 10th, 2019, http://www.rudaw.net/english/interview/10032019

$8.9bn for 2020, although the KRG is aiming to reduce the public payroll in order to save an annual amount of $1bn. However, this saving is not assumed in the table given the difficulty of implementing such a measure in the current environment.

- The KRG's debts:

- The KRG's Minister of Finance noted in November 2018 and March 2019 that[50]: The KRG paid back private banks $500m in 2018, $220m by March 2019 and planned a further payment to these banks of $10m per month for the reminder of 2019. The reports noted that the KRG borrowed $1 bn from banks following the ISIS crisis, however these figures are much smaller than reported earlier. Moreover, the KRG paid back the private sector contractors $200m by March 2019 and would follow on a promise made in 2018 to pay them $20m per month. The report further noted that the KRG had about $2.5bn in outstanding loans to contractors. The table assumes that for 2019 the KRG would pay contractors $20m per month as well as $10m per month to banks, while it would increase these monthly payments by 20 percent in 2020.

- For a review of the KRG's debt to banks and private sector contractors see the sections on "Independent central bank and a currency" as well as "Debt: Arrears and borrowings" in the author's 2018 report[51].

- KRG goods, services and maintenance spending, and Investment spending. The last reported figure was an annualized rate of $2.6bn for each in 2014 (World Bank report showing the figures for H1/2014[52]). The table assumes spending at 50 percent and 10 percent of each respectively in 2017, the same

50. "KRG repays debts of $500 million to private banks", Rudaw, November 7th, 2018
http://www.rudaw.net/english/business/0711201 Hiwa Jamal, "KRG owes $10 billion in back pay to public sector employees", Rudaw, March 10th, 2019, http://www.rudaw.net/english/interview/10032019

51. Ahmed Tabaqchali, "Statehood in the Kurdistan Region of Iraq through an Economic Lens", The Institute of Regional and International Studies (IRIS), March 2018,
https://www.auis.edu.krd/iris/sites/default/files/Statehood%20in%20KRI%20through%20an%20Economic%20Lens_%20FINAL_March2018_0_1.pdf

52. "The Kurdistan region of Iraq : assessing the economic and social impact of the Syrian conflict and ISIS", World Bank Report, April 16th, 2015,
http://documents.worldbank.org/curated/en/579451468305943474/The-Kurdistan-region-of-Iraq-assessing-the-economic-and-social-impact-of-the-Syrian-conflict-and-ISIS, table 1.1 page 20

for 2018 and then increasing by 20 percent in 2019, and again 20 percent in 2020. This is because of the urgent needs for such increases given the severity of the cuts from 2014onwards and the growth in needs since then.

Table II: The KRG's budget with revenues from share of GoI budget

GoI budget payments + transfering all oil exports to SOMO	2019 e	2020 e Pessimistic case	2020 e Neutral case	2020 e Optimistic case
GoI budget payments $	8,221,030,093	8,221,030,093	8,221,030,093	8,221,030,093
Other revenues $	1,143,607,143	1,257,967,857	1,257,967,857	1,257,967,857
Additional net proceeds from PSC / pipeline licensing agreements $	868,254,693	868,254,693	868,254,693	868,254,693
US government payments for Peshmerga $	277,915,966	138,957,983	138,957,983	138,957,983
Total revenues $	**10,510,807,896**	**10,486,210,627**	**10,486,210,627**	**10,486,210,627**
Oil operating expenses (IOC payments) $	2,418,947,491	1,720,048,480	2,410,205,502	3,100,362,524
Other non-oil expenses $	523,910,725	523,910,725	523,910,725	523,910,725
KRG salary expenses $	8,608,403,361	8,884,033,613	8,884,033,613	8,884,033,613
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $	690,000,280	138,000,056	138,000,056	138,000,056
KRG debt repayments $	690,000,000	432,000,000	432,000,000	432,000,000
KRG goods, services and maintenance $	1,607,489,748	1,928,987,697	1,928,987,697	1,928,987,697
KRG investment spending $	321,686,723	386,024,067	386,024,067	386,024,067
Total expenditures $	**14,860,438,328**	**14,013,004,639**	**14,703,161,661**	**15,393,318,683**
Net $	**-4,349,630,432**	**-3,526,794,012**	**-4,216,951,034**	**-4,907,108,056**

The same assumptions hold for this table as for table I.

Appendix 2: The 2018 and 2017 tables with explanations

This section shows the tables for 2018 and 2017 that were used as the basis for the extrapolations made for 2019 and 2020. These were made possible by the Deloitte reports on the KRG's oil production, export, consumption and revenue for 2017 and 2018[53]. The assumptions and sources for expenditures and other sources of income are the same as those made in Appendix 1.

Note that the first Deloitte audit for H1/2017 report did not provide much granular data on all expenditures or income (such as debt payments, tariff payments or other sources of income), however, that successive reports provided

53. The Deloitte reports for H1/2017, H2/2017, Q1/2018, Q2/2018, Q3/2018, and Q4/2018 are available at:

http://cabinet.gov.krd/a/d.aspx?s=010000&l=12&a=56305

http://cabinet.gov.krd/a/d.aspx?s=010000&l=12&a=56996

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57041

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57395

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57589

http://cabinet.gov.krd/a/d.aspx?s=040000&l=12&a=57842

more granular data, but without sufficient information to understand the full picture.

It's worth repeating, that due to the opaqueness of the KRG's budget as well other incomplete information, the analysis portrays the operating dynamics of the KRG's finances for 2018 and 2017 rather than depicting an accurate picture.

Table III: The KRG's 2018 budget including revenues from share of GoI budget

	Q1/2018 A	Q2/2018 A	Q3/2018 A	Q4/2018 A	2018 A
Total sales bbl	30,462,232	29,355,258	35,842,393	39,764,918	135,424,801
Days	90	91	92	92	365
Exports bbl/d	338,469	322,585	389,591	432,227	371,027
Oil sales revenues (A) $	**1,663,708,781**	**1,838,818,555**	**2,262,409,784**	**2,149,809,755**	**7,914,746,875**
Avg price $/bbl	54.62	62.64	63.12	54.06	58.44
Brent average price $/bbl	66.81	74.50	75.22	67.71	71.06
Discount to Brent $	12.19	11.86	12.10	13.65	12.62
IOC payments $	459,263,330	549,528,356	616,149,067	782,195,553	2,407,136,306
IOC payments as % of oil revenues	*28%*	*30%*	*27%*	*36%*	*30%*
Turkish Energy Company "TEC" tariffs $	93,899,661	98,673,309	108,094,863	135,581,373	436,249,206
Tariffs % of export revenues	*6%*	*6%*	*5%*	*6%*	6%
Forward oil sales charges $	8,990,721	5,075,227	3,001,580	2,609,973	19,677,501
Legal fees $	20,000,000		4,587,158		24,587,158
Oil operating expenses (B) $	**582,153,712**	**653,276,892**	**731,832,668**	**920,386,899**	**2,887,650,171**
Electricity related payments $	115,816,288	70,953,536	64,597,595	160,049,622	411,417,041
Other payments (inc. debt payments) $	7,103,157		11,512,112	93,878,415	112,493,684
Non-oil expenses (C) $	**122,919,445**	**70,953,536**	**76,109,707**	**253,928,037**	**523,910,725**
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $	100,000,000	200,000,060	115,000,060	275,000,160	690,000,280
Forward oil sales repayments $ (Negative = over-draft)	428,760,513	-201,654,971	181,385,298	-91,569,430	316,921,410
Forward oil sales interest payments $	4,740,715	4,138,383	4,595,539	7,303,095	20,777,732
Oil financing & debt expenses (D) $	**533,501,228**	**2,483,472**	**300,980,897**	**190,733,825**	**1,027,699,422**
Total expenses (E = B + C + D) $	**1,238,574,385**	**726,713,900**	**1,108,923,272**	**1,365,048,761**	**4,439,260,318**
Net proceeds from oil sales (F = A- E) $	**425,134,396**	**1,112,104,655**	**1,153,486,512**	**784,760,994**	**3,475,486,557**
Additional net proceeds from PSC / pipeline licensing agreements (G) $	223,455,047	197,795,251	135,286,862	311,717,533	868,254,693
Additional forward sales (H) $			104,598,002	86,000,000	190,598,002
Total proceeds (I = F + G + H) $	**648,589,443**	**1,309,899,906**	**1,393,371,376**	**1,182,478,527**	**4,534,339,252**
Other revenues (J)					914,885,714
US government payments for Peshmerga (K)					262,184,874
GoI salary payments (L)					2,397,478,992
Total revenues (M = I + J + K + M) $					**8,108,888,832**
KRG salary expenses $					6,668,363,816
KRG debt repayments $					500,000,000
KRG goods, services and maintenance $					1,339,574,790
KRG investment spending $					268,072,269
KRG expenditures (N) $					**8,776,010,875**
Net (O = M - N) $					**-667,122,043**

Table IV: The KRG's 2017 budget

	H1/2017	H2/2017	2017
Total exports bbl	100,167,897	86,980,610	187,148,507
Days	181	184	365
Exports bbl/d	553,414	472,721	512,736
Oil sales revenues $ (A)	**4,069,634,337**	**3,853,777,857**	**7,923,412,194**
Avg price $/bbl	40.63	44.31	42.47
Brent average price $/bbl	51.64	53.38	52.51
Discount to Brent $	11.01	9.08	10.04
Kirkuk Petrodollar payments $	62,000,000	30,000,000	
IOC payments $	658,871,171	624,998,472	
IOC payments as % of oil revenues	*16%*	*16%*	
Turkish Energy Company "TEC" tariffs $		233,940,615	
Forward oil sales charges $		78,034,998	
Legal fees & legal settlement $			
Other payments $	742,694,946	14,592,100	
Oil operating expenses (B) $	**1,463,566,117**	**981,566,185**	
Electricity related payments $		154,782,107	
Other municipality payments $		15,515,310	
legal settlement $		518,169,127	
Non-oil expenses (C) $		**688,466,544**	
Debt repayment to TEC & Turkish Petroleum Int'l Co. "TPIC" $		233,940,615	
Forward oil sales repayments $	513,179,291	121,200,706	
Forward oil sales interest payments $	16,786,387	13,193,138	
Oil financing & debt expenses (D) $	**529,965,678**	**368,334,459**	
Total expenses (E = B + C + D) $	**1,993,531,795**	**2,038,367,188**	**4,031,898,983**
Net proceeds from oil sales (F = A- E) $	**2,076,102,542**	**1,815,410,669**	**3,891,513,211**
Additional forward sales (G) $	1,252,108,577	183,825,333	1,435,933,910
Total proceeds (H = F + G) $	**3,328,211,119**	**1,999,236,002**	**5,327,447,121**
US government payments for Peshmerga (I)			196,638,655
Other revenues (J)			914,885,714
Total Revenues (K = H + I + J)			**6,438,971,491**
KRG salary expenses $			5,929,411,765
KRG goods, services and maintenance $			1,339,574,790
KRG Investment Spending $			268,072,269
KRG Expenditures (K) $			**7,537,058,824**
Net (L = J - K) $			**-1,098,087,333**

Disclaimer

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