IRAQ OIL REPORT

Iraq Oil and Financial Dataset (IOFD) – Analysis
April 2015

INTRODUCTION

This edition of the IOFD monthly brief focuses on the cooperative oil export and revenue sharing agreement between the KRG and Baghdad. We've updated the spreadsheet to include several new data points, which enable us to crunch some numbers with potentially large political consequences. In summary: it now appears the KRG is substantially meeting its commitments, while Baghdad is not.

ANALYSIS

Let's first turn to some of the new rows we added last month, which are continuing to tell an interesting story. You will recall we began calculating the total monthly value of federal oil sales from Ceyhan (Row 59) -- oil sales that flow through the KRG's pipeline and are enabled by the budget deal. We then compared this number against the federal government's actual budget transfer to the KRG (Row 51), giving us a rough approximation of whether one side or the other is "profiting" from the deal (Row 60). Over the first three months of the year, we found the two sides were essentially breaking even: the value of the budget payment hewed fairly close to the value of northern exports. This led us to hypothesize in our March note that the KRG has, in essence, been "selling" its oil to SOMO.

In April, however, that picture has changed rather drastically. The KRG has increased its transfers to SOMO by about 77 percent, month-on-month, but the budget payment from Baghdad has actually decreased. The value of SOMO's northern exports was about $750 million, whereas the budget payment was just $407.5 million. By any metric, the financial benefit of this deal, as implemented, is now skewed heavily in Baghdad's favor. The implication here should be obvious: the ongoing implementation of this agreement depends on political goodwill, which is unlikely to survive if this kind of asymmetry continues. This oil deal is in trouble.

This month we are also adding a new set of data (Row 34). As Ashti Hawrami disclosed in March, he and Adil Abd al-Mahdi agreed on Jan. 23 to a schedule of oil transfers that would result in an annualized average of 550,000 bpd in KRG transfers to SOMO, in apparent adherence to the budget law. Our new data set expresses those oil transfer expectations as a daily average to be achieved throughout a given month. In April, for example, according to the Jan. 23 agreement, the KRG was expected to transfer 468,333 bpd to SOMO's tanks at Ceyhan.

The addition of these new data allows us to see how the KRG has performed against this political expectation (Rows 35 and 46). We can see that the KRG came close in January and February (between 82 and 92 percent compliant), and then fell off somewhat in March (transfering 66 percent of the expected crude). These shortfalls had political and financial consequences, as leaders in Baghdad used them to justify smaller-than-expected budget transfers.

In April, however, the KRG exceeded expectations, transferring between 105 to 114 percent of the agreed upon volumes. (The KRG and Baghdad record slightly different amounts of crude transferred to SOMO for the month, but data from both sides reflect the KRG's outperformance relative to the Jan. 23 transfer schedule.) Even if we dismiss the Jan. 23 agreement as a merely political document, we can still compare the KRG transfers against the 550,000 bpd expectation set in the budget law. Using that metric, the KRG still -- according to Baghdad's numbers -- fulfilled more than 90 percent of its obligation.

We can also use these numbers to evaluate whether Baghdad is committed to implement the deal according to its own interpretation of the terms. The federal oil minister has previously said that the monthly budget transfer is determined through a series of calculations: first, they deduct Iraq's monthly sovereign expenses from total monthly federal expenses; second, they calculate 17 percent of the remainder, to determine the KRG's theoretical, full budget dues; third, they determine how fully the KRG has met the oil transfer obligations, and multiply the theoretical budget dues by that fraction. Thus, for example, if total federal expenses were $150, and sovereign expenses were $50, then the KRG would theoretically be due 17 percent of $100, or $17 -- and if the KRG had transferred half the oil required by the budget deal, it would receive half of its theoretical dues, or $8.50.

Happily, we are already tracking total federal expenditures (Row 19) and sovereign expenditures (Row 20), so we can do the full calculation ourselves. We can determine the theoretical monthly budget payment to the KRG by applying the oil minister's formula either to the Jan. 23 transfer schedule (Row 56) or to the flat 550,000 bpd expectation (Row 57). Doing so, we find absolutely no evidence that such a formula has been applied to determine the actual budget payment over the past four months.

- In January, with a budget payment of $208 million, the federal oil minister's formula appeared to call for a transfer of either $441 million or $165 million, depending on whether the transfer expectation is defined by the Jan. 23 agreement or the 550,000 bpd budget benchmark.
- In February, with a budget transfer of $408 million, the federal formula called for either $635 million or $391 million.
- In March, with a budget transfer of $439 million, the federal formula called for either $488 million or $382 million.
- In April, with a budget transfer of $407 million, the federal formula called for either $695 million or $596 million.

In aggregate, this evidence suggests that Baghdad's budget payments to the KRG are not the result of a strict, mathematical calculation. (In fact, we can find no statistically significant correlation between the amount of the budget payment and any of the other data points we track.) So, although Abd al-Mahdi may be advocating in good faith for the Abadi administration to apply a straightforward formula, the actual amount of money transferred to the KRG is probably the result -- at least in part -- of a non-mathematical and likely quite political process.

CONCLUSION

As Iraq Oil Report has documented extensively in news stories, Baghdad and the KRG disagree fundamentally about how to interpret the oil and revenue agreement enshrined in the budget. Our analysis of the latest data now suggests that the dispute may be even more irreconcilable than previously thought: Baghdad appears to be falling short of even its own interpretation of the deal. We do not impugn the motives or good will of leaders in Baghdad, who face a variety of impossible tradeoffs involving political pressures, a severe financial crisis, and military spending demands associated with combating the threat posed by ISIS. We simply note our skepticism that the deal can survive much longer, given the imbalance of oil and revenue transfers and the apparent capriciousness of payments from Baghdad.