

TURKEY'S ENERGY STRATEGY: KURDISTAN OVER IRAQ

Turkey seeks to position itself at the crossroads of international hydrocarbon transport infrastructure networks. A lack of domestic hydrocarbon resources, a growing demand for energy, and increasing insecurity across the region has led Turkey to deepen its cooperation with Kurdistan. From the perspective of securing energy imports from a stable and trustworthy supplier, this is the right decision, but not one without risk. Recent territorial advances of the newly formed Islamic State threaten to cut the blossoming energy relationship between Turkey and its partner of choice, Kurdistan, before it has had the chance to reach its full potential.

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Turkey's energy dilemma has been a significant driver for deepening its energy relationship with Kurdistan.¹ However, this development has come at the expense of alienating Turkey's longstanding relationship with Baghdad. Kurdistan, in turn, seeks to support its independence from Baghdad by transporting oil through Turkey. Deepening ties with Kurdistan makes sense for Turkey from an energy security perspective because Kurdistan has ample supplies of oil and gas and is more secure than the rest of Iraq. Turkey's strategy to diversify its energy supply, however, will depend on the Kurds' ability to maintain stability in the face of the threat of the Islamic State.

Turkey's Thirst for Hydrocarbons

With the exception of its reserves of low-grade coal, Turkey lacks significant domestic hydrocarbon resources. In 2012, Turkish production accounted for approximately 6.7 percent of oil demand and just 1.4 percent of natural gas demand. In that same year, Iran and Iraq provided over half of Turkey's oil supply and Russia and Iran provided approximately three-fourths of Turkey's natural gas supply. Turkey wants to diversify away from these suppliers; Iraq's turbulence makes it undependable, Iran as a supplier suffers from decaying infrastructure and international sanctions, and Russia uses its control of hydrocarbon supplies to gain political leverage.

To improve its access to oil and gas, Turkey has sought to develop its status as an energy nexus by building international hydrocarbon transport infrastructure that passes through its territory. The most prominent and successful example of such infrastructure is the Baku-Tbilisi-Ceyhan Pipeline, which brings Caspian oil to the Mediterranean by way of Turkey. The pipeline has a capacity of over one million barrels per day (bpd). Until recently, another oil artery passing through Turkey was Baghdad's often dysfunctional Kirkuk-Ceyhan Pipeline; the territory through which this pipeline runs has since fallen under control of the Islamic State.

Similarly, there have been attempts to build gas pipelines that pass through Turkish territory. TANAP, for instance, is a proposed natural gas pipeline that would transport Caspian gas through Turkey on to Europe.

Ultimately, Turkey aims to access Kurdish natural gas; more so than is the case with oil, which is a fungible commodity sold on global markets. Turkey would significantly benefit as a consumer by having natural gas transportation infrastructure located in its territory. Because natural gas is more cumbersome and costly to transport to end-users than oil, countries in which gas pipelines terminate

¹ In this article, Iraqi Kurdistan will be referred to simply as Kurdistan. In other contexts, the term Kurdistan can be used to reference areas associated with Kurds in Syria, Iraq, Turkey, and Iran.

can reap consumption and price benefits. This is important because, as is the case with many countries, gas as a share of energy consumption in Turkey is set to increase in coming decades. Turkey's Ministry of Energy and Natural Resources, for instance, estimates that between 2013 and 2023, Turkey's demand for natural gas will rise from approximately 45 billion cubic meters (bcm) to nearly 70 bcm annually. Laying the groundwork for energy cooperation with oil pipelines, therefore, is the first step in a long-term strategy of ensuring natural gas supply, which in turn facilitates Turkey's future economic growth.

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Disputed Oil Rights

Kurdistan has for many years sought to pursue greater autonomy from the rest of Iraq, a venture that began in earnest following the end of the First Gulf War. The primary mechanism through which Kurdistan has attempted to expand its autonomy has been by establishing control over its hydrocarbon resources independently of Baghdad. Because oil revenues make up the vast majority of government budgets in both Kurdistan and the rest of Iraq, gaining control of this revenue stream could facilitate autonomous development.

Traditionally, Kurdistan has not been able to independently export oil. It has instead needed to negotiate the sale of its oil through SOMO, Iraq's federally-controlled oil company. In exchange for contributing to Iraq's oil exports, Kurdistan received a portion of Iraq's overall federal budget. In theory, Kurdistan was to provide 17 percent of Iraq's oil exports and, in return, it would receive 17 percent of the federal budget.

There were several disagreements, however, between Erbil and Baghdad regarding the specific mechanisms of contributing oil and distributing revenue. Both sides argued that the other was falling short of fulfilling its end of the bargain. Additionally, Baghdad and Erbil fought over who had the right to engage oil companies for exploration and production projects, as well as over what types of contracts these companies were offered. Sustainable solutions to these disputes were never achieved, and in 2012, negotiations broke down.

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As a result, Iraq cut off budget payments to Kurdistan. Although portions of budget payments have periodically trickled to Erbil since then, for the most part, Erbil has been starved of its financial base. For this reason, Kurdistan has desperately sought new ways to independently generate revenue by transporting its petroleum to global markets. At first, Kurdistan resorted to trucking oil across its borders. This oil, which went to Turkey and likely Iran, was then transported on to markets outside of the immediate region. The quantities of petroleum exported were minimal, however, given the inherent constraints of exporting *via* truck.

A Kurdish Pipeline is Realized

In late 2013, Kurdistan dramatically increased its export capacity by announcing that it had built a pipeline connecting its oilfields to the Turkish port city of Ceyhan. The news confirmed speculation that Turkey and Kurdistan had signed backroom deals on future energy cooperation. The pipeline was a huge boost for Kurdistan because it allowed for the transportation to Turkey of far larger quantities of crude than had previously been possible. Whereas before, Kurdistan was reportedly exporting 40,000 bpd *via* trucks, Kurdish authorities have stated that the pipeline will allow one million bpd of oil exports by the end of 2015 (likely an exaggerated figure, but still a good indication of the dramatic increase in export potential). Iraq responded by threatening legal action against Ankara, Erbil, and companies engaged in Kurdish oil transactions.

In June 2014, the oil tanker United Leadership left Ceyhan carrying a cargo of Kurdish oil that had been transported *via* the new pipeline. Oil market analysts anxiously watched United Leadership’s journey, wondering who would be willing to anger Baghdad by unloading the oil. Nearly two months later, the answer to this question remains unanswered; the contentious cargo has yet to make port. United Leadership is sitting off the coast of Morocco near Casablanca, where it has been located since Moroccan authorities indicated they did not want to get involved in the skirmish over oil rights between Erbil and Baghdad.

United Leadership turned out to be the first of several tankers that left Turkey with Kurdish oil from the autonomous pipeline. Shortly thereafter, another tanker un-

loaded its cargo in Ashkelon, Israel. A third tanker currently sits off the coast of Texas in international waters after a US judge ordered marshals to seize its cargo. A fourth tanker sits near New Jersey; the original buyers of the cargo stated they will not go forward with the transaction until it is determined who has the right to sell the oil, Erbil or Baghdad. A fifth tanker recently transferred some of its cargo to another tanker in the Malacca Strait in an attempt to covertly sell the oil.

Some observers have pointed to the uncertain fate of the Kurdish tankers as evidence that Kurdish autonomy aspirations still face significant hurdles. But the fact of the matter is that momentum is in the Kurds' favor; as each new tanker leaves Ceyhan, it becomes more unlikely that Iraq will be unable to stop a buyer from purchasing one of the increasing number of cargos at sea. This is particularly true because Baghdad is facing much larger problems than Kurdish autonomy, namely a burgeoning caliphate at its doorstep.

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The Distraction of a Caliphate

In June 2014, the Islamic State of Iraq and Syria (ISIS) quickly replaced the Kurds as Baghdad's primary concern. Over the course of a few days, ISIS forces swept in a southeasterly direction from their strongholds in Syria and western Iraq, with Iraqi security forces fleeing from their path. First Mosul fell, then Tikrit. Media reports were rife with accounts of how quickly Baghdad's forces melted before the oncoming threat, with stories of soldiers leaving behind their uniforms and ISIS taking control of large weapons caches left behind. Then the ISIS advances slowed and eventually three zones of control were established: ISIS in the west, the Kurds in the north, and Iran-backed Baghdad in the south.

With Baghdad fighting for its survival, the Kurds took advantage of the distraction to press forward with their autonomous oil exports. Perhaps the most important development in this respect was the Kurds' seizure of Kirkuk, a symbolically important city to the Kurds that houses large oil reserves. Until ISIS entered the picture, Kirkuk had lain at the frontier between the zones of control between Erbil and Baghdad, and neither side had clear authority. The Kurds have since announced

their intentions to link Kirkuk to their nascent pipeline network, presumably with the intent to bring its oil to international markets. Additionally, Kurdistan issued a statement that Iraq was attempting to illegally prevent its right to export oil, threatening to counter Baghdad with legal action. Tanks in Ceyhan that were reserved for Kurdish oil were filled to their capacity of 2.5 million barrels.

In subsequent weeks, Western media became fixated with events in Ukraine and then Palestine. It appeared that ISIS' momentum had stalled and that no developments of note were occurring in Iraq. This changed with ISIS' announcement of the establishment of a caliphate and ISIS' rebranding as the Islamic State. Currently, Iraq dominates the headlines once more as stories have emerged about the persecution by the Islamic State of the Yazidi ethnic minority group, about the increased confrontations between the Islamic State and the Kurds, and about Iraqi Prime Minister Nouri al-Maliki's relinquishing of power. The US has responded by bombing Islamic State forces near Erbil, and multiple countries have provided airdrops to Yazidi refugees. The Kurds have called upon the US to provide support in order to combat Islamic State advances.

Improving Turkish Energy Security

Favoring Erbil over Baghdad improves the security of Turkey's energy supply. Firstly, Turkey does not need to import oil from Iraq at all. It can instead import shipments from international markets; oil is a global commodity, and there are numerous suppliers besides Iraq that can meet Turkey's demand. It is true that there are some benefits to being directly linked to an oil supplier *via* pipeline, however Iraq's appeal in this respect is minimal because of its inability to consistently fill pipelines to Turkey; previously, the Baghdad-controlled Kirkuk-Ceyhan Pipeline regularly ran under capacity due to militant attacks (a foreshadowing of ISIS advances to come). With the Islamic State now controlling much of the territory through which Baghdad's pipeline passes, not to mention the seizure of Kirkuk by the Kurds, it is extremely unlikely that Baghdad will be able to provide Turkey with oil any time soon.

Iraq is also not a viable natural gas supplier to Turkey. In theory, Iraq could provide Turkey with significant amounts of gas *via* as of yet unbuilt pipelines. However, this arrangement seems unlikely given the history of security concerns for oil pipelines in the territory through which Iraqi natural gas pipelines would also need to pass. Furthermore, it is unclear how soon Iraq would be able to construct natural gas pipeline export infrastructures, given the ongoing conflict between Baghdad and the Islamic State.

Kurdistan, unlike the rest of Iraq, is in many ways an ideal supplier of hydrocarbons for Turkey. A 2012 International Energy Agency (IEA) report, for instance, stated that Kurdistan could potentially export 20 bcm of gas annually (for comparison, Turkey consumed 45 bcm in 2012), although experts agree this number is likely unrealistic. It is also worth noting that in the referenced EIA report, this production would not occur until 2035. However, in all scenarios examined by the EIA, the bulk of overall Iraqi production of non-associated gas comes from Kurdistan.

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Since the 2012 breakdown in oil export arrangements with Baghdad, Erbil has been bereft of its portion of the federal budget. In the interim, Kurdistan has reportedly depended upon significant borrowing to cover expenditures, but in the long term, it desperately needs to earn oil export revenues to sustain itself. While it is true that the Kurdish region is prospering in some non-oil sectors, over 90 percent of its budget before the breakdown in negotiations with Baghdad depended on oil revenue. In this arrangement, Turkey holds all the leverage over Kurdistan; whereas it can import oil from global markets, Kurdistan's economic survival relies upon accessing consumers *via* Turkish territory.

It is possible that Turkey could use this leverage to negotiate favorable oil import deals or transit fees for Kurdish oil passing through its territory. More likely, though, is that Turkey will use its advantage to arrange favorable natural gas import deals once such infrastructure comes into play. As previously mentioned, Turkey is thirsty for natural gas, and importing *via* pipelines is the preferred method to meet this demand. Although Kurdistan has yet to develop natural gas export pipelines, this is certainly the next step in its energy independence agenda. Should this come to pass, Turkey will then have a compliant natural gas supplier with abundant reserves at its doorstep.

An Important Caveat

It makes sense from an energy perspective for Turkey to favor Kurdistan at the expense of Iraq, but only if Kurdistan is able to provide it with oil and gas. With the establishment of the Islamic State, however, Kurdistan's prospects as a stable

energy supplier have diminished. To evaluate if Turkey's energy strategy has paid off, therefore, observers must wait and see if Kurdistan will be able to withstand the chaos. With the instability in Iraq increasingly taking on regional dimensions, it is difficult to forecast the Islamic State's evolution and how this will impact Kurdistan.

As of the time of this writing, multiple energy companies in Kurdistan have announced full or partial halts to their operations for fear of ISIS disruption. Kurdish President Massoud Barzani has called for international support to combat the Islamic State, casting doubt on the Kurds' reputation as the force in Iraq that is best able to withstand the Islamic State's advances. Refugees are flowing into Kurdish territory, putting a strain on an economy that has been cut off from the federal budget since late 2012. Concurrently, the threat of sleeper cells in Kurdistan has risen over fears that Islamic State infiltrators are hidden amongst the refugees. There have also been a limited number of ISIS attacks in Kirkuk and, more worrisome, in areas near Erbil. Turkey's energy strategy may still pay off, but the Islamic State threatens Kurdistan's dependability as a partner in energy cooperation.