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## A DIFFERENT BATTLE IN IRAQ

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In 2017, the Iraqi federal budget will prioritize reconstruction in areas retaken from the Islamic State, and Baghdad will be forced to rely on outside funding for many of its domestic projects.

The fight between Arbil and Baghdad over oil production cuts and revenue sharing will deepen the divide between political parties in the Kurdistan Regional Government.

The 2017 budget's military allocations will provoke backlash from Sunni and Kurdish politicians.

### Analysis

As the campaign to retake Mosul from the Islamic State grinds on, a political battle is winding down about 400 kilometers (roughly 250 miles) south in Baghdad. After repeated delays and much debate, Iraq's parliament passed its 2017 budget on Dec. 7. Although the worst of that struggle is now over, the issues that drove it remain. Facing another year of scant oil revenue, the Iraqi government will encounter an array of familiar challenges in 2017, but its focus will stay firmly fixed on the fight against the Islamic State.

### Another Year of Austerity

Baghdad is caught between a rock and a hard place where its budget is concerned. Discontent is growing among the Iraqi people after years of austerity measures, but between stagnant oil prices and the conditions of Iraq's World Bank and International Monetary Fund loans, there is no end in sight to the spending cuts. Iraq, whose oil production is second only to Saudi Arabia's among OPEC members, is one of the most oil-dependent countries in the Middle East. In 2015, 85 percent of the nation's budget derived from oil export revenues. Despite OPEC's recent decision to cut oil production in 2017, the odds are low that oil prices will make a dramatic recovery in the next year. Assuming that the country would sell its oil at a modest \$42 per barrel, Iraq's lawmakers arrived at a budget of 100.7 trillion Iraqi dinars (about \$85 billion), a 6 percent reduction from this year's.

The largest item on the budget, at 12 trillion dinars, is the effort against the Islamic State, and even more money will go toward reconstructing areas that have been captured from the group. Baghdad is focusing its funds and attention on these communities to try to prevent the spread of extremist ideology as it tries to re-establish its authority there. As the largest and most diverse

Iraqi territory under Islamic State occupation, Nineveh province – where Mosul is located – will present the biggest challenge for the Iraqi government once it has been reclaimed. But even communities recently rid of the Islamic State, such as those in Anbar, Salahuddin and Diyala provinces, are struggling to recover, let alone thrive. The World Bank estimates that 41.2 percent of people in regions under the Islamic State's control lived in poverty in 2015, compared with the national average of 14.5 percent. Despite their country's economic straits, Iraqi lawmakers allowed for new government expenditures through the Interior, Defense, Education and Health ministries in the 2017 budget, recognizing the extent of the damage in these communities.

The rest is an exercise in austerity. To continue receiving funding from the World Bank and International Monetary Fund, Baghdad must keep its expenses down in the coming year. In fact, the new budget has earmarked the loans, along with German, British and U.S. aid, for critical infrastructure projects. Under the 2017 budget, federal salaries and pensions will be cut by 3.8 percent, and new rules require state workers to take a certain amount of leave each year at reduced pay. Water and utility prices, meanwhile, will increase – much to the dismay of the Iraqi people. Though Prime Minister Haider al-Abadi has managed to galvanize public support over the past two years by invoking the government's difficult battle against the Islamic State, that tactic may not work for much longer. As coalition forces continue to gain ground against the extremist group, demands for increased public spending in Iraq's neglected provinces and impoverished towns will grow louder and more adamant.

### Trouble From Kurdistan

In Iraqi Kurdistan, the 2017 budget is already causing a stir. As usual, 17 percent of Baghdad's spending in 2017 is designated to cover the expenses of the Kurdistan Regional Government (KRG). The budget further stipulates that the money is intended to pay 650,000 salaries in the KRG in exchange for 550,000 barrels per day in oil production from Iraqi Kurdistan, to be sold through Iraq's State Organization for Marketing Oil. The arrangement is similar to agreements the KRG struck with Baghdad in February of this year and in December 2014 – and has since more or less ignored, reluctant to give up its right to independently market oil. Unlike past budgets, however, the 2017 plan absolves Baghdad of its 17 percent payment if Arbil fails to meet its quota.

By including these conditions, the 2017 budget merely makes explicit the terms that Baghdad has proposed, and has been tacitly observing, for sharing oil profits with Arbil. Nonetheless, high-ranking officials in the ruling Kurdistan Democratic Party (KDP) have decried the deal. Other Kurdish parties – including factions of the Patriotic Union of Kurdistan (PUK), the KDP's main rival – support the budget, even going so far as to thank the Iraqi legislature's financial committee for arranging such a generous deal. The parties' differing views highlight the growing divisions between the PUK and the KDP. Earlier in the year, the KRG's parties were unified in their skepticism of Baghdad's February budget deal, but today, the KDP is alone in its outrage over the Iraqi government's threats to withhold payment. Since the KDP controls much of the KRG's oil production, the PUK and its fellow bloc members blame the ruling party for failing to uphold its end of the bargain with Baghdad, thereby depriving Arbil of much-needed cash. Still, if the past two

years are any guide, a 17 percent share of the federal budget is unlikely to persuade the KRG to stop selling oil outside Baghdad's channels.

Further complicating matters, Iraq and the KRG have yet to hash out how they will divvy up the 210,000 barrels per day in production that OPEC expects them to cut. Although the KRG is generally reluctant to participate in production cuts, it is open to discussing the issue with Iraq. To do so, however, the PUK and KDP would first have to put aside their many differences.

### Keeping Up With Payroll

The budget's military allocations are also controversial. Now that a recent law has made the Popular Mobilization Forces an official part of Iraq's security forces, the paramilitary organization stands to receive funding through the 2017 budget for up to 110,000 fighters. Though the group includes Sunni fighters as well, Sunni leaders are concerned that the Popular Mobilization Forces' predominately Shiite militias are getting preferential treatment, an argument that will continue for years to come. At the same time, the move has angered Kurdish leaders, who are trying to get as much money as possible for their peshmerga fighters. According to the new budget, the allocation for the Popular Mobilization Forces will be decided according to census data. Peshmerga forces, on the other hand, will receive allocations from the Iraqi army's ground troops budget based on forthcoming data from the KRG's Ministry of the Peshmerga. But no matter what numbers the ministry in Erbil sends to Baghdad, the Iraqi government will be unable to pay all the fighters in the peshmerga's ranks, which have grown precipitously since the fight against the Islamic State began.

KRG President Massoud Barzani complained about the expected shortfall Dec. 8, saying that it is further evidence of Baghdad's efforts to sideline the peshmerga and the Kurds. Barzani also expressed confidence that the United States would continue its support for the Kurdish fighters, though the issue is not as simple as he may think. Washington provisionally promised \$415 million to the peshmerga this year for its role in the Mosul offensive, supposedly contingent on the Kurds' relinquishing control of reclaimed territory to Baghdad. Furthermore, though the United States will maintain a presence in Iraq after the battle for Mosul is over, as U.S. officials recently confirmed, Washington's interest in arming the peshmerga will likely fall off when the fighting does. And once the campaign for Mosul has ended and the battle to claim the retaken territory begins, both Erbil and Baghdad will look to the United States for support.

As the new budget demonstrates, defeating the Islamic State is the Iraqi government's main priority in the year to come. But once the fighting is over, Baghdad will have to reckon with the country's other unresolved conflicts.