IHS ENERGY

Quarterly Insight Newsletter

September 2014 ihs.com

Fragile borders: How violence in Iraq and Syria could reshape the investment environment in the Middle East

Raad Alkadiri, Senior Director, Research, Upstream Research, IHS Energy

The June offensive by Islamic State (IS) extremists into northern Iraq was a stark reminder of the risks of violent spillover from the civil war in Syria and the challenges it can pose to the sovereignty of neighboring states. The collapse of the Syrian state and the violent power vacuum that has replaced it is not only creating a regional humanitarian crisis in the Middle East; it is also exposing the fragility of Syria's neighbors, many of which lie on shaky foundations, and corrosive influence of tension between regional powers.

The speed and success of IS's offensive into Iraq and the group's subsequent ability to control territory despite its relatively small numbers (Western intelligence agencies estimate IS's core strength at around 2,500–3,000 fighters) says as much about Iraq's internal political divisions as anything else. IS has been able to tap into the frustration and discontent of Iraq's Sunni population, which feels victimized by the Shia-led central government in Baghdad and ostracized from the post-2003 political order. IS's offensive is a symptom not a cause of instability in Iraq, and the reaction of the country's two other main communities (Kurd and Shia) reinforce this sense: the former initially saw it as an opportunity to advance its independence agenda, seizing disputed territory—including the oil-rich Kirkuk area—and demanding greater decentralization of government; the latter circled the wagons to protect itself from what it has always perceived as a threat by Iraq's Sunnis and remnants of the old Saddam Hussein regime to restore their power. What is unfolding in Iraq is another civil war that is threatening the territorial integrity of the state.

This threat to existing borders is not unique to Iraq; it extends from the western borders of Iran to the shores of the eastern Mediterranean. Instability and receding state power across the region has prompted communities to rely on local actors to provide protection and welfare. Political geography is becoming more atomized as a result, with communal, ethnic, tribal, and sectarian links replacing citizenship and national identity as the principal focus of loyalty and organization. IS's declaration of the caliphate in the areas of Iraq and Syria under its control may not resonate with large swaths of the population in those areas, and certainly not with sovereign governments in the Middle East and worldwide. But it does underline the fact that borders are not immutable. Instead, they are a reflection of prevailing political, economic, and security relationships, many of which are changing as states in the Middle East begin to fail. The example of Yugoslavia in the 1990s is a powerful reminder of how quickly, and how violently, borders can change.

Fragmentation in the Middle East is not preordained. Nevertheless, the outlines of a new political geography are already evident. The Kurdistan Regional Government in Iraq has taken increasing steps toward independence, and an autonomous Kurdish entity now exists in Syria as well. Syria's Allawite community has sought refuge in its traditional coastal redoubt, and in Iraq, internal sectarian boundaries between Sunni and Shia provinces have become increasingly stark. The spillover of violence from Syria into Lebanon is testing the bonds of what has always been a weak state that amalgamated powerful local sectarian factions, and Jordan is showing signs of vulnerability to domestic Islamist extremism. If central governments fail, power and authority will quickly and violently devolve to local groups. The

Contacts

Raad Alkadiri, Senior Director
Raad.Alkadiri@ihs.com

borders on the map may remain formally unchanged for some time to come, but in practical terms they will mean very little.

This evolution would have significant implications for the oil and gas sectors in these countries. It is not just that security risks will rise; license to acreage, access to infrastructure and sanctity of contracts will all come into question. The travails of investors in Iraqi Kurdistan over the past decade and the current challenges to independent exports from the region illustrate the investment risks that could emerge. The failure to restore Libyan production since the fall of the Qadhafi regime offer another clear example of how state collapse will directly affect operations and investment. A quick look at a map of the Middle East shows that in the areas most vulnerable to collapse—resource base and infrastructure—do not conveniently follow emerging internal borders.

The danger for oil and gas production is not just from security-related shut-ins therefore; the real risk is that disputed title and contract uncertainties that result from state fragmentation will deter investment and therefore undermine the long-term production upside that markets anticipate from these countries. Moreover, disruptions and negative market sentiment are likely to add a risk premium to global crude prices. None of these challenges will recede quickly. The Middle East is undergoing what is potentially a once-in-a-century transformation, and that process—beyond being messy and violent—is likely to take a generation to unfold, even if borders do ultimately remain the same.