



Iraq's Economy after ISIS: An Investor's Perspective

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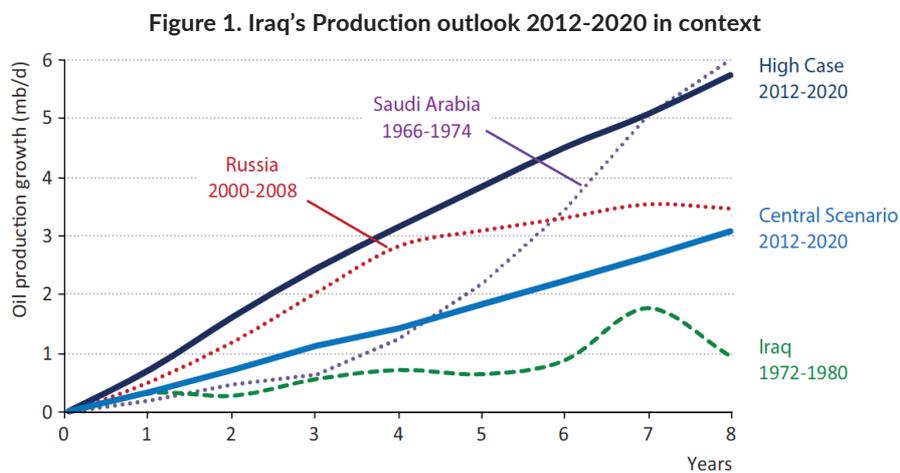
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LIST OF FIGURES

- 1 Iraq's Production outlook 2012-2020 in context
- 4 Iraq GDP Annual Growth Rate
- 4 Iraq Crude Oil Production, 2006-2016
- 4 Iraq Imports, 2006-2016
- 5 Iraqi GDP per capita, 2006-2016
- 6 Iraq's Production outlook 2012-2020 vs Actual Crude Production 2012-YTD2017
- 10 The RSISUSD Index 2009-YTD 2007

This article¹ assesses the country's potential as a post conflict investment opportunity from an investor's perspective. Following the liberation of Mosul from ISIS, Iraq is moving toward a better place economically, despite a number of false starts since the fall of the Saddam Hussein regime in 2003, and remaining political and legal structural issues that will have to be overcome.²

The optimistic period of 2010-2013 witnessed massive investment inflows into Iraq, both into the real economy and the equity markets, due to the need for enormous reconstruction following decades of conflict. With oil prices above USD100/barrel and Iraq's ambitious plans to increase oil production to about 9 mb/d³ by 2020 from around 2.5 mbl/d in 2012 (chart below), analysts saw the potential for significant wealth accumulation, citing similar production expansions in Saudi Arabia (1966-1974) and Russia (2000-2008) and the subsequent transformative effects on those economies.



Source: IEA Iraq Energy Outlook 2012

However, the ISIS invasion of the country in 2014, followed by the collapse in oil prices, dampened these expectations. While the need for reconstruction now is significantly higher than it was then, it is reasonable to wonder whether Iraq can rebuild what was destroyed over the last three years, let alone embark upon the major reconstruction needed after over 35 years of conflict. Iraq has reached the limit of its spending capacity, and, while oil production has increased significantly, oil prices are almost half of pre-conflict levels, and concerns remain that oil prices will stay lower for longer than previously thought.

I argue that the current pessimistic mood overlooks important markers of potential growth. First, the unintended consequences of lower oil prices have made the continuation of the rentier state in its present form untenable and is forcing a rethink. Secondly, the state's dire need for private investors' capital for the provision of goods and services, rebuilding the economy, and re-construction will be the key to unlocking the potential rewards of the post

¹ The information is based on information publically available through web sites, publications, presentations, and research reports. Hard data is from the Central Bank of Iraq, Iraq's ministries, IEA, EIA, BP, tradingeconomics.com, the IMF & World Bank databases and country reports. No representation or warranty, expressed or implied, is made as to their accuracy, completeness or correctness. The analysis reflects my own views and outlook.

² The challenges, political & structural, Iraq faces post ISIS are covered in this piece that explores the opportunities but addresses the challenges ahead (in the last section).
https://mei.nus.edu.sg/themes/site_themes/agile_records/images/uploads/Fanar_-Insight.pdf.

³ mb/d is shorthand for million barrels per day, others are LC/LG's for Letters of Credit/Letters of Guarantee, GW for Gigawatt

conflict recovery. The combination of these unintended consequences is forcing a necessary set of political, institutional and legal changes that Iraq has yet to introduce but are essential for the development of robust industrial and service sectors. Ultimately, these sectors should take the lead in the effort to diversify the economy away from oil and eventually be the main drivers of economic growth.

BACKGROUND: A BRIEF HISTORY OF IRAQ'S ECONOMY

The succession of revolutionary governments since 1958, culminating in the 1968 revolution led by the Baath party, which espoused pan-Arabism and socialism, were inspired by anti-colonialism and social justice. They brought with them progressive and socialist policies of wealth redistribution away from the perceived beneficiaries of colonialism, i.e. the feudal landowners and merchant classes. Successive governments developed the public sector largely through the nationalisation of industry, agriculture, and financial services. The nationalisation of the oil industry provided the wherewithal to fund the expansion of the state. Eventually, the economy was centralized, command-driven, dominated by the massive oil sector, in concert with state control over the agricultural and manufacturing sectors, as well as financial services, with only small-scale private enterprise in agriculture, light manufacturing, and services.

The state's role expanded significantly during the long Iraq-Iran war in two ways. First, compulsory draft into the army and its associated industries solidified the state's control over the labor force, and secondly, the diversion of all resources to the military industrial machine starved investments, both human and capital, in the productive agricultural and industrial sectors. To meet the war demands, the state started to open the economy to the private sector through privatizations of State-Owned Enterprises (SOE's) and allowing the private sector into industry and finance. However, the socialist mentality continued to dominate, perhaps most clearly evidenced through the requirement in company articles of association that companies contribute to the development of their respective industries for the benefit of the country.

The major effect of the First Gulf War was the destruction of the country's capital stock, while the fourteen years of sanctions in its wake increased the state's power and furthered the population's dependence on it through the Oil-for-Food programme. Although the state increased the pace of privatization and encouraged the growth of private enterprise, corruption was endemic; the regime's associates controlled all enterprises, thereby decimating most of the independent private enterprise and driving the rest toward the shadow economy. Consequently, the industrial and agricultural sectors continued to decline. The agricultural sector, in particular, suffered from lack of investments and neglect, compounding the effects of desertification and prompting the continued migration of farming communities to urban areas, which added to the stress on the provision of services in the cities.

Although the Second Gulf War further devastated Iraq's capital stock, its aftermath reverberated through the unintended consequences of the policies, both political and economic, of the Coalition Provisional Authority (CPA). The CPA hollowed out the country's much weakened institutional capacity to function, ranging from planning, policy making, and managing the country in general.

Thus, the years of political, social, and economic upheavals through 2014, including civil war and the proliferation of terrorist attacks, saw the revival of Iraq's oil industry with

growth in oil production as the economic engine for rebuilding. Despite an influx of foreign aid and Foreign Direct Investments (FDI), the country had no institutional capacity to absorb these funds, and lacked the infrastructure to handle the requirements of reconstruction. As a result, the pervasive corruption that characterized the latter Saddam years only grew more entrenched morphing from a centralized form to a decentralized form with wide participation across the board. In the meantime, the new political system, in which ethno-sectarian political parties divided ministries and resources between them, framed each party's measure of power by the size of its ministries and associated state-owned enterprises (SOEs). Ministries and SOEs continued to be the driving force of the economy, employing over half of the working population and thus creating a bloated public sector. Although some SOEs were initially viable enterprises, most were vehicles for employment under past regimes, and continued to function in this role, even expanding as a way to increase party influence. Not only were SOEs high cost unproductive enterprises draining government resources, but they also attracted employees from the private sector, which could not compete with generous state benefits.

Until 2014, high oil revenues catalyzed the growth of the state with increasing revenues year after year to nurture future growth through expanding production. This oil wealth was the magnet for drawing investments into Iraq's economy and its equity markets. However, it was highly unrealistic to expect that the transformation to a functioning market economy governed by an institutionalized democracy would take root⁴, let alone take place, in under a decade nor that it would be without significant challenges. The pace of recovery for Iraq post-conflict, is closely correlated to the scale of the damage as a result of conflict, especially to its institutional capacity to function. Iraq's conflicts span the course of nearly four decades, and therefore its path to recovery will be particularly difficult, and thus the time frame for that recovery will be longer than optimistic forecasts and un-even.

While the country enjoyed strong GDP growth up to 2014 (Figure 2) as a result of the growth in oil production (Figure 3), the shrunken agricultural and industrial base still could not meet the population's demand for foods and goods. This gap was met by imports (Figure 4), with the result that the bulk of local production was in retailing and related industries. Local industry, for the most part, was unable to compete with imports due to weak or non-existent tariff collection and was consequently starved of capital to diversify and grow. While state spending was a boon to the construction and government service providers, the failure to provide electricity to meet the needs of industry acted as an additional obstacle to its development.

⁴ In addition to the challenges of emerging from nearly four decades of conflict, Iraq was transitioning from a decades-long authoritarian regime to democracy, and experiencing all the challenges that come with transition, such as the rise of widespread corruption and, generally, slower growth. The two links below are two interesting studies, one theoretical and one empirical, that show an inverse relationship between democracy and corruption, i.e. corruption increases as a young democracy emerges from authoritarianism, generally in the process inhibiting growth. But as the democracy takes hold and matures, corruption declines as a result and ultimately growth can resume. While there are multiple variables and challenges, the studies suggest that the "turning point in corruption occurs rather early in the life of new democracies at 4-15 years and at rather low per capita incomes."

- <https://www.un.org/development/desa/publications/working-paper/corruption-and-democracy>
- https://www.researchgate.net/publication/223854551_Democracy_rent Seeking_public_spending_and_growth

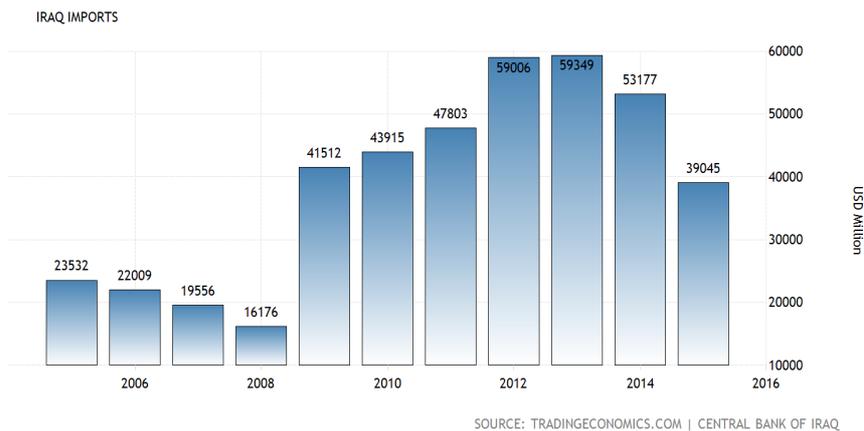
Figure 2. Iraq GDP Annual Growth Rate



Figure 3. Iraq Crude Oil Production, 2006-2016



Figure 4. Iraq Imports, 2006-2016



Moreover, while GDP per capita grew in nominal terms (Figure 5), growth was not inclusive. Official unemployment statistics stood at 11% but that number was likely much higher, especially among women and youth, and in the rural areas poverty rates reached

40%⁵. Moreover, the banking system was dominated by state-owned banks, which accounted for about 90% of total assets and deposits, with the state and SOE's accounting for most of these⁶. The commercial banking sector, which accounted for about 40% of private sector loans and deposits, did not have the capital, deposit base, or the infrastructure to become the engine for loan expansion.

Figure 5. Iraqi GDP per capita, 2006-2016



Finally, continuous political infighting among alliances of Kurds, Sunni Arabs, and Shia Arabs, with each pursuing its own interests in the name of its constituents but not necessarily to their benefit, paralyzed decision making. The result was gridlock, with no hope of real progress on any significant front.

THE ISIS CONFLICT

In 2014, the double whammy of the ISIS invasion and the collapse in oil prices had a devastating effect on the economy as government finances were crushed by soaring expenses and plummeting revenues. Because resources for maintaining basic services were diverted to military spending, the government was forced to make dramatic cuts. The years of conflict stretched the country's capacity to function to the extreme.⁷

REASONS FOR FUTURE OPTIMISM

While initial hopes for the high growth in oil production were wildly optimistic, production growth since 2014 has been in line with the IEA's central case assumptions (2012). Production thus far in 2017 - above 4.5 mb/d from 2.5 mb/d in 2012 - has met IEA's central case projection by end year 5, which then called for under 2 mb/d in extra production. While the government aims to reach a total of 5 mb/d by end of 2017, yet

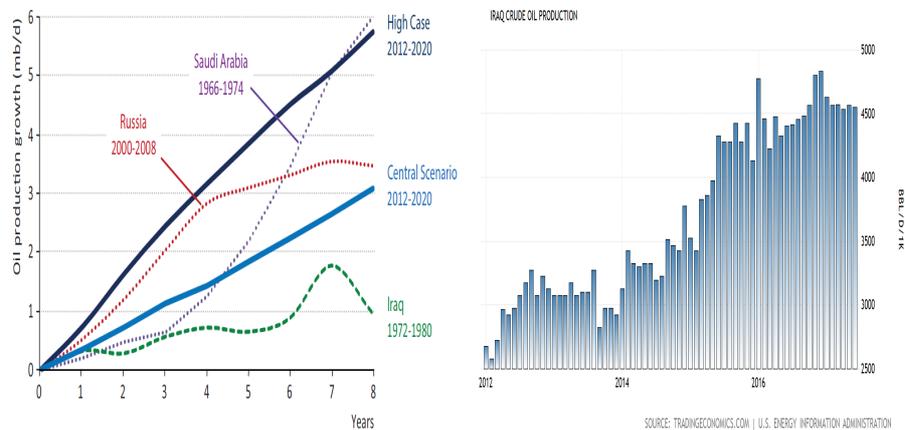
⁵ Figures are from IMF country reports and in particular the (IMF Country Report No. 13/217 released in July 2013). 2013-2014 time-frame represented the peak until the combination of the ISIS invasion and collapse in oil prices in H2/2014 derailed the economy and worsened the figures considerably. <https://www.imf.org/external/pubs/ft/scr/2013/cr13217.pdf>

⁶ Data from above cited IMF report, and author calculations based on data from Central Bank of Iraq (CBI) annual statistical bulletins, available at time of writing until 2015 <https://cbi.iq/page/19>.

⁷ The effects of the ISIS invasion and the state's responses were in a piece by the author at <http://www.iraq-businessnews.com/2017/07/17/economic-consequences-post-mosul/>.

these are on the optimistic side. While meeting year 8 targets is highly unlikely, the country overcame a significant number of operational and logistical challenges by reaching the current target in a hostile environment without the benefit of the massive capital spending envisaged by these projections.

Figure 7. Iraq's Production outlook 2012-2020 vs Actual Crude Production 2012-YTD2017



Concurrent with the progress in oil production, Iraq has committed to the reduction of flaring of associated natural gas.⁸ Previously, Iraq flared over 70% of its associated natural gas, which cost the country billions of dollars annually in lost revenues, billions more in importing natural gas for electricity production,⁹ and even billions more in importing electricity. The significant increase in oil production caused a similar increase in associated natural gas, which thereby increased the amount of gas flared and magnified the financial losses. The government expects that, the Basra Gas Company (BGC), in concert with other smaller projects, to reduce this flaring to 60% by the end of 2017, with the likelihood of further reductions over time, and a target of zero by 2020-2022.¹⁰ The BGC represents a new undertaking for Iraq's energy industry; it is a joint venture between the state-owned South Gas Company (51%), Shell (44%) and the Mitsubishi Corporation (5%). However, the effort to reduce flaring took considerably longer than planned; it has been six years since the agreement to form the BGC in 2011, to the start of operations in 2013, until now, underscoring the significant time and resources needed. Yet, while a number of contractual, infrastructural and logistical challenges remain and need to be continually addressed, this project is underway now. Moreover, it should have a positive impact on net revenues, begins meeting the needs for agriculture and industry for electricity production, and should lead to the creation of the myriad industries down the

⁸ While Iraq is estimated to have almost 1.5% of the world's proven gas reserves, 75% of those are thought to be associated gas, mostly concentrated in the giant southern oil fields. Iraq's associated gas has a high content of natural gas liquids (NGLs) at 30% of total of which 15% is ethane and 8% propane (IEA & South Gas Company). The IEA (2012) estimates that ultimately recoverable gas reserves are at least double current estimates.

⁹ During a recent conference in London (<http://www.iraqconferencelondon.com>), Iraq's oil minister estimated that flaring results in about USD 6.5bn in lost revenues annually. The elimination of this flaring will not only lead to savings but direct and indirect revenue generation. Direct as flared gas is processed into (1) dry gas sold for power generation initially to meet local needs and exported afterwards; (2) Liquefied Petroleum Gas (LPG) for use in home fuels for heating & cooking for domestic use and exports, and (3) Condensate for exports. Indirect through the multiplier effect as the process creates a chain of associated industries and services that grow as a consequence. A major potential export for gas would be Kuwait for its power generation needs, which currently, like most of GCC, mostly uses crude oil.

¹⁰ Data from BGC (<http://www.basrahgas.com>) and Iraq's oil minister in the conference above in London.

value chain with the associated job creation. The BGC venture was initially stymied by internal conflicts, perhaps exacerbated by memories of earlier struggles to nationalize the oil industry. However, the need to develop the gas industry in the current low oil price environment gained primacy. The success of BGC should lead to more such joint ventures, accelerate the development of the gas industry, and contribute to the growth of domestic gas-powered electricity generation.¹¹

Addressing the needs for electricity generation also took a much longer time to address than planned and proved far more torturous. By 2013, analysts estimated that nameplate capacity was about 15GW, equal to theoretical demand,¹² but in fact the electricity delivered was about half that number, due to neglect of aging plants during the decades under sanctions. A number of projects operated by the private sector are expected to start commercial operations and add electricity to the national grid later this year or early next year. They should double the country's production of electricity when peak production arrives. The plants will be operated by the private sector, with the government supplying natural gas and guaranteeing the purchase of electricity at fixed prices for 15-17 years. The availability of gas was a major challenge, given Iraq's underdeveloped gas industry which relied upon the importing of gas from Iran. Due to sanctions and the construction of gas pipelines, those imports were also, unsurprisingly, delayed. It is important to note that even if the target of peak production is met on time, the available electricity would only meet the needs of the country in 2013, far from that required currently or in the future. Yet it is just as important to note that the projects are providing continuously increasing electricity and should lead to additional such projects to be developed given the resolution of a number of challenges. Moreover, their existence would make other projects more feasible¹³ and more quickly implemented.

In order to provide short term solutions to the electricity shortage, the government began to implement privatization¹⁴ of aspects of the of distribution of electricity in early 2016, four years after parliament voted for it in 2012. After dividing the country into 180 areas, private companies will take over responsibility for the distribution in each area and ensure around-the-clock electricity in return for a percentage of electricity tariffs and encourage consumption rationalization by the population. The first such project started in 2016 and 2017 in Baghdad neighbourhoods with positive initial results¹⁵, and a planned roll-out for

¹¹ The net benefit from looking at the larger picture is substantial for Iraq. It will accelerate the development of its gas industry and gas-powered electricity generation, and as gas replaces oil, it will free the oil for exports.

¹² Demand estimates vary as peak demand takes place in the summer months but is unmet and so impossible to estimate accurately. Demand growth estimates are based on current consumption patterns and as such do not take into account expanded consumption due to the availability of electricity. Finally, the demand figures do not take into account the 10-20% of spare capacity needed to ensure a continuous uninterrupted supply while allowing for maintenance and unplanned outages.

¹³ To underscore the points made, the UK Export Finance announced USD117m in financing for the build-up of two 750 MW gas-fired power plants in southern Iraq in early August 2017.

¹⁴ The term privatization is used by the Ministry of Electricity but it is more of working with the private sector as service level providers. The scheme basically is: The private sector investor would receive 12.9% of the fees collected from consumers. The figure was decided through bidding. In return, investor is required (1) to curb waste, provide maintenance to the grid in their zones, (2) pay 80% of employees' salaries of the distribution office in their zones, (3) Install smart meters. They also, have the option to transform grids in their zones into underground grids to avoid waste, the cost of which is recovered through increased percentage of the fees collected after the transformation is first approved by the ministry of electricity.

¹⁵ Experiences of several zones in Baghdad such as Yarmouk, Harithiya, Al-A'amiriya, Mansour, Al-Jama'a, and Al-Saydiya showed: (1) reducing consumption of electricity by 30%, (2) curbing 100% of waste, and (3) collection of 100% of fees. The first three zones (715, 712, and 714) in Zayoona, started in April 2016, the consumption of

the rest of the country over the next few months. While this is merely a stop gap measure, because the production of electricity remains substantially below demand, its implementation should begin to address the needs of the country and contribute to increased productivity, especially for industry. Moreover, the involvement of the private sector should lead to further private sector job creation, with potential multiplier effects, in addition to the benefits of the continuous availability of electricity.

The electricity sector was not alone in its challenges; the commercial banking sector also needed to confront a number of impediments to its growth. State banks dominated the industry, because legislation required the government and SOE's to hold accounts and deposits only with state banks, and to only accept checks and LCs/LGs¹⁶ issued by state banks. Payment of salaries and pensions were restricted to state banks as well. As a result, commercial banks were deprived of large sources of liquidity. Without a deposit insurance scheme, state banks had the additional benefit of an implied state guarantee and thus dominated private sector deposits and loans with about 60% market share. Only in providing trade related finance through LCs/LGs did the commercial banking sector earn a major role in the economy, engaging the private sector with a 72% market share. While commercial banks could not provide banking to the lucrative state sector, they also had a secondary role in providing banking for the private sector and were deprived of the state's trade related fee income. Moreover, in the absence of a credit rating agency, and lacking the ability to assess employee salary history, commercial banks could not effectively provide consumer loans. The government addressed some of these obstacles in 2016 by removing restrictive legislation, preparing plans for a deposit insurance scheme, and starting a project with support from USAID to introduce regulations for the creation of a credit registry. To provide impetus for loan generation by commercial banks to the SME sector, the Central Bank of Iraq (CBI) started to implement the government's 2015 plan to provide state guaranteed loans¹⁷ through commercial banks,¹⁸ totalling about USD 800m to the SME sector and an additional USD 4bn to agriculture and infrastructure projects. While by late 2016 only 2% and 10% of these funds, respectively, were utilized, the process has started to gain traction and should pick up over time, especially after the drawdown of the military campaign and the shift from a war footing to reconstruction.

Commercial banking's¹⁹ metrics have improved considerably in the period 2010-2015²⁰, while starting from a low base which tends to magnify the percentage gains yet growth

electricity was reduced from 52 MW to 27 MW. Source of the two above footnotes
<http://www.bayancenter.org/en/wp-content/uploads/2017/09/909865676600.pdf>.

¹⁶ The main state banks, Rafidain (established in 1941) and Rasheed (established in 1988), dominate business with the government and the SOE's (assets & deposits) while the Trade Bank of Iraq (established in 2003) handles all the government & SOE's trade business and LC & LG's issuance.

¹⁷ While commercial banks are extremely liquid and do need funds to create loans, the project's aim is to provide low interest rate loans to SME's as bank loan rates are extremely high and require equally high collateral, sometimes over 200% of loan value, mostly due to the lack of proper credit risk assessment.

¹⁸ The CBI deposits the funds with commercial banks, which in turn provide the loans to the end user.

¹⁹ Paid up capital includes that of private commercial local banks and branches of foreign banks operating in Iraq, while credit and deposit growth is private sector credit/deposit with commercial banks. Data from CBI Annual Statistical publications 2010-2015.

²⁰ Worth noting that the crisis years 2015-2017 would have negatively affected the sector. In that paid capital increased somewhat; loan growth was halted and the size of the loan book decreased due to provisions; while deposit growth mostly stagnated.

was real and in the right direction. Paid up capital up 260% from USD 1.9bn to 6.8bn in response to the CBI's requirement²¹ and loans to the private sector up 164% from USD 2.5bn to USD 6.6bn which in the process increased their market share from 34% to 42%. Despite maintaining a stagnant market share of only 39%, in large part because over 85% of the currency in circulation is still outside the banking system, private sector deposit growth increased 65% from USD 4.7bn to 7.8bn.

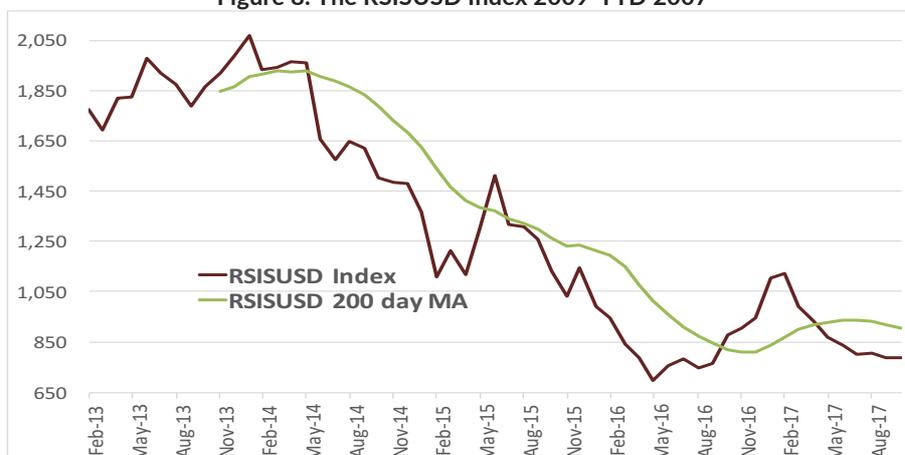
Moreover, a number of regional banks bought significant stakes in several Iraqi banks to facilitate the businesses of their clients as they entered the Iraqi market beginning in 2007. To be sure, they faced the full extent of integration issues given the undeveloped nature of the sector and the environment it operated in prior to Iraq opening up to the world. However, many of these issues have been addressed over the years, with local entities more closely aligned with their majority owners in terms of operations and systems, and hence in a far better position to operate like banks in other developing economies.

A number of local companies have also developed recently in a wide variety of sectors, including manufacturing and construction, energy, power generation, oil services, and consumer goods. Those that survived the economic crisis are in a position to benefit from the improved operating environment, and should be able to attract capital for sustainable growth. As they develop, they should act as catalysts for more companies to follow suit, especially as their success should encourage capital to flow into their respective sectors. A significant beneficiary of potentially increased capital inflows is the country's emerging e-commerce sector in which young, educated entrepreneurs have established e-commerce businesses. Spurred by the economic shock of the last three years, young entrepreneurs have sought alternative means of income separate from the state, aided by the introduction of 3G in 2015 and the country's increased reliance on the internet. They were able to start with little capital and, given the sector's low operating costs, were able to grow, even flourish. As young entrepreneurs, they would be receptive to the demands that come with private equity capital, as opposed to more traditional family businesses. The availability of capital, along with the continued creation of market niches, could lead to growth in these numbers, and a concomitant impact on the economy.

The country's stock market, the Iraq Stock Exchange (ISX), went through a typical boom and bust cycle during this period. The first foreign portfolio inflows came in 2010, following the entry earlier by regional banks and companies that acquired majority stakes in local entities. The expanded trading volumes and increased liquidity led to a predictable boom. But as foreign portfolios inflows reversed due to investors exiting en masse following the ISIS invasion and the collapse in oil prices, the market dropped, reflecting the general sense that optimism was premature or misplaced. Regulators, entities, and brokers weathered the storm during a brutal two-year period that saw the market decline 68% from the peak in 2014 to the bottom in 2016, as measured by the Rabee Securities' RSISUSD Index (chart below). With total capitalisation at under 5% of GDP, the market is still in the very early phases of its evolution and has yet to play a significant role in the economy. Nevertheless, the need for capital for growth and reconstruction puts it in a position to play a part as a source for raising capital.

²¹ The CBI in 2011 required banks to increase their minimum paid up capital, from IQD 100b to IQD 250b by end of 2013. Similarly, in 2014 it required branches of foreign banks to increase their minimum paid up capital, from USD 7m to USD 70 m by end of 2015.

Figure 8. The RSISUSD Index 2009-YTD 2007



Source: Rabee Securities, Iraq Stock Exchange, Asia Frontier Capital

Like most resource rich countries, successive Iraqi governments, by opting for the rentier state model, failed to build a diversified economy, adhering - whether by accident or design - to the rentier state model. Iraqi governments since 2003, irrespective of international help, failed to embark on sound economic policies. Even when buffeted by a crisis, such as the collapse in oil prices following the financial crisis of 2007-2008, have half-heartedly started such reforms only to abandon them when high oil prices provided an illusory substitute to hard decisions. However, the government has no wriggle room for avoiding following sound economic policies given that new environment that it finds itself in: an era of lower oil prices, the enormous scale of damage following the ISIS conflict, the colossal need for reconstruction, not to mention an unsustainable bloated public sector, all coupled with no fiscal buffers or a sovereign wealth fund. Granted, the expansionary effects of current higher oil prices and the declining costs of war, would provide a temporary respite allowing the government to soften the blow to the vulnerable but it pales in significance to the needs for reconstruction. Iraq, by following through with the necessary policies, could echo the experiences of its neighbor, Iran, on how to move forward when faced with similar constraints. As a similarly oil-rich country, Iran was forced to diversify following the crippling sanctions imposed by the world community, with oil accounting for less than 10% of the economy²² alongside well-developed industrial and services sectors capable of providing sustainable economic growth.

Guided by the IMF following the signing of the Stand-By Arrangement (SBA) in June 2016, the Iraqi government should embark on the long process of decentralizing the state by reducing its role in the economy, encouraging the development of the private sector in agricultural and industrial production, and stimulating private sector employment. The straight jacket of the low oil price environment, the absence of financial buffers and sovereign wealth funds, plus the need for reconstruction should leave the government a

²² Central Bank of Iran, Iranian calendar 2015/2016 Annual Review. Oil accounted for 9.4% of GNP down from 13.6% in the prior fiscal year. While the extent of the decline is exaggerated by the drop in oil prices during the time, and in 2016/2017 & 2017/2018 will show an increase due to recovery of oil prices and the resumption of exports from January 2016 onwards, the normalized figure would be small compared to other oil-producing countries.

few options but to continue on this path, build upon it, and ultimately ensure its eventual success. Granted, a tall order and one that no Iraqi government has ever followed through on, yet the trauma of the ISIS conflict and the massive need for reconstruction are powerful forces for change in the right direction. Similar powerful forces led the country away from the abyss of total disintegration following the ISIS invasion and collapse in oil price to fight and emerge, scared but, victorious in an existential brutal conflict.

One of the initial positive steps taken in the rationalization program was to address the bloated public-sector payroll through hiring freezes and employee reduction by natural attrition. Another was the recent introduction of social security benefits for private sector employees on par with the state sector, thereby removing one of the largest impediments against private sector employment development. The necessity of the requirements for fiscal consolidation and broadening of the revenue base will have other significant benefits should they be implemented. For example, avoided in the past yet long overdue and not easy to implement is the issue of increasing taxes on imports and effectively implementing border controls. Yet, its implementation will enable local industry to better compete against cheap imports, attract capital to further develop, and lessen the country's reliance on imports. A reduction in subsidies, especially in the electricity sector, in which the government recoups only 18% of the costs of its generation, is necessary yet fraught with challenges and controversy. Similarly, implementation will have positive implications for encouraging both public and private investment in the sector, not to mention supporting rational commercial enterprises that do not rely on an artificially low cost of electricity in order to be viable.

Even the country's much maligned political class has shown some signs of responding to pressure from its citizens for reform and the provision of services²³ in response to the failures over the last twelve years in establishing a functioning state. The unravelling of monolithic ethno-sectarian alliances, which have dominated Iraqi politics since 2003, led to the fracturing of political parties and to potential cross-sectarian parties and alliances over the last twelve months. Major changes in regional relationships with the country's neighbours have taken place both at government and party levels. While, for now, this is a case of the same faces wearing different hats, the disintegration of the status quo presents opportunities for progress and change.

Fuelling these changes has been the evolution of Iraq's civil society, first manifested during the 2011 demonstrations inspired by the Arab Spring, and accelerated by the mass demonstrations in the summer of 2015 that continue into the present. Shaped by the trauma of years of sectarian conflict and lost opportunities, Iraq's younger generation, free from the memories and demons of the older generations, spearheaded this broad movement. In rejecting sectarian conflicts, religious and identity politics, and extremist

²³ The population's anger has focused on the confessionalism that arose post-2003, in which political and institutional power was distributed proportionally among the country's ethnic and sectarian (confessional) communities as a response and a solution to past victimization and marginalization. The main reason has been the failure of the political classes representing these communities over the previous 12 years to better the lives of the very communities that the system was supposed to serve. The economic crises post-ISIS exposed the extent of the failures for the provision of services. Thus, the system and the political class behind it became the focus of anger. The demands, embraced by a broad spectrum of the population since 2015, have been for an end to corruption, for the delivery of services, and a representative, inclusive government. The unravelling of the ethno-sectarian alliances and the parties within them has been one of the unnoticed successes of democracy in Iraq. Broad-based pressure from the ground up is forcing political parties to adapt. Equally promising has been the failure of past ethno-sectarian messages to resonate with the respective communities in the way that they did in since 2003.

movements Iraq's civil society re-embraced co-existence and diversity. The continued demands for reform, a working economy, and functioning inclusive government will further exert influence on the political scene for positive change.

In conclusion, the grounds for optimism do not suggest that the country's ills and challenges have been resolved or even addressed²⁴, as the number of political and institutional challenges that need to be addressed is daunting. But, they make two arguments. The first is that the cycle of negatives reinforcing each other could be coming to an end and that there is a real chance of an emerging cycle of positives re-enforcing each other. While, the second is that there are a sufficient number of building blocks²⁵ to enable the country to embark on a sustainable post-conflict recovery. Thus, the environment, for the first time since 2003, is finally promising for making long-term investments to participate in this recovery. A realistic, informed and risk aware long-term investment horizon is key as these building blocks, while essential, are not sufficient on their own and would take time to come together in building a functioning economy.

²⁴ Just to highlight a few of the many challenges: (1) the country's refining industry was aged and dilapidated even before the ISIS invasion and is now much worse and early responses are still in the drafting stage; (2) Reforming SOE's is a huge task as the IMF estimates that there are about 176 SOEs, employing over 555,000 people of which 30-50% are excess, plus most SOE's are non-functioning. While maintaining them drains resources, the government cannot shutter them due to the significant social cost and privatizing them while maintaining the employment levels is a difficult circle to square; (3) Rationalizing the state sector is much more daunting and fraught with more risks than those associated with SOE's (4) The upcoming provisional and parliamentary elections in 2018, held simultaneously for the first time, are crucial and will be closely watched given that the end of ISIS will likely bring forth differences that were held back during the conflict (5) Addressing the Kurdish region in light of the events following the referendum and addressing the simmering issue of the disputed territories is essential for the long term stability of the country.

Also, it is worth repeating an earlier footnote: The challenges, political & structural, Iraq faces post ISIS are covered in this piece that explores the opportunities but addresses the challenges ahead (in the last section). https://mei.nus.edu.sg/themes/site_themes/agile_records/images/uploads/Fanar_-_Insight.pdf. While, the challenges that the government faces in addressing corrosive systematic corruption is addressed in the second half of this article: <https://foreignpolicy.com/2017/10/16/haider-al-abadi-is-succeeding-at-the-worlds-hardest-job/>.

²⁵ Some of these building blocks are pilot projects that have yet to prove themselves, and a political class that has not moved to reform or wholeheartedly embraced it.

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