Iqtisadi
Middle East Economy
Tel Aviv University
The Moshe Dayan Center for Middle Eastern and African Studies

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Vol. 4, No. 9   September 30, 2014

Money makes the world go round: A Middle East round-up

By Paul Rivlin

The Middle East is sliding towards ever more extremism and violence, much of which is so fanatical that it defies explanation. There are, however, some features of the current situation that have an economic basis that can be explained, because "money makes the world go round."

The IS (or ISIS) is a terrorist organization that relies, like others, on ransoms, robberies and charges that it imposes in territories that it controls. In Syria, it has seized eight oil and gas fields in the provinces of Raqqa and Deir Ezzor. The turnover in Iraq runs into hundreds of millions of dollars. According to the Iraq Energy Institute, ISIS controls the production of 30,000 barrels of crude oil a day in Iraq and 50,000 barrels in Syria. By selling the oil on the black market at a discounted price of $40 per barrel (compared to about $90 per barrel in the free market), ISIS takes in $3.2 million a day or nearly $1.2 billion at an annual rate. Light crude, which is higher priced on global markets, sells at up to $60 a barrel. Crude smuggled abroad is priced higher.

Through recent kidnappings, the IS is using hostages to raise revenue. Given the small number of detainees released, that revenue is likely much less reliable than that from the local economy. The other source of external funding consists of wealthy donors and radical Sunni individuals in the Gulf, and this has sharply fallen as their governments recognize the severity of the Islamic State threat to the region.

Radicals run an extortion system from the cities that they have seized, such as Raqqa in Syria and Mosul in Iraq, which are 465 kilometers (250 miles) apart from one another. Such extortion methods include business and farm tributes, public-transport fees and protection payments from Christians and other religious minorities who choose to live under the militants rather than flee. IS also does business with people from some of the same regions whose governments are fighting it. From the territory the group has taken, it controls the sale of oil, wheat and antiquities, spurring a vast gray market with buyers as unlikely as the Syrian regime, Shi'a, Kurds, and others from Lebanon, Iraq, Iran and Turkey.

Qatar was reported to have paid a $20 million ransom for UN troops kidnapped in Syria. Although this has been denied, Qatar has been a strong financial supporter of Islamic fundamentalists. Was this done for humanitarian reasons or to help finance IS? Qatar was also a major financial backer of the Islamist Muhammed Morsi when he was president of Egypt, and of Hamas in Gaza. The latter's leader, Khaled Mashaal, lives in Doha, the Qatari capital.

Qatar has the world's third largest gas reserves; at 885 trillion cubic feet they are 2.6 times those of the United States. Gas export revenues are estimated at $70 billion a year and Qatar also exports oil that in 2013 earned $62 billion. The population is about 2.2 million, of whom fewer than 300,000 are citizens, and so it has accumulated huge financial reserves.

In August 2014, the German Development Minister, Gerd Mueller, suggested that Qatar was financing terror but his remarks were quickly retracted. One reason for this change of view may be the fact that German arms exports to the six nations belonging to the Gulf Cooperation Council increased from $740 million in 2011 to $1.8 billion in both 2012 and 2013. The German government intends to provide guarantees for the planned export of more than 100 patrol and border control boats to Saudi Arabia with a total value of around €1.4 billion ($1.9 billion). Yet Germany is not the only country trying to sell weapons to the Gulf.

Between 13 June 2012 and 29 July 2013, the US signed contracts worth $24 billion to sell arms to Qatar, including $11 billion for Patriot missile batteries and Apache attack helicopters. These are part of the huge Gulf arms market, dominated by Saudi Arabia.

According to the US Congressional Research Service, in 2004-2007, the US signed contracts worth $14 billion to sell weapons to Arab states and $1.8 billion with Israel. In 2008-2011, those figures rose to $81 billion and $5.9 billion respectively. Since then more contracts have been announced. In 2010, the Obama administration notified Congress that it is to sell $60 billion worth of weapons to Saudi Arabia. In December 2013, the Pentagon notified Congress of the sale of 15,000 Raytheon anti-tank missiles to Saudi Arabia worth $900 million. This raised speculation that the weapons were going to Syrian rebels. In February 2014, it was announced that Saudi Arabia would buy $10 billion worth of military vehicles as well as training and support services from the Canadian subsidiary of General Dynamics. In August 2014, Saudi Arabia gave $100 million to the United Nations Counter-Terrorism Center, an agency that was first proposed by the Saudis' King Abdullah in 2005 and formally inaugurated in 2011 with a $10 million contribution also made by Saudi Arabia. The Counter-Terrorism Implementation Task Force (CTITF) was established by the Secretary-General in 2005 and endorsed by the General Assembly in 2006. On July 1, 2014, Saudi Arabia provided $500 million to United Nations humanitarian relief efforts in Iraq, where hundreds of thousands of people have been uprooted by the Islamic State in Iraq and Syria.

Saudi Arabia also provided grants and loans worth more than $1 billion to strengthen Lebanon's armed forces, which have recently battled ISIS fighters on the Syria-Lebanon border. The Saudis are also huge financial underwriters of Egypt's new anti-Islamist government. In 2013, Saudi oil export revenues came to $274 billion and the Saudi Arabian Monetary Agency (equivalent to its central bank) has foreign reserves exceeding $700 billion.

According to the United Nations, the conflict in Syria has transformed the country from being one of the few Arab nations to surpass the UN's Millennium Development Goals to one of the world's poorest performing countries and is doing better than only one other state in the region: Somalia. Syria's GDP fell from $60 billion in 2010 to $56 billion in 2011; $40 billion in 2012, and to about 33 billion in 2013. The estimated loss of real GDP (at constant USD prices of 2010) during the past three years totals $71 billion. Consumer prices inflation reached its highest level – at 90 percent - during 2012-2013, while the prices of food and beverages inflated and increased by 108 per cent during the same period. The acceleration of the inflation is the result of the devaluation of the Syrian Pound against foreign currencies on the black market, leading to an increase of 173 per cent in prices during 2010-2013.

The total losses (damage to infrastructure) suffered by the Syrian economy during the three years of the crisis (2011-2013) are estimated at $140 billion, the private sector lost $96 billion, representing 68.7 per cent of total losses, while those of the public sector amounted to $ 44 billion. How does Assad's regime survive? On a life-support system: Russia supplies arms against partial and/or future payment and Iran supplies finance. This is enough to pay the army, buy fuel and a limited range of basic supplies.

Since the war began in Syria, Iranian financial largesse has been ever more critical. In January 2013, Syrian state media announced a $1 billion credit facility agreement with Iran. Five months later, Syrian officials announced that Iran would provide Damascus an additional $3.6 billion line of credit to finance the purchase of petrol and associated products. Iran has also offered Syria conventional and unconventional military aid and intelligence training and cooperation. While Iranian leaders continue to support Assad’s government, Iran’s policies have also caused huge damage to the economy including rapid inflation, a high rate of unemployment, loss in oil export revenues, negative economic growth, and stock market declines. The Assad government’s failures have resulted in a continuing economic burden and for Iran there is no guarantee that Assad will win and pay back the debt.

Syria has become an economic burden for Iran, whose economy is suffering under the impact of international sanctions. According to the US Congressional Research Service, oil exports fund nearly half of government expenditures and, by late 2013, sanctions had reduced Iran’s oil exports to about 1 million barrels per day compared to 2.5 million barrels per day exported during 2011. During 2012-2013, the loss of revenues from oil and the cut-off of Iran from the international banking system, caused a sharp drop in the value of its currency, the rial; raised the inflation rate to over 50%; and cut off Iran's access to most of its hard currency held outside the country. In 2013, Iran's economy shrank by about 5 percent as many Iranian firms reduced operations and failed to repay loans.

The Joint Plan of Action (JPA) of 24 November, 2013, was a six-month interim agreement that including the approximately $7 billion in sanctions relief, of which $4.2 billion was access to hard currency from oil sales. In addition, provisions of several laws and executive orders were waived or suspended. The JPA extension until November 24, 2014 continues all sanctions relief provisions, including $2.8 billion in access to hard currency. US Under Secretary of the Treasury for Terrorism and Financial Intelligence David Cohen testified before Congress in July, 2014, that Iran's economy is 25% smaller than it would have been had it remained on pre- 2011 projections, before many of the most stringent sanctions were imposed. Many employees in the private sector went unpaid or were subject to long delays in payments. The unemployment rate rose to about 20%, although the Iranian government reported the rate at 13%. The sanctions relief of the JPA has stabilized the economy somewhat. In 2014, according to the International Monetary Fund, economic growth will be about 1-1.5%, a lower rate than that of the population and so income per capita will decline again. Sanctions relief has not been sufficient to produce a strong economic rebound but it has given the regime desperately needed relief that enables it, among other things, to help Assad. Iran's ability to support Assad therefore depends on its own economic strength, something that will in turn be determined by its nuclear program and by sanctions.

Having extricated the United States from the two wars in Iraq and Afghanistan, President Obama has been very reluctant to get involved in the Syrian civil war or in the escalating conflict in Iraq. On September 11, 2014, he ordered US forces to attack IS and other terrorist bases in Syria, having authorized action against the IS in Iraq in August. This was done as a result of the beheading of US citizens by the IS, the killing of Yazdis and other minorities in Northern Iraq, and the threat posed by Islamic fundamentalist groups to the US and the West. While all this is going on, a major change is taking place in international oil markets: energy production in the

United States has increased sharply, reducing its dependence on imports. In 2013, US oil production was almost 50 percent above its 2008 low.
This has strengthened the US' strategic position as well as its economy and so it has less need for the Middle East than ever before. While the US did not import much of its oil directly from the region, its allies did and the world economy in general was, is and will continue to rely on the Middle East for oil and gas. The US will gain relative to China, Europe and others by being less reliant upon energy imports in general and on those from the Middle East in particular.

By around 2020, according to the US government's Energy Information Administration (EIA) the United States is forecast to become the world's largest oil producer and will start to see the impact of new fuel-efficiency measures in transport. The result will be a continued fall in US oil imports, to the extent that North America will become a net oil exporter around 2030. This will accelerate the change in direction of international oil trade towards Asia that is now taking place, with a focus on the security of the strategic routes that bring Middle East oil to Asian markets. The United States, which currently imports around 20% of its total energy needs, will become almost self-sufficient in net terms – a dramatic reversal of the trend seen in most other energy importing countries. North America as a whole will gain energy independence and become a net oil exporter with a net crude imports projected at 2.6 mb/d per day and potential net product exports of around 3.5 mb/d, making it a titan of unprecedented proportions in product markets. With this comes the challenge of balancing the product slate to fit world demand patterns and of adapting storage and export infrastructure to the increased volumes.

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