Editors: Paul Rivlin and Yitzhak Gal Assistant Editors: Teresa Harings and Gal Buyanover
Vol. 3, No. 3, March 2013

Iraq: A Leap in Oil Exports, Accelerated Economic Growth and Implications

Yitzhak Gal

This year marks a decade since Saddam Hussein's downfall, which ended thirty years of economic destruction. The long war with Iran (1980-1988), the two Gulf Wars with the United States (1991 and 2003) and the near decade of harsh international sanctions between these two wars – all had an enormous economic toll. At the end of Saddam Hussein's rule, Iraq's GDP per capita, was a third lower than it was in the early 1980's, while most Arab states' GDP doubled or tripled in size during the same timespan.
As a result, Iraq went from being one of the wealthiest, most developed Arab states into one of the poorest, as can be seen in the comparison presented in Chart 2.

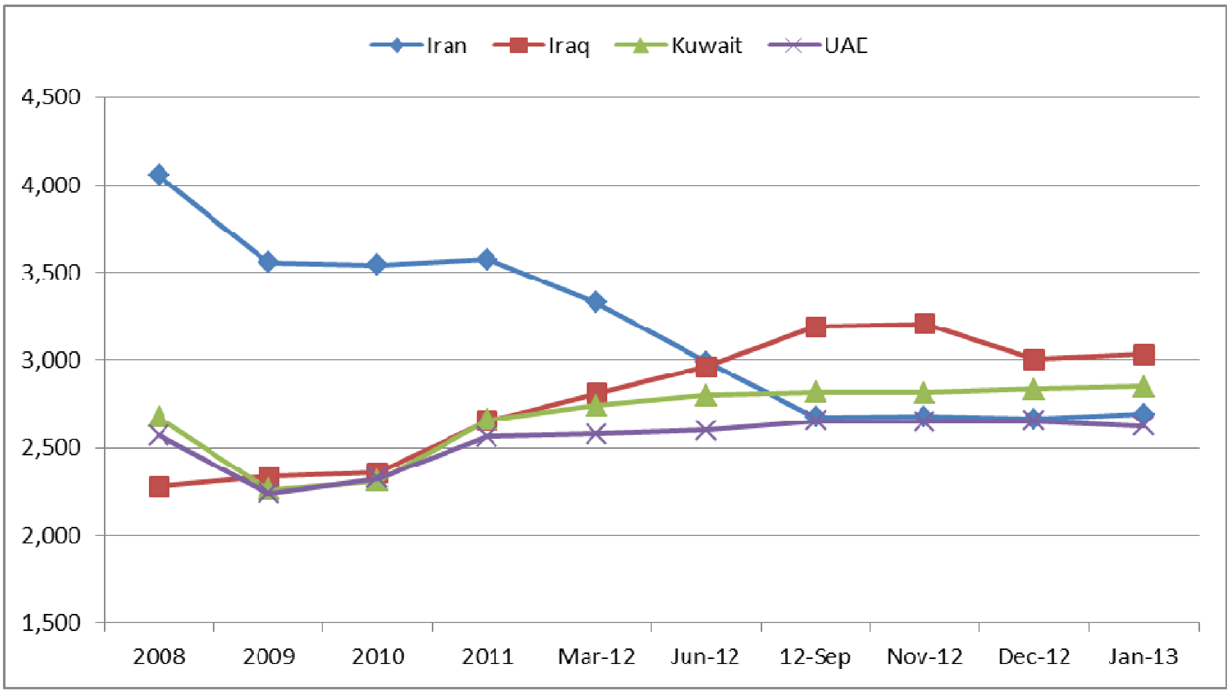
In the first years after Saddam Hussein's downfall, the Iraqi economy stabilized, despite political and security difficulties. Moreover, since the beginning of the current decade, Iraq has enjoyed an accelerated economic growth, caused by a leap in oil exports. These processes have important implications – both in the regional context and in the context of the global oil market.

The most important development is the significant, continuing growth in Iraqi oil production and oil exports. Iraqi oil production went up considerably in the last year, leveling off at three million barrels per day (mb/d) – doubling the production levels of the end of Saddam Hussein's rule. Iraq is now the second largest oil producer and exporter in the Middle East after Saudi Arabia. Iraq is also the third largest oil exporter in the world, after Saudi Arabia and Russia. It has replaced Iran, which is now the fifth in the Middle East.

The growth in Iraqi oil exports in the past year has been one of the main factors cushioning the sharp decrease in Iranian oil exports in the global oil market. As international sanctions have damaged Iran's oil exports, international oil prices have remained unaffected. Considering the relatively large amount of oil needed for internal use in Iran and the direct effect of the sanctions on Iranian oil exports, the decrease of about one third of Iranian oil production manifested itself in a decrease of about 50 percents in oil exports, from about 2.5 mb/d in 2011 to about 1-1.3 mb/d in the last quarter of 2012 and the first months of 2013. Iraqi oil exports, on the other hand, grew from 1.5 mb/d in 2005-2008, to approximately 1.8 mb/d in 2009-2011, and to 2.5 mb/d since the second half of 2012.

The accelerated development of Iraqi oil fields is just beginning. The main potential is in two regions: in southern Iraq in the Basra Governorate and in northern Iraq - in the Kurdish region and in the border areas between Kurdistan and the Arab part of Iraq. The growth in production in recent years came almost entirely from the southern fields, which contributed about three fourths of total Iraqi oil production in 2012. The development of the northern fields remains stagnant due to political disputes between the Kurdish Regional Government and the central Iraqi government in Baghdad. According to a recent forecast published by the International Energy Agency (IEA), the continued development of the southern fields is predicted to double Iraq's oil production by 2020, to over six mb/d. If the Kurds and the central government in Baghdad will find political solutions which will allow the development plans of the northern fields to be realized, Iraq's oil production is predicted to reach a volume of between eight and ten mb/d during the next decade (between 2020 and 2030), turning Iraq into an exporter of Saudi Arabia's class..

Chart 1: Iraq's Oil Production in Comparison with Other Leading Oil Producers in the Middle East
(thousands of barrels per day)



Note: Saudi Arabia is not presented in the chart. Its production is three to four times higher than that of any other producer.
Source: OPEC

In fact, the total scope of contracts signed with international oil companies reflects a five-fold increase in Iraqi oil production, to about fifteen mb/d during the next decade (until 2030). However, barriers in different parts of the oil production and transport system, along with considerations regarding the growth of demand in the global oil market, all lead to a forecast of eight to ten mb/d, as mentioned above.

At any rate, even according to the more modest predictions, Iraq is expected to provide nearly fifty percent of the total world increase in oil production this decade and become a key oil supplier for China and the other growing economies of East and Southeast Asia. Furthermore, during the coming decade (2020-2030), Iraq is expected to have untapped oil production capacity, making it, alongside Saudi Arabia, a stabilizing factor in the global oil market.

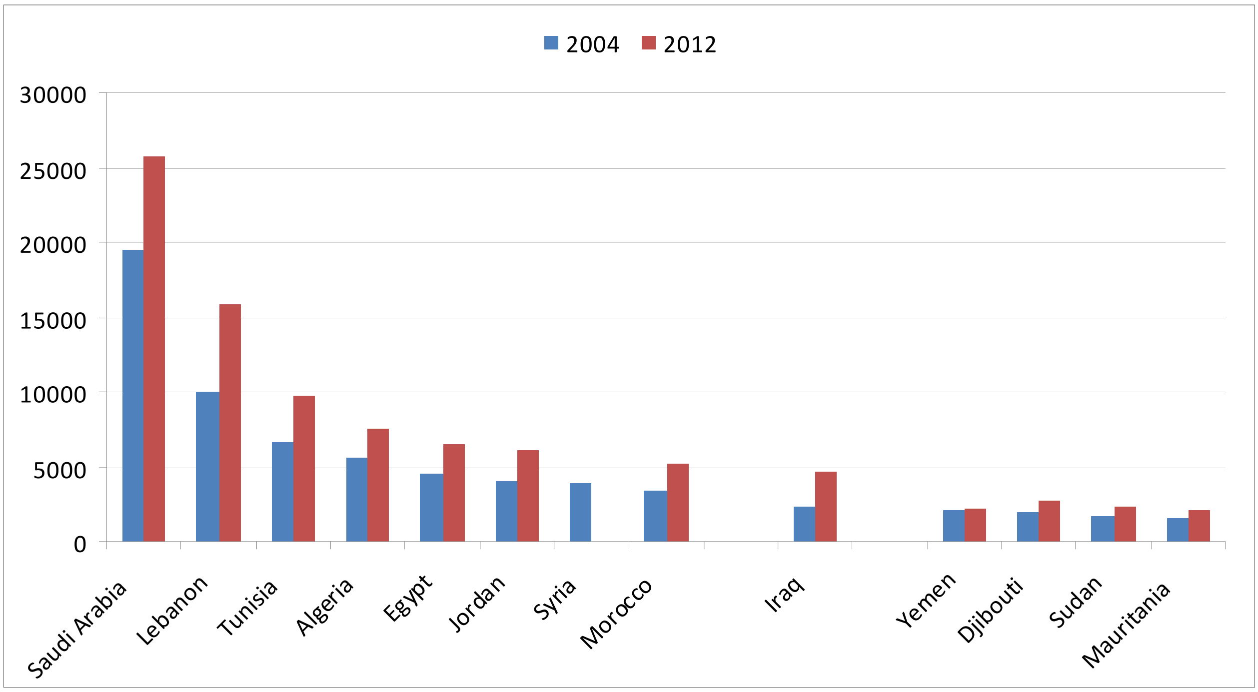
Along with realizing its potential regarding oil production, Iraq is planning to use the large amounts of associated gas, which is released in oil fields during the oil production process, and which until now has been burnt during the production process. Additionally, it is planning to produce gas from the large gas fields already discovered and from other fields in high potential areas that haven't been searched for gas yet. The goal is not to develop a gas export industry, rather to produce large enough quantities of gas to replace domestic use of oil for electricity production and for industrial and other uses in the domestic market, and to direct larger quantities of oil for export – similar to the Saudi gas development policy.

In the past years, Iraq has had impressive economic growth rates, of over ten percent per year in real terms, and a similarly large growth in investments. Despite the rapid growth of population, a certain improvement in GDP per capita has been achieved, in comparison with the bleak position Iraq had deteriorated to under Saddam Hussein's rule, as can be seen in the comparison between 2012 and 2004's data, in Chart 2.

Oil export revenues are the engine of economic rehabilitation in Iraq. Oil revenues increased from about thirty billion dollars per year in 2004-2005 to about 50 billion dollars a year between 2008-2010, to nearly 90 billion dollars in 2012, and are expected to surpass 100 billion dollars by 2014. By the end of the decade, the IEA estimates that Iraq's annual revenue from oil exports will increase to about 200 billion dollars per year, and this gradual growth is forecasted to continue into the next decade (all estimates are at the fixed prices of 2011).

According to IMF estimates, the Iraqi economy is expected to continue growing at a rate of about 10 percent a year, in real terms, throughout the current decade. This process is expected to turn Iraq, at the end of the decade, to one of the largest Arab economies, although significantly smaller than the two large Gulf economies - Saudi Arabia and the UAE - and also smaller than Egypt.

Chart 2: GDP Per Capita in Iraq in 2004 and 2012 in Comparison to Other Arab States
(in dollars, adjusted to domestic purchasing power)

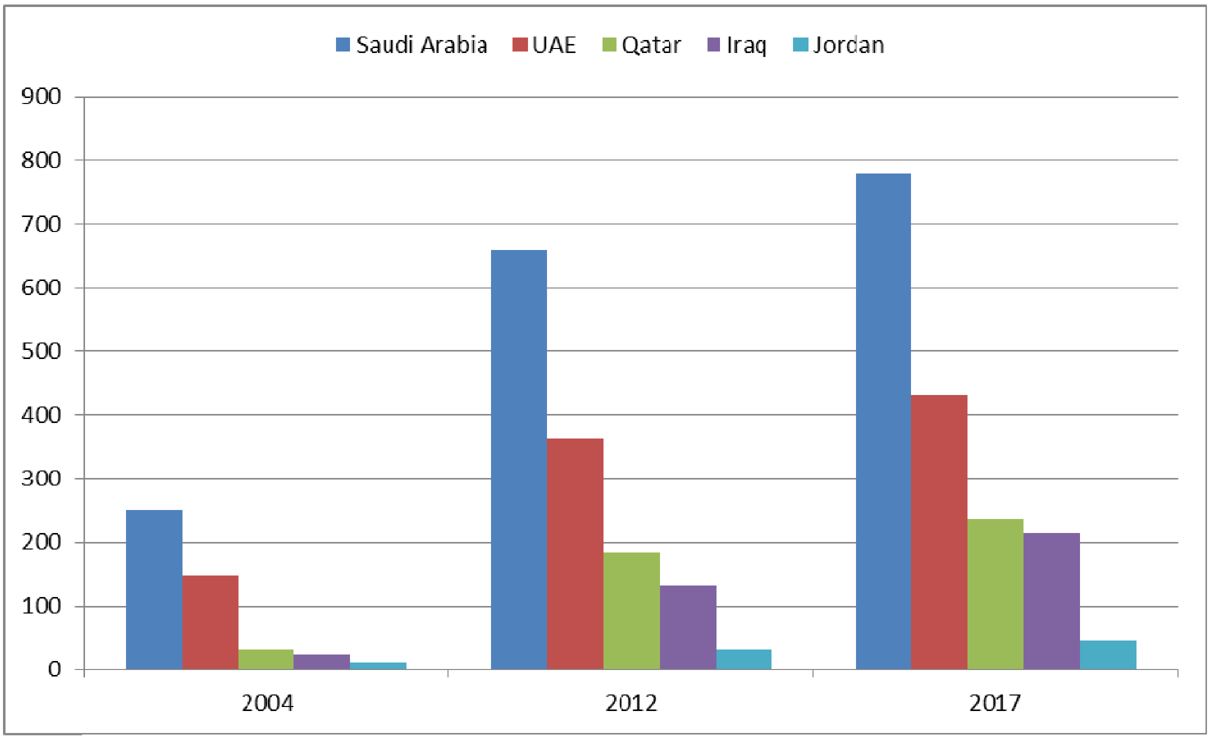


Notes: (1) 2012 data is estimated; (2) very wealthy (relatively to the size of the population) Gulf States, such as Qatar, the UAE and Kuwait, whose GDP ranges between 50,000 and over 100,000 dollars per year, were not included in the comparison.
Source: the International Monetary Fund (IMF)

The main challenge for the Iraqi economy is diversification. The oil sector's dominance in the Iraqi economy is the highest among all oil exporters in the Middle East. Oil exports stand for 95 percent of all exports, and government revenues from oil exports are about 70 percent of the GDP. The rate in Saudi Arabia and in Kuwait is around 50-55 percent of the GDP, and in Iran it stands at 25 percent (data for 2011).

Although the increase in oil exports provides the Iraqi economy with sufficient funds to finance the huge investments required both for the development of the oil and gas sector and for the rehabilitation and development of its economic infrastructure, as well as for diversification of the economy to spheres other than the energy sectors – the realization of these investments is encountering non-financial obstacles.

Chart 3: Iraq's GDP's Development in Comparison with Other Arab States: 2004-2017
(billions of current dollars)



Notes: (1) 2012 data is estimated; (2) 2013-2017: IMF estimates.
Source: The IMF

The tremendous scope of the damage done by thirty years of Saddam Hussein's rule to the economic infrastructure is still evident in every part of the Iraqi economy. After almost a decade of rehabilitation activities, Iraq is still suffering from a severe shortage of electricity supply. The scope of electricity production in Iraq nearly doubled in the second half of the past decade and is continuing to increase, however, most consumers in Iraq still suffer from electricity blackouts lasting a quarter, sometimes even half a day. Ninety percent of all households are connected to private or neighborhood generators in order to overcome the unstable electricity supply. Providing enough clean drinking water remains problematic, as does transportation and other areas of civilian infrastructure. These issues, including the various weaknesses of the administrative and legal systems and the political instability, pose tremendous obstacles for economic development.

In the north, Kurdistan's economy runs for the most part separately and independently, under the autonomous Kurdish government seated in Erbil. There are disagreements and economic conflicts with the central Iraqi government in Baghdad, mostly revolving around the distribution of oil revenues and the development of the oil fields in the border areas between Kurdistan and the Arabic region of Iraq.

The Kurdish economy is slightly more diversified than that of the Arab region of Iraq. According to indicative data, agriculture, construction and other sectors of the Kurdish economy are growing rapidly and running into fewer obstacles than in Iraq's Arab region. However, Kurdistan's economy is heavily dependent on oil exports as well, and its ability to progress depends on the development of northern Iraq's oil fields. According to the KRG's data, GDP per capita in Kurdistan is slightly higher than the Iraqi average.

A prominent and important characteristic of the Kurdish economy is the close relationship with the Turkish economy. Turkey is Kurdistan's main trade partner. A large share of Kurdistan's imports originates in Turkey, and the close economic ties between Turkey and Iraqi Kurdistan have had significant influences on the political/strategic developments in the Turkish-Kurdish arena in recent years.

The increase in oil revenues and rapid economic growth reflect on the growth of Iraqi imports. The total amount of Iraqi imports is expected to be about 70 billion dollars this year, 3.5 times larger than it was at the end of Saddam Hussein's rule. The IMF forecast is that imports will continue to grow at a rate of about five billion dollars per year.

The rapid growth rate of Iraqi imports has turned Iraq into a very important market for its two neighbors to the west and north: Turkey and Jordan. Turkish exports to Iraq, both to Kurdish region and other regions, reaches today an annual sum of about 10 billion dollars; this equates to approximately seven percents of all Turkish exports and is five times higher than Turkey's exports to Israel. Jordanian exports to Iraq are today over one billion dollars per year, or approximately fifteen percent of Jordan's total annual exports.

In the regional-strategic context, it is worth paying attention to the economic-strategic relationship developing between Iraq and Jordan in parallel to the close economic relationship between Turkey and Iraqi Kurdistan described above. Jordan serves as a gateway for Iraqi imports from the west, and the Jordanian Port of Aqaba has been Iraq's entryway to the West for many years. A railroad connecting Aqaba to the Iraqi train system, meant to bolster the continued growth in Iraqi imports, is now in the development stages.

Considering the heavy economic strain of oil imports on Jordan, coupled with the difficulties in the Egyptian gas supply to the Hashemite Kingdom, Jordan has been importing growing quantities of Iraqi oil at lowered prices. At the end of 2012 an agreement was signed to construct an oil pipeline with a capacity of one mb/d that will reach the Aqaba port. This pipeline will transform Iraq into Jordan's main oil supplier. Oil will be supplied under preferable conditions, thus providing a long-term solution to one of Jordan's main economic problems. For the Iraqis, this pipeline will be an important supplementary channel for exporting Iraqi oil.

Along with the oil pipeline, a gas pipeline is also in the works. It will allow Iraq to export gas to Jordan, replacing Egyptian gas. These developments strengthen the economic cooperation between Iraq and Jordan even further, and the critical importance of this cooperation for the Jordanian economy has, of course, important strategic implications worth paying attention to.