



Iraq Economic Review

The Dinar & Al-Sudani's Agenda

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ABOUT IRIS

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What's Happening with the Dinar?

Interview with *Ahmed Tabaqchali*

Iraq Economic Review (IER): Over the past several months, Iraq has witnessed enormous instability in the value of the Iraqi dinar versus the US dollar. How did the problems with the dinar begin?

Tabaqchali: The crisis began in November 2022 when Iraq finally became part of the international electronic banking system.

IER: And why did the implementation of the electronic system impact the value of the dinar?

Tabaqchali: The electronic system – which is what all major economies utilize – is essential in transfers since they typically involve a number of banking intermediaries in multiple countries. The system allows banks around the world to conduct automatic checks on transfers of money from Iraq to other countries. In short, the system heightens the visibility of red flags. As soon as the system was implemented by the Central Bank of Iraq (CBI) in November 2022, many transfers from Iraq were rejected, creating a sudden drop in transfer volume and a reduction of the overall availability of dollars. Just imagine, average daily international transfers in the CBI dollar auctions dropped from roughly 180 million USD to 67 million USD by mid-February. While cash dollar sales rose from 38 million USD to 48 million USD, the combined volume still went down from 218 million USD to 114 million USD. With far fewer dollars available, the dinar-dollar exchange rate was significantly impacted.

IER: Was this expected?

Tabaqchali: This was not altogether surprising. Iraq has been using a paper-based system for its entire

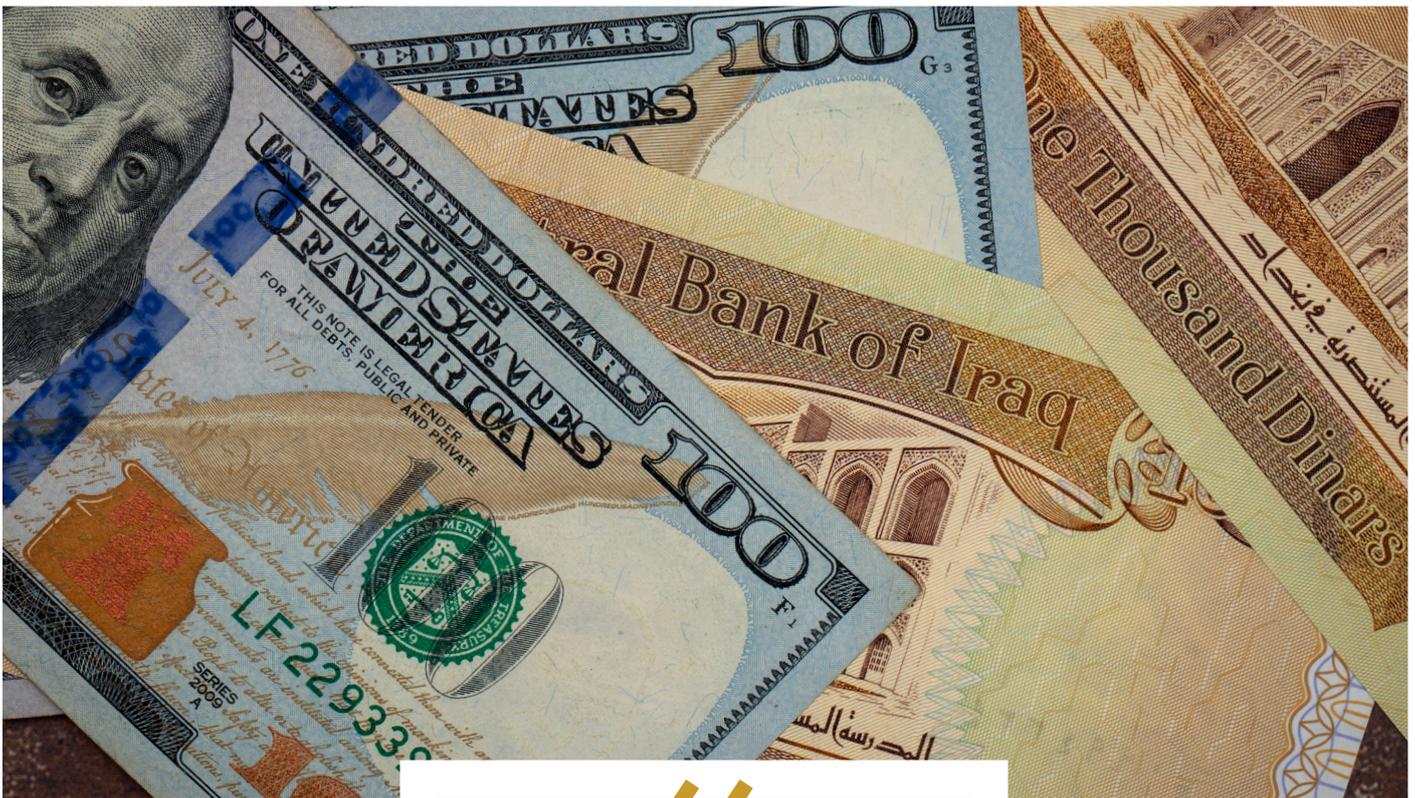
history, which meant that questionable international transfers were able to evade the normal level of scrutiny. The CBI and Ministry of Finance were supposed to implement the new electronic system, and the associated procedural requirements for transfers, as early as 2018, but the protests and then COVID-19 slowed the process and delayed implementation. The new administration under Prime Minister Al-Sudani came into power just as the new system was being implemented.

IER: Did the new government do anything to make the situation worse?

Tabaqchali: To be sure, Al-Sudani is not responsible for the emergence of the crisis, and his government's early responses were positive – and essential – in speeding up the economy's transition away from the dominance of cash and dollarization. But I do think it's fair to say that some of the symbolic responses to the crisis backfired. For example, in January, the security forces quite publicly raided two prominent cash exchange houses in Baghdad in an effort to prove that the government was cracking down on corruption. Irrespective of the guilt or innocence of the two exchange houses, the move had the predictable and unfortunate consequence of reducing access to dollars on the market and further distorting the dinar-dollar exchange rate.

IER: But why would closing just two money exchanges impact the dinar value so dramatically?

Tabaqchali: Well, for almost two weeks, the closure of the two exchange houses had a chilling effect across *all* money exchange houses, with many in



The crisis began in November 2022 when Iraq finally became part of the international electronic banking system.

American Bank And Iraq Central Bank Dinar and Dollars Mixed (source Shutterstock)

Baghdad stopping any selling or buying of dollars except with people they knew personally. They didn't want to be the next victim of enhanced government scrutiny. This happened right at the moment when international transfers were witnessing a dramatic decline due to the implementation of the electronic system. So, US dollars were scarce in the banking system and on the street at the exact same time. That's when the dinar hit over 1,700 to the dollar. This was an unnecessary development, to be sure.

IER: And what about the recent move to establish a new official exchange rate of 1,310? Did this help or hurt?

Tabaqchali: It lowers the official price of the Iraqi dinar from effectively 1,460 to 1,310, but it doesn't address the drop in the dollar transfer volume in the CBI auction. The value of the dinar on the street will not sustainably stabilize through this kind of measure, and

it will continue to trade at a high premium to the official price.

IER: So why was this move to the electronic records system such an imperative? If we knew that it would cause such instability in the value of the dinar, why even go ahead with it? Could

Kadhimi or Al-Sudani have stopped it?

Tabaqchali: No, they could not have stopped it. The CBI, which is an independent institution, had already committed to these changes in longstanding negotiations with the US and, possibly, European countries. I think it's helpful to trace the current situation back to 2015 at the start of the war with ISIS. Before that time, the US and European countries had granted Iraq a lot of flexibility in its progress towards integrating with the global banking and financial system. But in 2015, things changed due to concerns over financing terrorist groups.

IER: What happened exactly in 2015? Did the US make any concrete demands that forced the CBI to act?

Tabaqchali: The US wasn't willing to keep flying physical dollars over to Iraq without some assurances that the money would not end up in the hands of ISIS or other sanctioned entities. It demanded that the CBI put more robust controls and systems on the cash dollar sales in the auction. Keep in mind that this affected the cash dollar sales and not international transfers, although the two are intertwined. So temporarily, in summer 2015, the US Federal Reserve stopped flying dollars from the CBI's account in the US to the CBI in Iraq as it normally would. By the way, it does this for the CBI and other international central banks who hold accounts with it, and it's obliged to ensure that these central banks comply with provisions for anti-money laundering, combating the financing of terrorism, and sanctions.

IER: What did Iraq have to do to start receiving dollars again?

Tabaqchali: The US was worried by the lack of clarity on where the dollars were going and wanted to see evidence that the CBI was providing clarity on these flows and placing tighter controls on Iraqi banks that buy these dollars. For several months, the US worked with the CBI to make sure that the disclosures that Iraqi banks provided were adequate and that they were in a format that could be used globally. Once this process reached a satisfactory point, the dollars started flowing again – after about 8 to 12 months.

IER: By 2016, the CBI was now in closer alignment with global banking standards?

Tabaqchali: Yes, but the process remained incomplete. The CBI was still relying upon mostly paper-based processes to substantiate the legitimacy of each individual international transfer, making it impossible for the banks across the world that are involved in a transfer from Iraq to ensure that they are complying with global provisions for anti-money laundering, combating the financing of terrorism, and sanctions. Essentially, if I'm a bank in Beirut or New

York, I can't really do much to verify a paper-based record from Iraq because you would need researchers to scan the individual documents and then check across the various systems that monitor sanctioned individuals, stolen funds, etc.

IER: So, the electronic system makes all of these checks automatic?

Tabaqchali: Exactly. If you're part of the electronic system, any red flags are instantly registered and transfers would be rejected. But the US Government and other Western nations understood that Iraq needed several more years to move to a fully digitized system. A paper-based compromise was made for the short-term, but the age of paper records now had a much more definitive expiration date. So, the CBI started the process of transferring over to the electronic system. It just so happens that Al-Sudani came to power at the culmination of many years of delays.

IER: Is this reduction in the volume of transfer in US dollars temporary? Will things normalize?

Tabaqchali: Yes, but it will take time for Iraqi banks to adopt to the new procedures and the electronic system, and probably years for the economy to move from the dominance of informality and cash. Plus, there are so many banks along the chain that can still block a transaction, even if the system does not raise any red flags. If I send a transfer from Iraq to New York, first it goes from, say, Iraqi Bank A to the CBI, then to the US Federal Reserve, then to a major private bank like JP Morgan, and then to a local branch, like First Bank New York. Any one of them can block the transfer. Under the paper-based system, there was no way to ensure that Iraq was running robust verifications on each transfer coming from Iraq. But now any irregularities are more or less spotted instantly and the transfer is blocked.

IER: Is it the same for other countries?

Tabaqchali: Yes, if I send a transfer to the Dubai, the chain would be Iraqi Bank A to the CBI, then to the Federal Reserve, then to the UAE Central Bank, then to a local bank in Dubai.



People Gather in the Dollar Market in Erbil, February 7, 2023 (Source -Ahmed Omer - Rudaw)

IER: Is it the same process if the CBI transferred its account with the Federal Reserve to elsewhere, say, to Europe?

Tabaqchali: Yes, other central banks operate along the same lines as the Federal Reserve and the global transfer system's requirements are the same.

IER: What can Al-Sudani do to improve the situation?

Tabaqchali: Over the medium and long-term, the government should continue to build upon its efforts to move away from cash, dollarization, and informality. But, in the immediate term, Al-Sudani has limited tools at his disposal. It may take a few years for the volume of transfers to return to normal, and Al-Sudani needs to communicate this to the public and provide assurances that this kind of transition is inevitable. Also, the government and the CBI need to work closely with private banks in Iraq to make sure they are not overreacting, and to speed up the development of their infrastructures. Anecdotally, what's happening is that many private banks are telling customers that they cannot transfer more than, say, \$10,000, so that it doesn't raise red flags in the international electronic system. This creates an additional constraint on the volume of transfers.

IER: Is there anything about the government's response to the dinar crisis that you find to be particularly positive?

Tabaqchali: Yes, certainly. In addition to what I've already said, I think Al-Sudani's policy towards the food basket sends the right message. With Al-Sudani's expansion of the food basket, his government is saying to vulnerable populations in the country: we're going to give you more items at lower prices and more frequently. In other words, we will take care of you during a transitional period. I mean, that's an important message, and it's only costing the government a few billion dollars a year. The poor should not shoulder the burden of integration with the global financial system. It's encouraging to see that the government takes this responsibility seriously.

The Prime Minister's Unfinished Business

Rania Bakr



Al-Sudani on an official visit to Mosul in 2018 (source - Wrrkaanews)

Mohammed Shia Al-Sudani was appointed as Iraq's prime minister on October 27, 2022. Since then, the new premier has made a number of statements hinting at the broad outlines of his economic vision. At an Arab engineering convention in Baghdad, he said: *"The government is working to provide everything that achieves the optimal investment of natural and human resources through economic reforms that focus on improving the work environment, overcoming obstacles to expertise and competencies, and diversifying sources of income. [This] cannot be achieved without a clear and serious partnership with the private sector."*¹ While the use of economic buzz

words such as "optimal investment" and "diversifying sources of income" might sound promising to many in the private sector, there is still far too little detail to understand how Al-Sudani's administration would put these ideas into practice. With the Iraqi dinar increasingly unstable, it is important for analysts to demand direct answers and concrete solutions about economic policy, rather than broad principles.

However, Al-Sudani's economic track record during his previous government positions can help us predict the approach he will take. Most relevantly, Al-Sudani served as head of Iraq's Ministry of Labour and Social

1 وكالة الأنباء العراقية. "السوداني: الحكومة تعمل على توفير ما يحقق الاستثمار الأمثل للثروات عبر إصلاحات اقتصادية." وكالة الأنباء العراقية 17, 2022. <https://www.ina.iq/173383--29-.html> .

Affairs (MoLSA) between 2014 and 2018. In theory, the MoLSA plays a central role in regulating the labour market and equipping the workforce through its various directorates. Al-Sudani's four-year tenure at MoLSA was arguably a productive period – at least in terms of major legislative initiatives. Sources in the ministry indicated that Al-Sudani championed the development and passage of the Iraqi Labour Law (no. 37) in 2015, which had not been updated since 1971. The law was developed in close consultation with the International Labour Organization (ILO) and was received favourably both domestically and internationally because it included robust protections for workers and employers alike. For many in the Iraqi private sector, the law's passage serves as a reminder that Al-Sudani has the capacity to introduce and implement economic policy reforms.

The law includes a number of far-reaching provisions. First and foremost, the law sets 15-years-old as the minimum employment age, which effectively makes child labour illegal. Additionally, the law prohibits sexual harassment or gender-based discrimination while looking for a job or during employment. Second, the law introduced important regulations of the informal sector by placing clearer parameters around temporary or short-term projects and restricting them to specialized contracts that guarantee the rights of both the employee and the employer. Many analysts view the attempt to regulate the informal sector as a vital step in reducing the grey areas of Iraq's economy, which has been documented in numerous reports². Finally, the law was groundbreaking in its requirement that state employment centers cooperate fully with both the public and the private sector. This means that, for the first time, job applicants enjoy MoLSA'S support in accessing opportunities at private companies.

Sources close to the ministry and the private sector claim that many of the law's most important provisions have yet to be put into practice in any substantive way. There is scarcely any evidence of compliance by

employers, exploitation of workers remains pervasive, and reporting standards for sexual harassment and discrimination remain exceptionally weak.

What explains this lack of effective implementation of Al-Sudani's signature economic reform? Those who have worked closely with the ministry say that major obstacles include weak reporting of violations and poorly structured evaluation mechanisms. In theory, the reporting channels for labour violations involve a telephone hotline and a dedicated social media platform. But, in practice, the public is scarcely aware of these avenues of redress and consequently they are not used. Moreover, the response time for workers who have attempted to report violations to these platforms is extremely slow. Additionally, workers are hesitant to lodge complaints due to social stigma and fear of retaliation by their employers. Other sources attribute the lack of effective implementation to poor stakeholder engagement and communication with private sector leaders. The law introduced requirements that employers must report information about fees and contracts of employees, but the MoLSA has not done nearly enough work to ensure adherence to the new mandates.

The initial success of passing the labour law and the sequent lack of implementation are a case study of what might occur under Al-Sudani as prime minister. His government will face even greater challenges presiding over the complex agencies that shape Iraq's economy, including the MoLSA, Ministry of Finance, and the Central Bank. The continuing Iraqi dinar devaluation crisis has already shown the extent of the troubles ahead. If Al-Sudani is going to chart a positive path forward, his administration will have to combine his capacity to shepherd economic legislation through parliament with much more effective implementation than he demonstrated during his tenure at MoLSA.

One way for Al-Sudani to show that he is serious about the economy is to complete his unfinished

2. "A Diagnostic of the Informal Economy in Iraq." ILO, November 1, 2021. https://www.ilo.org/wcmsp5/groups/public/---arabstates/-ro-beirut/documents/publication/wcms_830086.pdf.

business of implementing the new labour law. In order for his government to execute the law's provisions and regain the public's trust, he should take steps towards creating a bottom-up reporting mechanism facilitated by specialized digital platforms that protect citizens' privacy. These platforms must be created and managed in close coordination with the private sector, civil society, and vulnerable groups, including women. There is already a pervasive lack of trust in the government that dates back decades. Moreover, many of the violations concerning vulnerable workers and women are of a sensitive nature, such as harassment and discrimination. Therefore, reporting mechanisms and platforms must be designed in a way that gains the confidence of an understandably skeptical population. This would clearly establish Al-Sudani's intent to promote reforms through a public accountability system, which would enhance the overall reputation of government activities.

Sources in MoLSA have indicated that they are currently working on amendments to the law to align it more with the current labour market in Iraq. Yet, this raises the question of whether the amendments are a result of an effective and data-driven analysis or if they are part of another thinly veiled political agenda to gain credibility and avoid accountability for incomplete implementation of the 2015 law.

Al-Sudani is not a new actor on the scene in terms of economic policy and reform. He should not start from scratch, ignoring his previous initiatives that remain incomplete, but build on them. In addition to taking care of his unfinished business, Al-Sudani will also have to face some of the bigger challenges urgently confronting the Iraqi economy. As mentioned, the value of the Iraqi dinar continues to plummet, provoking widespread anxiety among both ordinary citizens and the private sector. Consecutive Iraqi

governments since 2003 have left Iraq with an unemployment rate of 16.5% — among women, this figure is 28.2%³ — and a complete lack of diversity in the country's economy. Moreover, corruption in both the public and private sectors is undeniable⁴. These challenges require the kind of bold vision that Al-Sudani demonstrated in championing the passage of the new labour law while at MoLSA, but this must be coupled with far more effective policy implementation and follow through. Otherwise, Al-Sudani will repeat the mistakes of previous governments in promising much, but delivering little to nothing.

3. "Iraq Labour Force Survey 2021," ILO, 2022, https://www.ilo.org/wcmsp5/groups/public/---arabstates/---ro-beirut/documents/publication/wcms_850359.pdf.

4. Toby Dodge, Associate Fellow, "Politically Sanctioned Corruption and Barriers to Reform in Iraq," Chatham House – International Affairs Think Tank, November 5, 2021, <https://www.chathamhouse.org/2021/06/politically-sanctioned-corruption-and-barriers-reform-iraq>.

Much Ado About China: The “Pivot to China” between Optics and Reality

Ahmed Tabaqchali



Chinese President Xi Jinping meets with Iraqi Prime Minister Mohammed Shia' al-Sudani in Riyadh, Saudi Arabia, Dec. 9, 2022. (Source - english.news -Xinhua-Yue Yuewei)

The guiding economic principles of Mohammed Shia Al-Sudani's government are set by the parties that back his premiership, and reflect the arguably contradictory compromises that emerged during the year-long government formation process following the surprising October 2021 parliamentary elections¹. Two broad policy contours are already evident.

The first contour – expansionary fiscal policy – is partly a reflection of longstanding patterns in Iraqi economic policy and partly a reflection of the new government's precarious political position. The Coordination Framework initially appeared to be the losers of the elections in terms of seats, but later emerged victorious after a lengthy bargaining process fraught with political conflict and confrontation.² This

1. Lahib Higel, "Iraq's Surprise Election Results", International Crisis Group, November 16, 2021. <https://www.crisisgroup.org/middle-east-north-africa/gulf-and-arabian-peninsula/iraq/iraqs-surprise-election-results>

2. Renad Mansour, Victoria Stewart-Jolley, "Explaining Iraq's election results", Chatham House, October 22, 2021. <https://www.chathamhouse.org/2021/10/explaining-iraqs-election-results>

unexpected turn of events was made possible by the resignations a few months earlier of the Sadrist Movement's parliamentarians, who had tried and failed to form a government in partnership with the KDP and Sunni Arab blocs. As a product of the Framework's need to broaden popular support and acquire greater legitimacy, Al-Sudani's administration is expected to put forward an expansionary budget characteristic of previous governments. In fact, initial indications point towards increasing expenditures in significant ways.

While the budget has not yet been presented to parliament, the government has outlined the priorities of the governing parties. The most important policy is an approximately 13% increase in the number of public sector employees. This would be the first public sector hiring push since the 2018 government, which was also the result of tenuous compromises during the government formation process and involved parties with similar ideological leanings. Other significant increases are expected for pensions, social security, and the universal food subsidy system, known as the Public Distribution System (PDS). Coupled with other populist measures, such as removing a 20% tax on mobile SIM cards, these policies are a rehash of those of the past 20 years, which have expanded the public sector, made it the primary vehicle³ for developing party patronage networks, and cemented the governing parties' control of state resources.

The government will also likely announce a large increase in investment spending on infrastructure and reconstruction projects. However, precedent suggests that such plans are rarely implemented. Given the significant historic under-execution of investment spending, Iraq is likely to witness a replay of the structural imbalance between current and investment expenditures that have marked all prior budgets since 2005.⁴

A full analysis of the budget and the economic policies behind it can only be made after it is presented to Iraq's parliament, the Council of Representatives (CoR), sometime in February 2023 and voted on after several months of debate by legislators – a process that will reflect the extensive political compromises needed for the government to pursue its agenda. However, it is logical to assume that it will utilise the expected 2022 budget surplus of IQD 50 trillion (~USD 39 billion) to make up for an expected budget deficit in 2023 arising from lower oil revenues⁵ and much higher current expenditures.

The second contour of the new government's economic policy, and the subject of this Iraq Economic Report (IER), is the "Pivot to China." A sizeable section of the Coordination Framework advocates deeper economic ties with China, as a means of curtailing US influence⁶ in Iraq, and alignment with China's global positioning versus the US. The strategy of

3. Ahmed Tabaqchali, "Will COVID-19 Mark the Endgame for Iraq's Muhasasa Ta'ifia?", Arab Reform Initiative, April 24, 2020. <https://www.arab-reform.net/publication/will-covid-19-mark-the-endgame-for-iraqs-muhasasa-taifia/>

4. Ahmed Tabaqchali, "Iraq's Investment Spending Deficit: An Analysis of Chronic Failures", The Institute of Regional and International Studies (IRIS), December 2018, <https://auis.edu.krd/iris/latest-iris-publications/iraqs-investment-spending-deficit-analysis-chronic-failures>

5. Estimated current expenditures for 2022 are about IQD 109.9 trillion (~USD 84.5 bn), with the public sector wage bill estimated at IQD 43.9 trillion (~USD 33.8 bn). The prime minister indicated that the public sector wage bill will increase to IQD 62.0 (~USD 47.7 bn). Other increases could easily bring 2023's total expenditures to around IQD 150.0 trillion (USD 115.4 bn). Data and estimates are based on Ministry of Finance (MoF) budget reports as of November 2022. Public sector salary figures are for 2023. "Al-Sudani says the government will boost salaries, announce Halabja a governorate", Al Shafaq News, January 3, 2023. <https://shafaq.com/en/Iraq-News/Al-Sudani-says-the-government-will-boost-salaries-announce-Halabja-a-governorate>

6. Harth Hasam, "Pivot to the East: The Implications of China's Growing Economic Foothold in Iraq", Emirates Middle East Center (EPC) November 3, 2022. <https://epc.ae/en/details/featured/pivot-to-the-east-the-implications-of-china-s-growing-economic-foothold-in-iraq>

pursuing deeper economic ties with China began in late 2015 under the government of Haider al-Abadi with the signing of memorandums of understanding for a comprehensive strategic partnership. But it was the government of Adil Abdul-Mahdi – which drew support from the same section within the Coordination Framework as Al-Sudani’s new administration – that started this pivot in late 2019 by seeking a “quantum leap”⁷ in the relationship through the “Iraq-China Agreement”. Also known as “Oil for Reconstruction”, it involved signing eight deals⁸ covering a wide range of sectors, but primarily reconstruction activities undertaken by Chinese companies and financed by a portion of Iraq’s oil exports to China.

This much ado about the pivot to China and away from the US is not only a major topic of contention and debate in Iraq, but also in the West, particularly the US. For the latter, the pivot is viewed within the broader context of China taking advantage of the US’ disengagement from the Middle East in crucial areas like energy, trade, and reconstruction. Combined with the Belt and Road Initiative⁹ (BRI) investments, this would embed Iraq in China’s sphere of influence.¹⁰

Underpinning Iraq’s advocated pivot to China is an increase in bilateral trade between the two, with both oil exports to China and Chinese exports to Iraq growing significantly – with Iraq’s positioning within the BRI¹¹ being a crucial factor in the pivot. This review unpacks these dynamics through the prism of the China-US positioning in Iraq by examining the trends in Iraq’s oil exports to both China and the US, their exports to Iraq, and BRI engagements.

Oil Exports to China and the US¹²

Between 2012 and 2021, Iraq’s total oil exports grew by a compounded annual growth rate (CAGR) of 4.0%, with oil exports to China growing by 13.1% CAGR, while oil exports to the US declined by 11.9% CAGR. In this time frame, oil exports to China increased from 13.0% of Iraq’s total exports to 27.6%, while oil exports to the US declined from 23.1% of total exports to 5.2%.¹³ (Chart 1)

This underscores China’s growing importance for Iraq’s oil exports, and thus for its revenues. However, it does not follow that exports to China have grown

7. John Calabrese, “China-Iraq Relations: Poised for a “Quantum Leap”?”, Middle East Institute (MEI), October 8, 2019. <https://www.mei.edu/publications/china-iraq-relations-poised-quantum-leap>

8. Majda Muhsen, “Iraq signs eight agreements with China”, Zawya, September 30th, 2019. <https://www.zawya.com/en/business/iraq-signs-eight-agreements-with-china-ofu74jvp>

9. “How the Belt and Road Initiative got its name”, The Economist, February 6, 2020. <https://www.economist.com/special-report/2020/02/06/how-the-belt-and-road-initiative-got-its-name>

10. “China positioned to thrive under Iraq’s new government”, November 2, 2022, Iraq Oil Report (IOR). <https://www.iraqoilreport.com/news/china-positioned-to-thrive-under-iraqs-new-government-45274/>

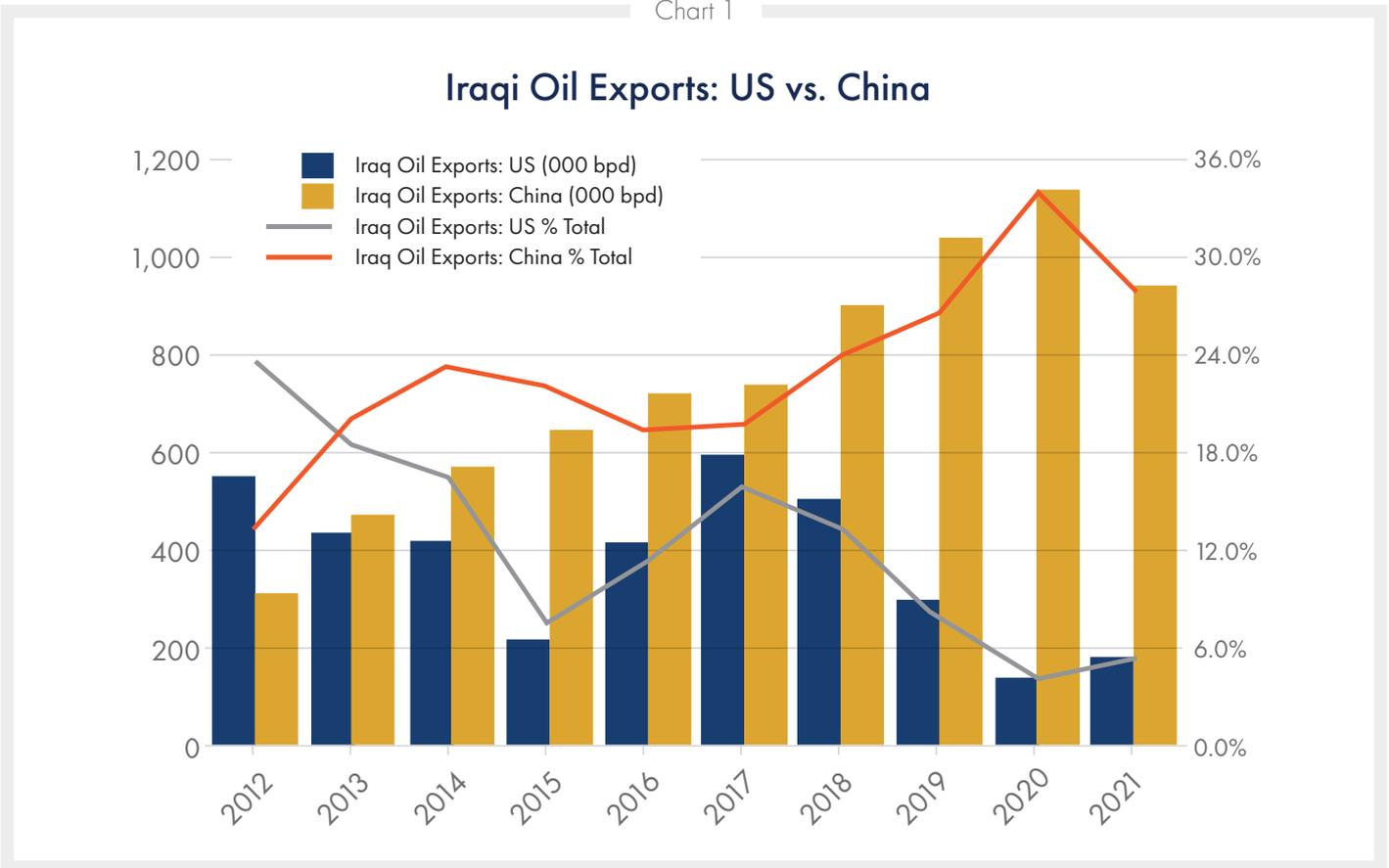
“China cements influence in Iraq through oil, infrastructure deals”, France 24 (AFP), August 22, 2022. <https://www.france24.com/en/live-news/20220822-china-cements-influence-in-iraq-through-oil-infrastructure-deals>

11. China wants to put itself back at the centre of the world:, The Economist, February 6, 2020, <https://www.economist.com/special-report/2020/02/06/china-wants-to-put-itself-back-at-the-centre-of-the-world>

12. Sources for this section: Annual Oil Export and Import figures for 2012-2021 are from OPEC’s Annual Statistical Bulletin 2022 accessed at <https://asb.opec.org/index.html>. China and US oil Consumption figures are from BP’s World Statistical Review of World Energy 2022 accessed at <https://www.bp.com/en/global/corporate/energy-economics/statistical-review-of-world-energy.html> Monthly seaborne oil exports to China for 2021- Nov. 2022 are from TankerTrackers.Com accessed at <https://tankertrackers.com/>. For Iran these figures are for crude and condensate (also known as natural gas liquids and are treated as a very light oil) exports and thus differ from the figures for Iranian crude seen from OPEC’s data.

13. It should be noted that the exceptional years of 2020 and 2021, during which oil price demand collapsed and OPEC+ embarked on an historic oil production cut, have negatively affected these figures. To put this in context, Iraq’s oil exports between 2012-2019 grew by a 7.3% CAGR, while oil exports to China grew by 16.4% CAGR, while oil exports to the US declined by 8.5% CAGR.

Chart 1



at the expense of those to the US; it merely reflects the different oil consumption and import profiles of the two countries. While US oil consumption has been mostly flat during this period, growing at 0.7% CAGR, its oil imports have declined by 3.6% CAGR, which reflects the emergence and rapid expansion of its shale oil industry. This fundamentally altered the profile of the US as an oil importer, with imports as a percentage of its oil consumption declining from 48.5% in 2012 to 32.7% in 2021. China’s oil consumption, on the other hand, has grown by 4.9% CAGR, but its flatlining domestic oil production means that imports as a percentage of its oil consumption have increased from 53.9% in 2012 to 66.7% in 2021.

Crucially, investment decisions in Iraq by China’s international oil companies (IOCs), the biggest of which are state owned¹⁴, are aligned with China’s strategic long-term oil needs. In contrast, US and Western IOC’s operating in Iraq are mostly privately

owned, governed by commercial logic and driven by shareholder returns. Therefore, their investments decisions are less influenced by geopolitical factors related to Chinese or US relations with Iraq.

The relative importance of China versus the US for Iraqi oil exports will continue along current trajectories, although this will moderate somewhat as Chinese economic growth slows and US shale production peaks. Crucially, China’s total oil consumption is 83.0% of that of the US, while its population is four times larger. This means that its oil consumption per capita is just 20.0% of that in the US. China’s increasing oil consumption per capita, while unlikely to ever reach the US’ levels, will continue to drive the growth in Chinese oil imports over the next few years.

This explains how China’s interest in Iraq’s oil production and its sizeable oil reserves drives its economic engagement. However, for Iraq, the importance of

14. J. William Carpenter, “The 5 Biggest Chinese Oil Companies”, Investopedia, September 13, 2022. <https://www.investopedia.com/articles/markets/091515/5-biggest-chinese-oil-companies.asp>

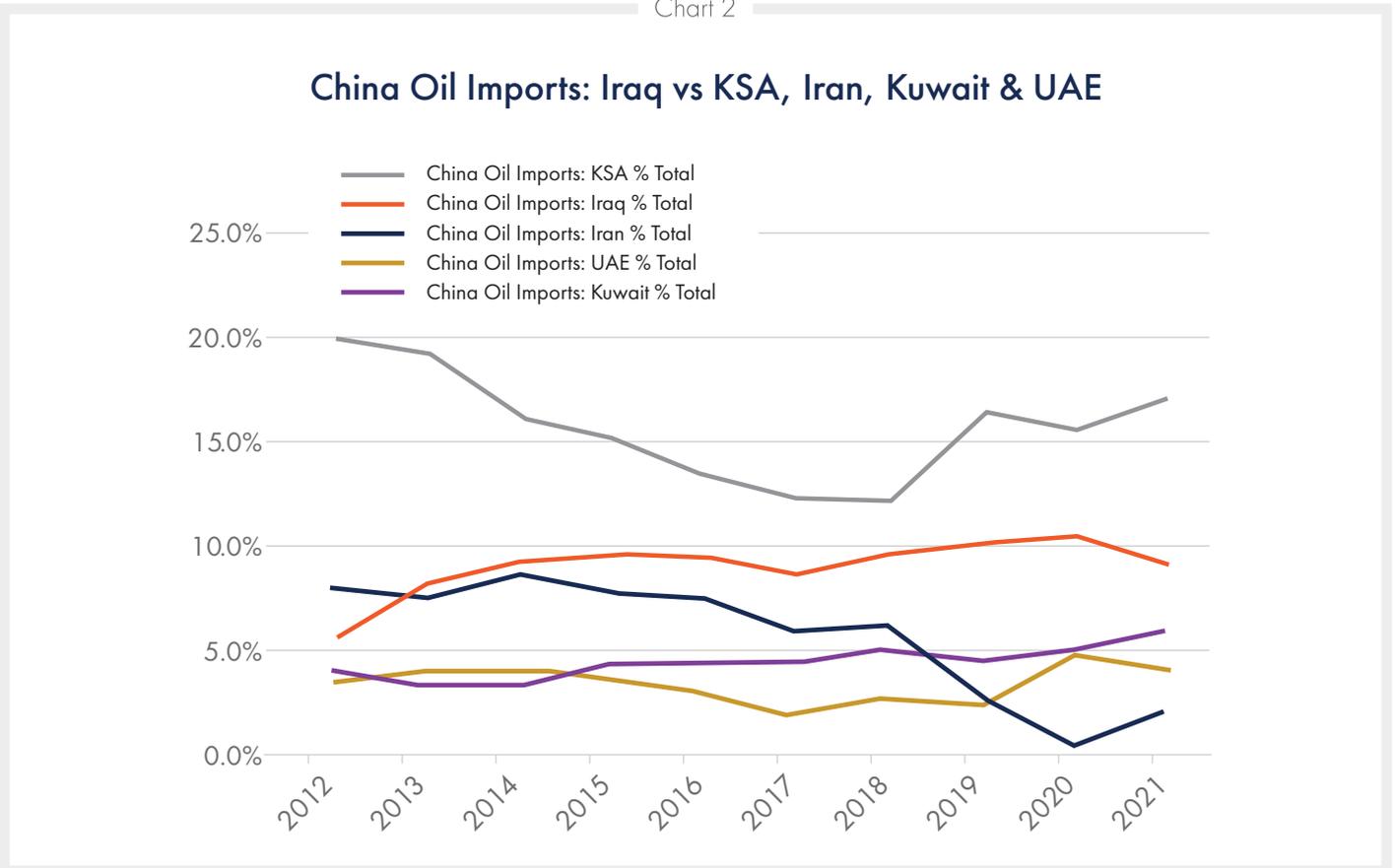
oil exports to China for its future economic growth comes with increased risks of dependence on a single customer. This concentration makes it vulnerable to any slow-down or change in Chinese oil consumption and to increased competition from other large oil producers who similarly view China as a vital market. This competition is beneficial to China’s energy security and diversification of its oil import sources, which can be seen from the market shares of some key OPEC exporters to China (Chart 2).

Moreover, China continues to diversify the sources of its oil imports by taking advantage of changing oil market conditions, such as those following the invasion of Ukraine in February 2022. The sanctions imposed on Russia meant that it had to divert its seaborne oil exports¹⁵ away from Europe — one of its top markets — to China and India¹⁶. This led to sharply increased

monthly seaborne Russian exports to China and a simultaneous drop in seaborne exports from some of China’s top sources — including Iraq, Iran, and Saudi Arabia (KSA)— especially during February-June 2022 (shaded area Chart 3). The subsequent decline in Russian exports, which still remain at two-year highs, allowed for a recovery of Iraqi oil exports that will likely stay at these levels while Chinese economic growth and demand for oil imports rebounds in 2023 with the end of its zero-COVID policy.

The diversion of Russian Urals exports came with sharp price discounts, expressed in the Urals’ much wider than normal price differential to Brent¹⁷. This led to a competitive disadvantage for similar quality crudes, such as Iraq’s main crude grade exports whose average blended price differential to Brent increased to \$5.2 per barrel (/bbl) in 2022 from \$2.1/bbl in

Chart 2

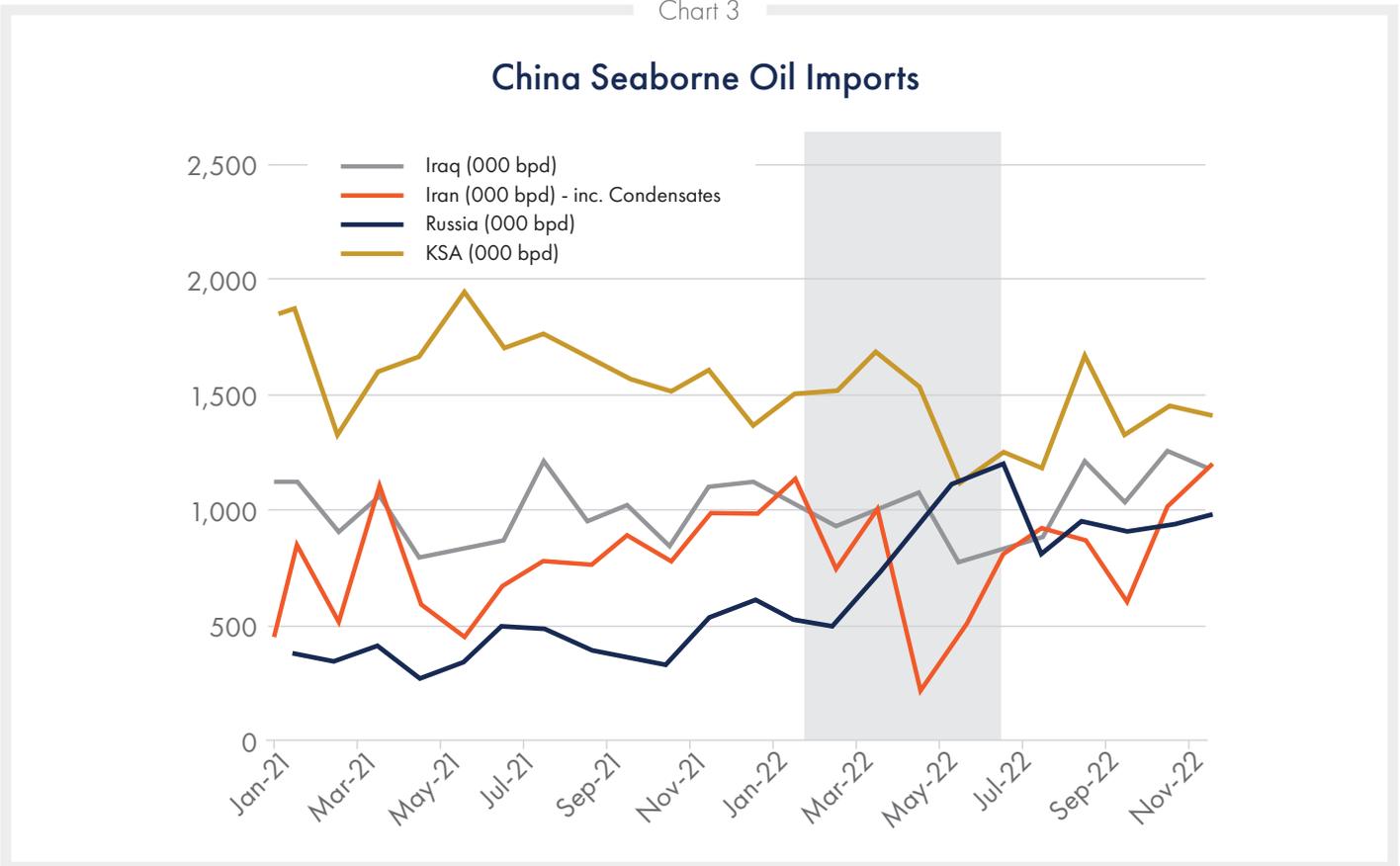


15. These are oil exports by tankers as opposed to those through pipelines.

16. Clifford Krauss, Alexandra Stevenson and Emily Schmall, “In Russia’s War, China and India Emerge as Financiers”, New York Times, <https://www.nytimes.com/2022/06/24/business/russia-oil-china-india-ukraine-war.html>

17. Oil markets use “formula pricing” as a basis of the oil pricing. In simple terms, crudes are priced with reference to a benchmark

Chart 3



2021, \$3.2/bbl in 2020 and \$3.4/bbl in 2019. This price differential is unlikely to improve in the near-term as China remains a crucial market for Russian exports, which have declined from the peak in June but are more than double the average normal seaborne export levels between January 2021 and February 2022.

Iraq’s Imports from China and the US¹⁸

There are similar dynamics in how Iraq exports oil to China and the US and how it imports goods from those two countries. Between 2012 and 2021, Iraq’s total imports grew by 1.8% CAGR, with imports from China growing by 9.0% CAGR and imports from the

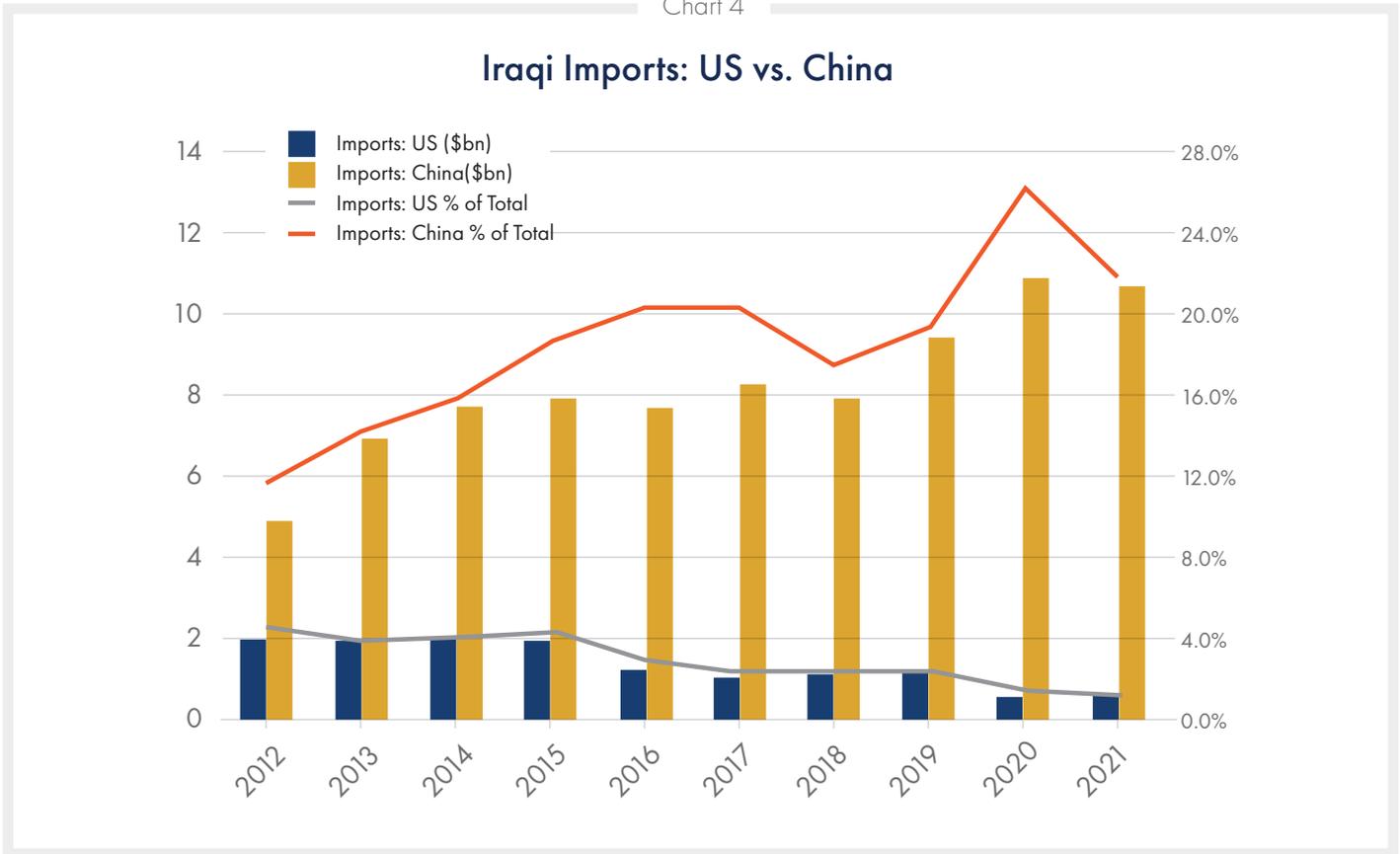
US declining by 10.5% CAGR. In the process, imports from China grew from 11.8% of total imports to 22.0%, while imports from the US declined from 4.8% of total imports to 1.5%. (Chart 4)

This underscores China’s growing importance as a supplier of goods for Iraq, but it does not follow that imports from China have grown at the expense of those from the US. It mostly reflects China’s economic rise and the growth of its global exports, as well as the development of Iraq’s consumer market. Despite the growth of China’s exports to Iraq, they only accounted for 0.3% of China’s total exports in 2021 and, even if they double or triple, would be of minor importance to China’s overall exports. Similarly, US

crude, plus or minus differentials that reflect crude quality differences, transport and insurance costs, and other factors, such as competitive offerings or political and legal risks. The benchmark oils are different for each oil export destination and this review uses Europe Brent Spot Price FOB as provided the US Energy Information Administration (EIA) as a proxy benchmark.

18. Note: This looks at the imports of goods and does not contain imports of services. All data sources, with the exception of imports from Iran, are from the UN’s Comtrade Database. Comtrade data for Iran is not available for a number of years, and thus are replaced by Iranian data (which are based on the Iranian fiscal year ending in March) after normalizing them for Georgian calendar. Moreover, the Comtrade data is for net exports for each country, i.e., re-exports are removed. Finally, Comtrade figures are provided by all countries to the UN, and as such do not reflect those of small individual traders known in Iraq as ‘suitcase traders’ (تجار الجبنة), nor do they include illegal trades or smuggling.

Chart 4



exports to Iraq account for less than 0.1% of its total 2021 exports. Moreover, as with Iraq’s oil exports, the trends underway in Chinese and US exports to Iraq will continue along the same lines into the near future as Iraq’s economy continues to evolve.

Often, Iraq’s trade relationships, including with China and the US, are assessed by considering the total value of imports to and exports from Iraq. However, the global price of oil has a significant effect on the US dollar value of Iraq’s exports. Fluctuations in the price of oil over time can give a misleading indicator of the nature of trading relationships – particularly with China given its long-term need for oil. Moreover, it is more useful to compare Iraq’s imports from China to those from Iran and Turkey, since all three countries trade at similar levels, than the US (Chart 5). Collectively imports from those three countries have grown from 52.4% of Iraq’s total imports in 2012 to 61.1% in

2021, significantly eclipsing all others. The next largest source of imports is the UAE at 5.3%¹⁹, followed by India at 4.2%, Germany at 2.2%, South Korea and Saudi Arabia at 2.0% each, Italy at 1.6%, and the US in tenth place at 1.5%²⁰. To a large extent, this reflects the development of Iraqi consumption patterns as its economy evolves, as opposed to any competition between the US and China and the different economic production outputs and, thus, exports of each.

Iraq’s Positioning within the Belt and Road Initiative

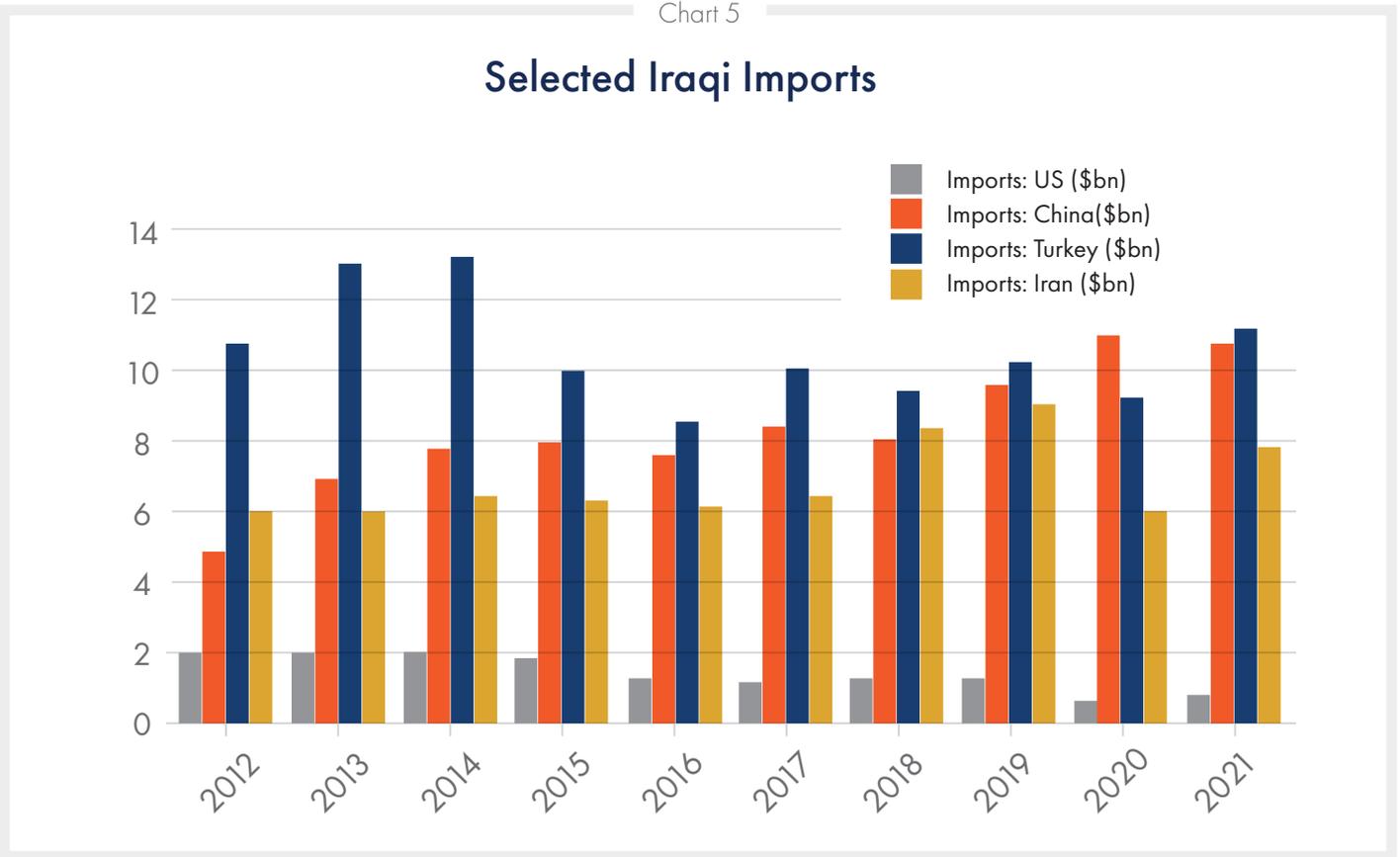
Iraq’s relevance to China’s Belt and Road Initiative (BRI) lies in its geographic location between China and Europe along both the “Silk Road Economic Belt” and the “Maritime Silk Road”²¹. The BRI is often viewed through the prism of US-China global economic and political competition and as an expression of

19. The UAE’s re-exports, which dwarf its net exports, to Iraq are excluded (above footnote).

20. The US had been among the top 10 every year in 2012-21, and number six in the cumulative total in the period.

21. The first of five memorandums of understanding for a comprehensive strategic partnership between Iraq and China signed

Chart 5



China’s rising economic power and a commensurate waning of US economic dominance. As part of this dynamic, China is diversifying some of its foreign exchange reserves away from US Treasury bonds, Treasury notes, and Treasury bills by investing in BRI-linked countries. The BRI also serves China’s domestic economy by opening international markets for its domestic manufacturing, technology, and construction industries and, in the process, integrates those economies into its own.²²

By the end of 2021, China’s total engagement in BRI since its launch in 2013 totalled \$829.4 billion, with the energy component accounting for \$362.7 billion, or 40.6% of total engagements. Iraq’s positioning within this framework, and apparent importance to the BRI, has come into focus as the third-most important partner in the BRI for energy engagement during this period. Additionally, it was the largest beneficiary of the BRI’s \$59.5 billion in total investment in 2021, with \$10.5 billion in energy and power-related construction contracts in Iraq.²³ However, it should be noted that the

in 2015 is an “understanding on participation in building the economic belt of the Hareer Road and the Maritime Hareer Road of 21st century”. Shatha Khalil, “Al-Hareer Road ... An economic belt linking Iraq with China”, Rawabet Center for Research and Strategic Studies, December 14, 2017. <https://rawabetcenter.com/en/?p=4650>

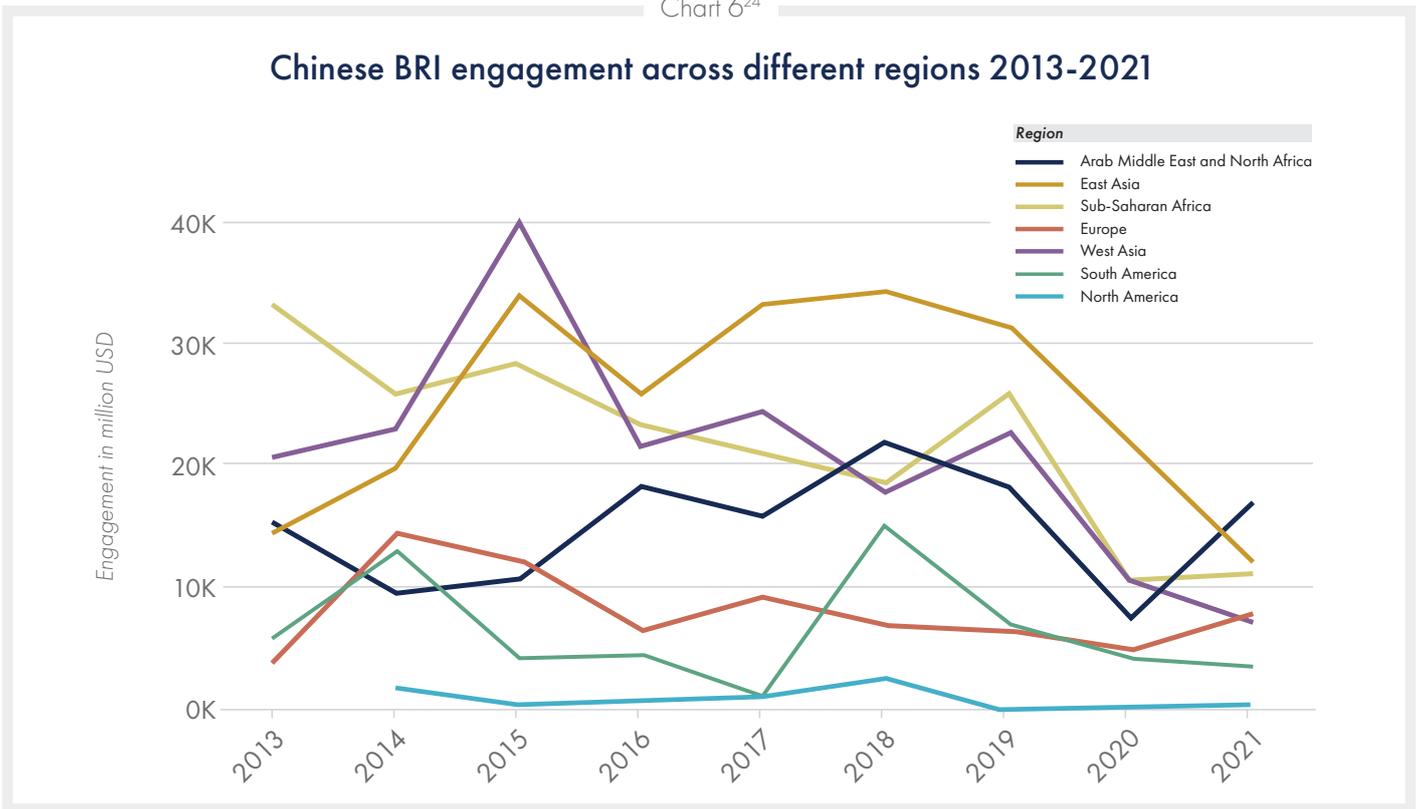
22. “What is China’s belt and road initiative?”, The Economist, May 15, 2017. <https://www.economist.com/the-economist-explains/2017/05/14/what-is-chinas-belt-and-road-initiative>

Yu Jie and Jon Wallace, “What is China’s Belt and Road Initiative (BRI)?”, Chatham House, September 13, 2021. <https://www.chathamhouse.org/2021/09/what-chinas-belt-and-road-initiative-bri>

Zana Gul, “The new era in the continuum of China and Iraq’s relationship”, December 5, 2022. <https://journals.sagepub.com/doi/full/10.1177/20578911221140690>

23. Christoph Nedopil Wang, “China Belt and Road Initiative (BRI) Investment Report 2021”, Green Finance & Development Centre, FISF Fudan University, January 2022. https://greenfdc.org/wp-content/uploads/2022/02/Nedopil-2022_BRI-Investment-Report-2021.pdf

Chart 6²⁴



capital investments of China’s IOCs operating in Iraq, counted within the BRI’s engagements, are recouped over-time by these IOCs as part of their remuneration under the oil production contracts and, as such, are ultimately paid for by Iraq.

The BRI engagement in Iraq should be considered within the context of total BRI engagements in different parts of the world (Chart 6). Moreover, it primarily reflects the importance of Iraq’s oil production profile to China’s future oil needs and for its energy security. As such, it cannot be seen as a function of China filling the vacuum created by US withdrawal or disengagement from Iraq.

The total amount of \$10.0 billion over a number of years envisaged for infrastructure projects in the “oil for reconstruction” agreement of 2019 is about 11% the \$88.2 billion²⁵ needed simply to rebuild the damage caused by the Daesh conflict – and would account

for a tiny fraction of the amounts needed for the country’s reconstruction following decades of conflict. Moreover, the arrangement where this investment is financed by Iraq through a portion of its oil sales to China and awarded to Chinese companies fits within the BRI’s aims of creating markets for China’s domestic industries, especially construction.

Conclusions and Policy Implications

China’s need for oil is the bedrock of the Iraq-China economic relationship and underpins the future relationship between the two. However, it is a relationship driven by China’s need for oil, with benefits to Iraq accruing from this need, as opposed to any active Iraqi role or engagement. This also defines Iraq’s relationship with its sources of imports, including the US, in that it has become an attractive market for all exporters given its almost non-existent domestic industry.

24. Source: Above

25. Maher Chmaytelli and Ahmed Hagagy, “Iraq says reconstruction after war on Islamic State to cost \$88 billion”, Reuters, February 12, 2018. <https://www.reuters.com/article/us-mideast-crisis-iraq-reconstruction-idUSKBN1FW0JB>

The trends in Iraq's oil exports to China and US, their exports of goods to Iraq, and the BRI investments in Iraq reviewed in this piece do not reflect a waning of US political influence that is being exploited by China, but a reflection of the evolution of the different stages of the US and Chinese economies, their demand for oil, and the nature of their exports. Moreover, these trends have been under way since 2012 and will continue along the same patterns into the near future irrespective of the political aspects of Iraq's relationship with the US or China.

For Iraq, an economic relationship with China is vital for its future economic growth, given the significance of China's, and Asia's, future demand profile for oil, especially in the context of US and European shifts towards non-fossil fuel energy sources. However, Iraq should diversify its oil exports to Asia without becoming overly dependent on a single customer — no matter how important — in the same way that China ensures that it has a diverse range of oil suppliers.

Ultimately, the imperative for Iraq is not a pivot to China or pivot away from the US, but a pivot to Iraq. In doing so, it should address its own economic structural imbalances that make it dependent on oil and external demand for its oil, whether by China or the US, which makes its economy vulnerable to external shocks — with the economic crisis in the wake of the emergence of COVID-19 and the collapse in oil prices in 2020 the most recent manifestation of this vulnerability²⁶.

26. Ahmed Tabaqchali, "Will COVID-19 Mark the Endgame for Iraq's Muhasasa Ta'ifia?", Arab Reform Initiative, April 24th, 2020. <https://www.arab-reform.net/publication/will-covid-19-mark-the-endgame-for-iraqs-muhasasa-taifia/>

Potential Features of Al-Sudani's Economic Program

Nabeel Al Tememi

As the value of the Iraqi dinar continues to decline, the state of Iraq's economy has become a major topic of conversation both in the media and on the street. It is therefore vitally important to understand the economic plans of Prime Minister Mohammad Shia Al-Sudani's new government. Initial statements seem to indicate that his administration will pursue potentially contradictory policies in an effort to appease different ideological factions. For those advocating central control of the economy through the state, Al-Sudani has promised to hire thousands of new public sector workers and to strengthen government-owned enterprises. Those preferring a more free market approach will also find reasons for optimism, with Al-Sudani making statements supporting a transition away from a state-centered economy.

To make sense of these divergent goals, it is necessary to look closely at two important documents that have guided government formation: the ministerial program that Al-Sudani presented when he was appointed prime minister and the political agreement drawn up by the political parties that support his government, a grouping known as the State Administration Alliance. The ministerial program appears ambitious, with sections dedicated to expanding government employment and social welfare, reviving public sector companies, unifying customs policies, improving the transportation sector, and further developing the energy sector. The most important economic aspect of the political agreement is a promise to reorganize the state's financing along the lines of Al-Sudani's desire to prioritize social justice. Let us consider potential features of the economic program in greater depth.

Public services and the potential for additional pressure on the budget

Al-Sudani's ministerial program is based on the slogan: "the government of services." This pledge is designed to show his government's commitment to providing the maximum level of public services like water and electricity to citizens, which would address a longstanding popular frustration and a major demand of the Tishreen protesters. Additionally, such policies would expand the number of citizens who directly benefit from the state through social programs, subsidized food rations, and public sector job opportunities. If implemented effectively and fairly, many of Iraq's most vulnerable citizens would receive much-needed economic assistance in the short-term. Yet many analysts believe that the cumulative effect of these policies would have a negative effect over the long-term and burden the state, particularly if the price of oil collapses again.

This approach is not much different from those adopted by nearly all previous Iraqi governments, with the possible exception of Al-Kadhimi's government which had expressed a desire to go in a new direction by reducing expenditures on salaries and pensions, although there is little indication that this was successful. Additionally, Al-Sudani's ministerial program is focused on reviving public sector companies, in part by encouraging partnerships with the private sector. This demonstrates the government's desire to preserve the state's central role in shaping both public and private drivers of economic growth.

The regional distribution of resources and wealth

Although there are signs indicating Al-Sudani's desire to put the state at the center of Iraq's economy, there are also political pressures based on regionalism that may take his government in another direction. The political agreement between the parties that support his government will dictate — perhaps implicitly — what spending policies are implemented. Sections that promise “additional allocations for oil and gas-producing governorates,” “increased funds for reconstructions projects in areas affected by terrorism,” and solutions to “the dilemma of oil production and export from the Kurdistan Region” represent political demands that may yield a chaotic economic approach. In the absence of clear mechanisms to implement these provisions, Al-Sudani's government will have to divert significant funds from ministries to the governorates, where spending will be overseen by provincial officials.

The State Administration Alliance, which supports Al-Sudani's government, is made up of the dominant components of the Shiite, Sunni, and Kurdish blocs. Given the need to preserve the support of these entities, it is likely that the diversion of funds to the governorates will not follow principles of equality and fairness relative to population size, poverty, and unemployment, but instead will be dictated by politically influential forces in the governorates. With regard to the Kurdistan Region, Al-Sudani's agreement with the Kurdish leaders during government formation pledged to preserve the Kurdistan Regional Government's (KRG) capacity to market oil and gas, develop fields, and increase investments. But this promise is becoming difficult to keep with the federal court ruling.

Apart from indicating plans for spending and resource distribution, the ministerial program promised a greater role for local investment agencies in agricultural and industrial development as a way to reduce unemployment and increase private sector activity. This may also lead to political forces in the

governorates ceding control of investment programs, project referrals, and employment procedures.

Oil will remain the main engine of the economy

The ministerial program includes many sections expressing a desire to diversify Iraq's economy in order to achieve growth, including by facilitating export procedures, setting unified customs policies, and leveraging the country's geographic location. But other sections are dedicated to boosting the energy sector, which calls into question the seriousness of the diversification push. The government's plans to expand oil production by volume is demonstrated by the continuation of partnerships with international companies to facilitate extraction, expand storage capacity, and develop export outlets throughout the country. This last point likely relates to a desire to build a new pipeline to the Jordanian port of Aqaba or another one through Syrian territory to Baniyas. The policies included in the ministerial program go beyond increasing production, with indications that Al-Sudani's government is open to investment from foreign companies to operate refineries and petrochemical processing plants. The program also extensively addresses the development of the natural gas sector, either through increased capture during oil extraction or from new drilling into gas reservoirs. This would reduce the need for imports and improve electricity generation, something that previous governments failed to achieve.

The Role of Geopolitics

As with previous administrations, the economic policies of the new government will also be affected by geopolitics. Al-Sudani's ministerial program does not include clear references to the government's approach to foreign economic policy, but analysts can look for clues about his vision in a letter that Al-Sudani published during an Arab-China summit, which declared that “Iraq is a region of convergence and integration between East and West.” He added that the country's stability depended on its embrace

of international and regional investment interests. In a bilateral meeting with Chinese President Xi Jinping on December 9, 2022 on the sidelines of the summit, Al-Sudani said that Iraq wanted to be integrated into the Belt and Road Initiative (BRI) and that he believed Iraq could learn from the Chinese experience of combatting poverty and transitioning to a market economy. Other articles in this issue of the Iraq Economic Review are skeptical about the extent to which Iraqi-Chinese economic relations will can develop.

Conclusion

This analysis of the ministerial program, the political agreement, and Al-Sudani's recent statements only give a general indication of the new government's economic approach, but it is clear that there are a number of questions that still need to be answered. First, how will Al-Sudani manage the divergent aims of preserving a centralized, state-run economy with regional decentralization initiatives? Second, how will his government diversify Iraq's economy, when the ministerial program prioritizes the continued development of the energy sector? Third, how will Al-Sudani manage the geopolitics that will inevitably influence Iraq's economic development? This last aspect is highlighted by the continued crisis related to the depreciation of the Iraqi dinar's value. Indeed, the only thing that is clear is that Al-Sudani must move quickly to clarify his economic policy program in order to demonstrate stability to domestic and international actors.

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