

Iraqi Oil: Turning the Curse to a Blessing

Dr. Muhammad-Ali Zainy
Senior Energy Economist and analyst
Centre for Global Energy Studies, London

Conference on *Iraq Oil Policy: A Review*
25-27 February, 2008
Center for Iraqi Researches
Fondation Maison Des Sciences De L'Homme
Paris, France

السياسات النفطية في العراق – أفق للمراجعة
مؤتمر دولي يعقد في باريس
بيت العلوم الاجتماعية / مركز الأبحاث العراقية
بالتعاون مع المركز الوطني الفرنسي للبحوث العلمية

Rentier economy

A rentier economy is an economy that depends to a large extent on revenues obtained from rent or exploitation of an exhaustible natural resource such as oil. A country with such an economy is traditionally called a “rentier state” where the government lives off an unearned income coming from the production and export of the natural resource.

The Arab oil and gas exporters represent typical rentier states where petroleum (oil & gas) exports form a significant portion of the country’s total exports, the contribution of the petroleum sector dominates the country’s GDP and petroleum export revenues are the significant source of financing the annual government budget. These conditions are illustrated in Figures 1, 2, 3 and Table 1 for the Arab members of OPEC for the year 2006; Norway is added as a comparative example, for reasons to be explained later.

The share of petroleum exports in the total exports of OPEC’s Arab members is shown in Figure 1 for the year 2006. This share ranged from 51% in the case of the UAE to 99% in the case of Libya. Normally, a country’s exports are almost the sole source of its foreign exchange and, in order for the country to be able to import as well as support the value of its own currency, such foreign exchange must at least cover its import needs, or else the trade balance will be in deficit. There is nothing wrong with a country exporting oil and gas and generating ample foreign exchange, provided that there is no abnormal dependence on this process. What may go seriously wrong is the large extent of dependence on such exports, where Libya would be a manifest example in this illustration. Anything goes wrong with the ability to export petroleum and this country is in deep trouble.

The other indicator of a rentier state is illustrated in Figure 2, where the GDP is dominated by the value added of the oil & gas sector. This domination is very pronounced in the case of Iraq, where the oil and gas sector during 2006 made 93% of the total GDP. Iraq, however, is a special case at present time, because of the ongoing

American occupation, widespread violence and lack of security throughout Iraq and, above all, collapse of the non-oil sectors of the economy, a legacy of Saddam Hussain's rule and UN economic sanctions. Leaving Iraq aside for the moment, we see that the oil and gas sectors during 2006 made up 62% in Qatar, 60% in Libya and 50% in Saudi Arabia. These shares are large indeed and show the relative lack of diversification of the economic base of these countries. Among this group of Arab states the UAE, again, scores the best figure, with the contribution of the petroleum sector to the total GDP of only 27%, thanks to the good performance of the vibrant industrial and services sectors of this country.

The last illustration, shown in Figure 3, concerns financing the governments' budgets of rentier states. Oil and gas revenues of these states provide the major portion of the government budget revenues. Again leaving Iraq aside for later, we see that petroleum export revenues financed 91%, 90% and 86% of the 2006 government budgets of Kuwait, Saudi Arabia and the UAE respectively. The only relatively lucky government is that of Algeria, which seems to have other means of non-oil income to finance 50% of the budget – not bad compared with the others, but still very vulnerable to downward dips in oil and gas income.

Effects of the rentier economy

It is generally observed that the government of a rentier state tends to be autocratic, unaccountable and dissociated from the rest of the country's people with regard to their rights, needs and aspirations. Furthermore, the economy of such a state is generally retarded when compared with the economy of a state with no dependence on the export revenues of mineral extraction (oil, copper, bauxite, etc.).

Several reasons have been put forward by development economists to explain why countries with huge mineral wealth – oil in the case of Iraq – tend to display, more often than not, certain adverse effects or, as fashionably called, a “resource curse” exemplified

in typically underdeveloped economies and weak, if not primitive, political institutions¹. One of the factors, put forward, leading to this effect is the severely fluctuating income of these countries resulting from the price volatility of their extractive export commodities. Such fluctuating income leads to “boom and bust years” which would obliterate rational economic planning and performance².

Another reason is the overvalued currency of the resource-rich country, or what has become to be known as the “Dutch Disease”, referring to the discovery and exploitation of natural gas in the Netherlands in the 1960s and the consequent adverse impact on its manufacturing sector. The negative effect of an overvalued currency of a country is exemplified in the impediment to growth of its export sectors. The result is that such a country would lose its competitiveness in exports of manufactured and agricultural goods, leading to the deterioration of these sectors. This effect is generally observed in all OPEC member countries, including the Arab ones.

These reasons, important as they are, can explain only part of the problem. The best explanation, though, comes as follows: as a result of the availability of resource-export revenues, the governments of resource-rich countries do not have to constantly worry about finding ways and means to finance their annual budgets, which are normally needed to run the country. With ample oil revenues, for instance, these governments become mostly self-sufficient – sometimes replete with cash – and the necessity to tax the people for the purpose of generating enough income to finance the budget vanishes absolutely.

This state of financial self-sufficiency leads to a corrosive or toxic state of affairs in two main ways. One way is that the government’s lack of need for tax-generated income reduces its incentive to promote a diversified tax-based economy strongly underpinned by the private sector. The other way is that the under-taxed, and mostly untaxed, citizens

¹ See Nancy Birdsall and Arvind Subramanian: *Saving Iraq from its oil*, in *Foreign Affairs* (July/August 2004) pp. 77 – 89.

² See, for example, CGES “*Saudi Arabia to 2020: oil, economics and politics*”, Spring 2002, Part Two, London, UK.

lose the desire to hold government accountable for its policies and actions. The result is weak civil society characterized by lack of checks and balances and proper growth-promoting institutions.

An exception to this thesis would be Norway. It is claimed that at the time that Norway became revenue-rich from the sale of natural gas (as of the mid-1970s) democracy in this country was well-entrenched, along with its relevant institutions, and that prevented corruption and other toxic consequences. This now explains why Norway, despite being hydrocarbon-rich, yet fared well compared with the Arab members of OPEC as reflected in Figures 1, 2 and 3. While the percentage shares of oil exports in total exports, oil GDP in total GDP and oil revenues in total budget revenues for Norway in 2006 were 51, 23 and 39 percent respectively, the corresponding average percentage shares for the Arab members of OPEC in the same year were 84, 52 and 83 percent respectively, showing that Norway is not strongly dependent on natural resource exports for its foreign exchange earnings, its economic base is fairly wide and diversified and the revenue of the Norwegian government budget is tax-based and not dependent on earnings from oil and gas exports (see Table 1).

Good but inconsistent hypothesis

If the economic environments of most resource-rich countries seem to encourage the establishment of autocratic governments (Norway being the exception because democracy was there before the country became resource-rich), then it follows that if these resource-rich Arab countries, like Saudi Arabia and other GCC states, Iraq, Libya and Algeria, were resource-poor instead, they would have developed democratic regimes, perhaps a long time ago. This cannot be farther from the truth. What supports this contention is a quick look at the existing resource-poor Arab countries. The governments of Syria, Jordan, Yemen, Egypt, Tunisia, Sudan and Morocco are not exactly democratic, nor are the governments of many resource-poor countries in Africa, Asia and Latin America, if we want to go beyond the Arab example.

It is the drive of a people, their past and present conditions, and the type and agenda of the government holding power in a country will, most likely, lead to the establishment of a democratic system in a certain country and the absence of it in another. If we take South Korea as an example of a resource-poor country becoming democratized as well as economically developed, it may be the effect of what we might call the “America-Japan” factor or the “pull-push” effect of these two countries. It may very well be that, a proud people like the Korean people, who were brutally treated and humiliated by Japan, and whose country was forcibly annexed during 1910-1945, had developed the driving force and determination to rise and excel in the wake of winning their freedom after Japan’s defeat in WW II (N. Korea fell under the communist sphere of influence after the war). The strong resentment or repulsion caused by the Korean horrendous experience with Japan may be called the Japanese “push factor”. On the other hand, the American “pull factor” or the paradigm of democracy and successful economy led S. Korea on the road of establishing one of the best educational systems in the world, adopting a market economy and opening up to foreign direct investment as well as turning to democratic rule.

On the opposite side of this equation are the resource-poor Arab countries. They did not democratize, nor did they build successful economies. In essence, their behavior wasn’t in any way similar to that of S. Korea. A number of reasons could be put forward to explain this situation. One of them is the strong pull factor of Islam with its present autocratic tradition, which tradition became enmeshed in a state of irrational departure from reason and liberal thinking. That, unfortunately, took place after the collapse of the rational school of thought in the 9th century, and the consequent victory of salafist ideology and adherence to a literal interpretation of the Quran to the detriment of Islam’s fundamental tenets. All of that was encouraged and done on the behest of theocratically absolute rulers, whose interests were very well served by such reactionary fall down. Because of this factor, it becomes, then, feasible to say that it is easier for an African nation, free of any burdens of a religion and attractions of a past, to become democratic, than an Arab nation pulled to its past by a fossilized brand of religion and a collective memory of a glorious civilization in the not-too-distant past.

Another reason to explain the retarded Arab situation is the Israeli factor. The struggle to liberate the occupied Palestinian lands offered opportunities for many Arab nationalist officers, as well as those harboring ambitions to control and rule, to carry out military coup d'états under the pretexts of ridding their countries of their reactionary governments and liberate Palestine from Israeli occupation. Very soon those countries became rife with such slogans as “everything is for the battle” and “nothing can rise above the battle”, which, virtually, impeded any potential for economic progress and, at the same time, emasculated the people and stripped them of their capabilities to demand democratic rule and respect for human rights, since all energies, allegedly, had to be saved for the “battle” while the issues of human rights, democratic rule and economic progress could, somehow, wait until Palestine was liberated. In reality, however, those officers, and the nationalist parties that supported them, did nothing in the way of liberating Palestine and, indeed, they lost more land to Israel as a result of their misadventures. Instead of nurturing democratic traditions in their countries – be they resource-rich or resource-poor – and building strong, diversified and growth-sustaining economies run by strong, educated and free people, which is the only way to stand up to Israel and win back the usurped Palestinian lands, they, instead, opted to subjugate their peoples, and chain them and deprive them of their rights and of any semblance of a decent living, thus rendering them poor, weak, helpless and ineffective. Furthermore, this new ruling elite steadfastly held to power and, along with their immediate families and cronies, indulged in self-enrichment, fostering, in the process, corrupt states with poor and underdeveloped economies.

One indicator of the dismal state of the Arab countries is their frightening level of corruption, as recently reported by *Transparency International* which speaks plenty of entrenched corruption in the Middle East and North Africa (MENA) region, as Table 2 shows. Judging by the score of the 2007 Corruption Perception Index (CPI), where 10 indicates the lowest level of corruption and zero the highest, Israel turned out to be the least corrupt among MENA countries followed by Qatar and the UAE, while Iraq, the “castle of Arab steadfastness”- as the Iraqi Ba’ath rhetoric goes - was rendered to the bottom of the most corrupt countries in the MENA region and only surpassed by Somalia

in this dubious “honor”, thanks to Saddam’s legacy of corruption which started with the Iran-Iraq war and, unashamedly, accelerated under those who came to rule afterwards. When compared on international level, Israel, again, comes on top of the MENA list, ranking 30 among 180 countries, followed by Qatar and the UAE ranking 32 and 34 respectively (Denmark, Finland and New Zealand, not shown in the table, came on top of the world list). The worst perpetrators, or most corrupt in the world, turned out to be Iraq with a rank of 178 (just two levels away from the bottom), followed by Somalia ranking 179 and Myanmar (not shown) ranking 180 in the bottom of the corruption list.

One last example which does not fit the hypothesis of the resource curse is Chile under Allende and Pinochet. Despite this country being copper-rich, Salvador Allende was elected in 1970 in a democratic manner to become the country’s president. Democracy, however, did not prevent Allende from adopting a populist program which involved nationalizations, price control and wage increases. Soon, the private sector started shrinking, capital flight ensued, inflation became out of control and the economy stagnated. While the Chilean economy was growing in real terms, during the pre-Allende period of 1961-70, at an average rate of 4.1% per annum, this rate shrank to just 0.5% per annum during Allende’s presidency 1970-73 (see Figure 4). In a coup d’etat – the key organizer was the CIA – Augusto Pinochet’s dictatorship was brought about in 1973. Setting aside that dictatorship’s brutality and human rights abuses, the Pinochet regime (and those democratically elected after Pinochet’s failure in 1988 to secure another 8-year presidential term) pursued sound economic policies, including adopting a market economy open to foreign direct investment and fostering a strong private sector. Other than a couple of minor downturns, such sound economic policies resulted in a remarkable period of economic growth, as Figure 4 shows.

Difference in performance

To go back to the oil-rich Arab regimes, their economic performance did not just assume one path, but was different from one country to another. Libya and the UAE do not have democratic regimes, but the UAE’s performance fared far better than Libya’s as the years passed. During the 20-year period 1987-2007, Libya’s real economic growth averaged a

dismal 1.3% per annum compared with 3.9% per annum for the UAE. During the period 1990-2007, the UAE's real economic growth jumped to 5.4% per annum compared with only 3.4% per annum for the Libya (see Figure 5). The reason for the UAE's better performance is due to what we can call "enlightened governance".

Let us take the performance of Saudi Arabia's economy under different periods. During the period 1969-81, the kingdom's real economic growth averaged a fantastic 11.7%, thanks to the expansion of production in the oil sector during that period and the advent of high oil revenues which allowed dual expansions in investment and consumption (see figure 6). During the period 1981-87, Saudi Arabia's oil revenues suffered a precipitous decline due to the dual deterioration in Saudi oil production as well as oil export price. As a result, the Saudi economy retreated at a frightening average rate of -4.5% per annum, during which period the Saudi regime was almost completely apathetic despite the painful economic retreat.

With the debilitating stroke of late king Fahad in 1995 and the relatively progressive and reform-minded King Abdullah (then Crown Prince) taking over as de facto ruler of Saudi Arabia, the economy (real GDP growth as a proxy) started moving upwards and achieved an average real growth rate of 3.3% per annum during the period 1995-2007. Precisely with the more enlightened governance of King Abdullah, and despite the inertia of the conservative Sudairi half-brothers and the entrenched wahhabi establishment, the Saudi economy achieved a much better growth of 5.3% per annum during the 5-year period 2002-07. Such performance was mainly due to higher oil production and prices, generating huge oil revenues which, in turn, allowed more investment and consumption. More importantly, however, it was due to instituting some serious reforms, including partial economic restructuring, opening up to foreign direct investment and accessing the World Trade Organization. With, hopefully, more to come in terms of speedier and wider economic restructuring, and more daring social and political reforms, King Abdullah's legacy would more likely be remembered as the best in pushing the kingdom in the direction of proper economic and political development.

The case of Iraq

If Iraq were resource poor, would it have developed a tradition of democratic government? The answer is definitely not! Since the founding of the present state of Iraq after the collapse of the Ottoman Empire, an oligarchy of Iraqi officers and functionaries from that defunct empire came to rule Iraq under the umbrella of a weak Hashimite monarchy established by the British in 1921. Iraq, then and until the early 1950s, did not enjoy any meaningful inflow of oil revenues in order to be afflicted with the alleged resource curse (see Figure 7). Although Iraq adopted a good constitution, perhaps even better than the present one, this constitution was almost always violated by a sectarian Sunni minority government, who had no regard to basic human rights, suppressed all sorts of freedoms provided by the constitution and always rigged parliamentary elections every time there was one.

During the four decades from 1932 when Iraq gained its independence and became a member of the League of Nations until 1972 when the Iraqi Petroleum Company (IPC) was nationalized, Iraq could not be considered as a resource-rich country, judged by the meager cumulative oil revenues of less than \$10 billion received during this period. Nevertheless, Iraq's successive governments, whether under the monarchy or under the republic, were undemocratic and repressive. Iraq became relatively oil revenue-rich only in the aftermath of the oil price explosions of the 1970s, as illustrated for us in Figure 7.

Despite the meager oil revenues Iraq was receiving, they were treated as a budgetary surplus to be allocated for infrastructure building. With the advent of the profit-sharing agreement with the oil companies as of the beginning of the 1950s, when oil profits began to be equally split between Iraq and the oil companies, the successive governments under the monarchy were able to prudently utilize the country's oil income to finance a series of economic development plans, by allocating 70% (later to drop down to 50%) of the oil revenues for such purpose. Nevertheless, the Iraqi governments continued their tradition of repressive rule until the monarchy was overthrown by a military coup d'etat in 1958.

Speaking in a nutshell, the inflow of large oil revenues did not cause the Iraqi governments to become autocratic, as they were as such since the founding of the present Iraqi state in the aftermath of the British occupation last century. The impact of the oil revenues, which became stupendous as of the mid-1970s, was to allow Saddam Hussain, who grabbed power in a blood bath in 1979, to become even more stupid. Indeed, if there is truly a curse associated with resource-rich countries, then Iraq, during Saddam hussain's rule, became its embodiment par excellence! What was built in Iraq with the help of the country's oil revenues, in terms of advanced and adequate infrastructure, a generous health care scheme and a very good educational system, was wiped out within a short period of time, thanks to Saddam's foolish military adventures.

To give examples of what happened, the successive Iraqi governments used most of the oil money, whose cumulative amount reached around \$100 billion by 1980, to finance the 5-year economic development plans. As a result of those genuine endeavors, the Iraqi GDP almost quintupled over the period 1960-80, growing in real 1980 prices, from around \$10.7 billion in 1960 to around \$53 billion in 1980, with a remarkable average growth rate of 8% per annum (see Table 3 and Figure 8). The Iraqi per capita income increased in real 1980 prices about 2.6 times from \$1,557 in 1960 to \$4,000 in 1980, making a yearly real growth of 4.7% despite the high Iraqi population growth rate during that period of around 3.3% per annum. Furthermore, on the road of economic diversification, the Iraqi oil sector's contribution to the GDP decreased from 66% in 1960 to less than 62% in 1980.

With Saddam sitting behind Iraq's steering wheel (1979-2003), what was built during three decades of sweat and toil and expenditure of over \$100 billion was all but wiped out (see Figure 8). With the start of the Iran-Iraq war in 1980 until the collapse of Saddam's regime in 2003, the Iraqi economy suffered horrendously. The destruction of Iraq's oil infrastructure at the beginning of the Iran-Iraq war coupled with a precipitous decline in oil production, caused the Iraqi GDP, which was growing at 8% per annum in real terms, to lose one-third of its value in just one year (1980-81), and continue at a stagnant level during most of the war years (see Figures 7 & 8). With the invasion of Kuwait and the

consequent Gulf war which precipitated almost the entire destruction of Iraq's infrastructure, including that of oil, Iraq's economy almost collapsed, with the GDP losing 75% of its real value during 1990-91.

The loss of domestic production was only one facet of the economic destruction that befell Iraq, the brutal sanctions years brought about hyper inflation and collapse of the Iraqi currency, wiping out in the process the savings of a large portion of the Iraqi middle class and causing its impoverishment. Since the 1991 collapse, the Iraqi economy never recovered, but continued limping at a level far below its peak in 1980.

To express that in figures, the Iraqi GDP in real 1980 prices averaged around \$13 billion during the period 1991-2007 compared with around \$53 billion in 1980, which should have continued growing in real terms at 5% per annum at least (see Figure 9). Associated with this low level of production and virtually no real growth is the lack of opportunities for gainful employment and the spread of poverty as a consequence. This is exemplified in the drastic decline, by 2007, of the Iraqi per capita income, to \$500 in real 1980 prices after peaking in 1980 at \$4,000, which was viewed at the time as one of the highest among the developing countries, with Iraq itself being considered by the United Nations as one of the most promising among emerging markets of the time.

Can the curse be turned to a blessing?

The answer is a definite yes. The horrendous Iraqi retreat, in almost all aspects, be it a result of a resource curse or the doing of inept and unscrupulous politicians is, at the end of the day, man-made. Anything man-made can be changed to the better as, the old adage says, if there is a will there is a way and, in the case of Iraq, a good will it must be.

The tragic story of Iraq tells us that, although foreign exchange generated from resource exports, oil in the case of Iraq, should be maximized to the extent possible, revenue maximization is not an end in itself or, in other words, it is not the end of the game, but only part of it. The end-game should be to prudently utilize the oil revenues for the benefit of the country. Iraq now needs a lot of rebuilding efforts which, in turn, need a lot

of money. Since the Iraqi economy got destroyed, the only source of money to finance Iraq's rebuilding efforts must come from the oil sector. This process might have to continue for a couple of decades until the Iraqi economy becomes sufficiently diversified and broad enough to act as a tax base to finance the government budgets. Furthermore, the revived economy should be vibrant and successful enough as to create a state of self-sustained economic growth without any heavy dependence on oil, as it is the situation of the Iraqi economy right now.

Conditions for a blessing

The blessing we envisage cannot happen unless two conditions are fulfilled. One condition is for the country to have enlightened governance, if not a full-fledged democracy from the outset. What we mean by enlightened governance is a form of benign rule where the citizens' human rights are secured and respected and, in parallel with that, the means of a decent material living are provided. There is now a semblance of benign rule in the smaller GCC states of the Arabian Peninsula, meaning Kuwait, Bahrain, Qatar, UAE and Oman.

In the case of Iraq, and after all of what the Iraqi people went through, a democratically elected government is the only form of government that can be accepted. Furthermore, such Iraqi government would have to be enlightened enough to realize and act upon the goal that a political solution to the present Iraqi predicament, acceptable to all Iraqi players, based on the key tenet of inclusion and not exclusion, should be attained – and sooner rather than later. This solution is absolutely essential for the political stability and domestic security of Iraq, both of which act as the bedrock supporting and allowing for the other required condition to work, that is the realization of a state of sustained economic development, necessary to provide decent material living for the people.

Economic development

Although respect for human rights in a country is absolutely necessary, it is not sufficient in itself for the citizens of that country to enjoy a decent living standard; a vibrant and successful economy is needed. The key to turning the curse to a blessing in the case of

oil-rich Iraq is to utilize the country's oil riches to rebuild Iraq's battered infrastructure, provide for good healthcare and education systems, and use the surplus money as a stop-gap finance source for government budgets until a state of diversified tax-based self-sustaining economy is reached.

This desired state of the Iraqi economy, or the state of sustainable economic growth, does not just happen by itself. Good planning and sincere efforts are needed to reach this state. There are good examples of successful economies attained in a myriad of developing countries Iraq can emulate. One must caution, however, that a successful economic development paradigm in one country may not be fully suitable for another, and economic development planners in a certain country must, somehow, tailor their development plans to fit the specific needs and peculiarities of the country in question in order to launch it on a path of successful economic development³.

There are, nevertheless, generally agreed-upon conditions and steps Iraqi politicians and planners can incorporate in a national development strategy to revive the Iraqi economy and send it on the course of a development trajectory. Some of these steps would be to redress past mistakes committed by former Iraqi regimes, and some of them can be viewed as necessary ingredients of a recipe needed for creating the conducive environment for economic development and self-sustaining growth⁴.

Adopting a market economy

From the beginning of the formation of the modern Iraqi state, the Iraqi economy grew under a market environment dominated by the private sector. With the increase in the country's oil revenues, the Iraqi government, through acts of direct investments, created an expanding public sector engaged in all sorts of economic activities, including mining, manufacturing and provision of services. This public sector obtained a big boost with the

³ See "Muhammad-Ali Zainy, *The Iraqi Economy: Past, Present and Future Options* (London, Al-Rafid Publishing, 2003, in Arabic), Chapters 1 & 16.

⁴ See "Muhammad-Ali Zainy, *The Iraqi Economy: Present State and Future Challenges* (EMIRATES LECTURE SERIES 54 (English) and 103 (Arabic). The Emirates Centre for Strategic Studies and Research, UAE).

nationalization, in 1964, of private sector enterprises worth around \$200,000 and larger, and then became the dominant sector in the aftermath of Iraq's skyrocketing oil revenues as of the mid-1970s and the ensuing heavy public investments in industry and other sectors of the economy.

Needless to say, socialist and public-sector dominated economies proved to be a failure all over the world, and Iraq was no different. Consequently, the Iraqi authorities need to get rid of these loss-making public enterprises and keep the government away from economic activities normally mastered and efficiently carried out by the private sector. The role of the government would, then, be confined to that of an honest broker and not a major economic player. Under this role, the Iraqi government should adopt a market-friendly approach and, at the same time, let the efficient private sector work, and only intervene where the market fails.

The market (the private sector) most likely fails in areas where the government is expected to be the major provider at low, often subsidized, cost where the private sector cannot realize acceptable level of profits without making heavy charges. Such charges, however, are normally viewed by the public as exorbitant, thus causing the private sector to shun such activities, or minimize them to such areas where acceptable level of profits are realized. The areas where the private sector fails – for lack of profits – and where government should assume the major provider role would be building the country's infrastructure, protecting the environment and providing such public services as education, health care and social security.

Economic restructuring

For the Iraqi economy to be successful it needs to undergo several steps of economic restructuring. Although adopting a market economy is, indeed, the major step in the direction of economic restructuring, there are other necessary steps which need to be taken to create a proper environment for a successful emerging economy. These steps include providing an independent legal system for the protection of property rights and resolving commercial disputes, high level of transparency, corruption-free environment,

minimum bureaucracy, reasonable tax regime, skilled labor force and adequate infrastructure. These, in turn, will open up the domestic environment for foreign direct investment (FDI), with its associated inflow of capital, technology and management expertise.

Sustainable growth

The ultimate aim in the case of Iraq's present dual economy (i.e. the case of being oil dependent) is to reach a state of economic diversification whereby this duality is abolished and dependence on the oil sector is eliminated. Coupled with this would be a situation of self-sustained economic growth whereby the Iraqi economy grows, in real terms, at least at 2-3% per annum over and above the population growth rate, thus securing a continuous improvement in the people's standard of living. This cannot, of course, be brought about, without securing the conditions that support such ultimate goal.

These conditions would be:

1. Macroeconomic stability: controlling fiscal and current account deficits, keeping inflation in check and securing a stable exchange rate for the country's currency.
2. Deep financial markets: organizing the country's financial system, encouraging domestic savings, inviting foreign capital and increasing banking competition.
3. Openness to trade: lowering import barriers, improving efficiency of domestic industry and encouraging transfer of technology.
4. Quality of government: providing adequate infrastructure, enforcing a proper legal system for doing business and resolving disputes and providing a vast array of other services.
5. New economy: propagating the use of information and communication technology and use of the internet.
6. Education: placing less emphasis on rote learning and dependence on memory, and more emphasis on scientific research and analysis and the practical application of knowledge.
7. Fulfilling such other conditions as providing good and adequate infrastructure, enforcing the rule of law, minimizing red tape and insuring a non-corrupt environment.

The conditions as enumerated above are necessary but not sufficient in themselves to create a state of self-sustained economic growth. There are, what some economists call, engines of economic growth. Some of these engines can be summarized as:

1. Easy start-ups and friendly environment for entrepreneurs.
2. Low tax rates and small government.
3. High rate of capital accumulation.
4. Innovation and inward transfer of technology.
5. Export promotion of non-natural resources.

Conclusion

The resource curse could be true in many ways. One way is to produce spoiled governments and spoiled peoples. Spoiled governments are produced in the sense that, having secured a large source of unearned income (oil rent in the Arab case) sufficient – and often more than sufficient - to finance its activities, the government of a rentier state has a propensity to become autocratic, unaccountable and dissociated from the interests and aspirations of its people. Additionally, such government will keep dragging its feet and will not sincerely endeavor to build a successfully diversified tax-based economy as long as its unearned income keeps flowing. Also, in a rentier environment, spoiled peoples are produced in the sense that, enjoying the overflow of a natural resource bounty and, at the same time, not having to pay taxes, the people of a rentier state become inclined to be lax and tolerant of autocratic traditions, and sometimes even complicit with their government by looking the other way when transgressions against the people and the state are committed.

In the case of Iraq, however, to use the word spoiled is to be most charitable. From the beginning of the formation of the modern state of Iraq, the successive governments of this country, regardless when Iraq was resource-poor or after it became resource-rich, had always been undemocratic and often ruthless, and when Saddam came to power his government became criminal in the full sense of the word.

When Saddam took over absolute power in the summer of 1979, he presided over a rich country with wonderful infrastructure and good public services, a strong and healthy economy expanding at a fast rate of 8% per annum in real terms, and a treasury of foreign exchange reserves of \$35 billion. All of that was dissipated in a matter of two decades of tyrannical rule and foolish military adventures, which left Iraq under a huge burden of \$120 billion foreign debts, battered infrastructure, rampant unemployment, collapsed services system and a crippled economy.

All of this tells us that, yes, it is quite prudent to have a proper oil law whose mandate would be to protect the country's oil riches and maximize their monetary value to the Iraqi people. However, maximization of the value of oil revenues to the country is not an end in itself but a means to an end. The end, broadly speaking, is to build the country. In order to achieve this noble cause, those Iraqis in charge must devote their sincere efforts to prepare the conditions for a blessing, in the way described above.

Figure 1: Values of oil exports and total exports of Arab member countries of OPEC in 2006 (\$billion)

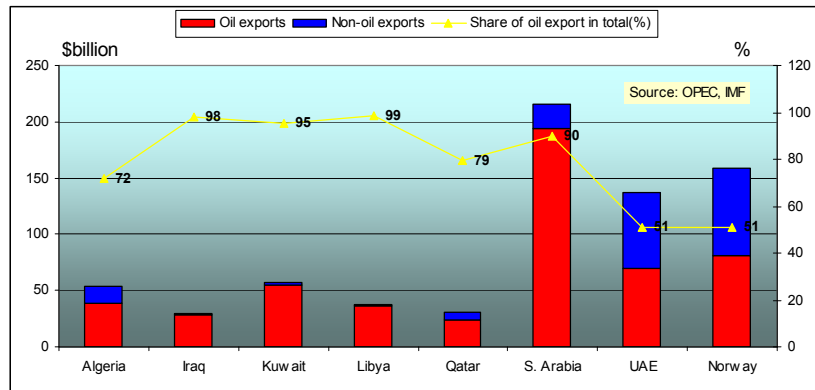


Figure 2: Contribution of oil sector to GDP of Arab member countries of OPEC in 2006 (\$billion)

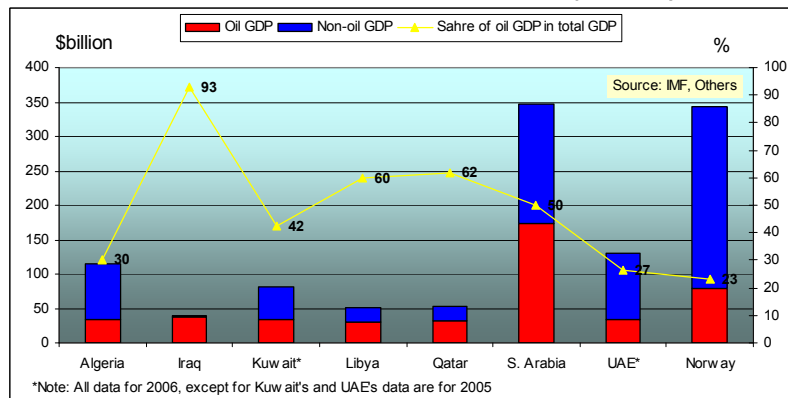


Figure 3: Contribution of oil export revenues to government budgets in Arab member countries of OPEC in 2006 (\$billion)

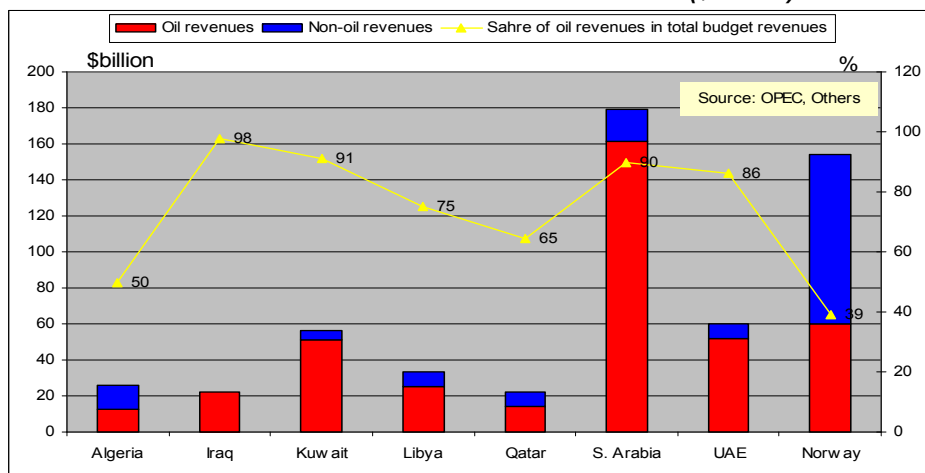


Table 1: Selected economic indicators of Arab members of OPEC and Norway (2006)

	Share of oil exports in total exports	Share of oil GDP in total GDP	Share of oil revenues in total budget revenues
Algeria	72	30.0	50
Iraq	98	93.1	98
Kuwait	95	42.3	91
Libya	99	60.0	75
Qatar	79	61.9	88
S. Arabia	90	50.1	90
UAE	51	26.6	86
Norway	51	23.1	39

Source: Various (including OPEC and IMF)

Table 2: Corruption in MENA countries (2007)

Country	Country Rank	Regional Rank	CPI Score 2007
Israel	30	1	6.1
Qatar	32	2	6.0
UAE	34	3	5.7
Bahrain	46	4	5.0
Oman	53	5	4.7
Jordan	53	5	4.7
Kuwait	60	7	4.3
Tunisia	61	8	4.2
Saudi Arabia	79	8	3.4
Algeria	99	10	3.0
Lebanon	99	10	3.0
Egypt	105	12	2.9
Mauritania	123	13	2.6
Yemen	131	14	2.5
Libya	131	14	2.5
Iran	131	14	2.5
Syria	138	17	2.4
Sudan	172	18	1.8
Iraq	178	19	1.5
Somalia	179	20	1.4

Source: MEES, 22 October 2007

Figure 4: Chile's real GDP index during 1961-2007 (1970 = 100)

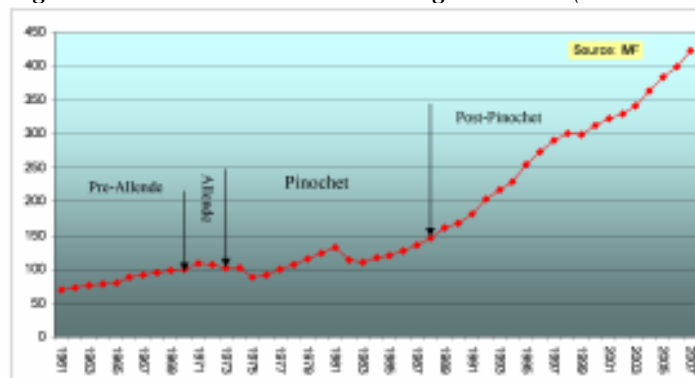


Figure 5: Real GDP index of Libya and the UAE during the period 1980-2007 (1990 = 100)

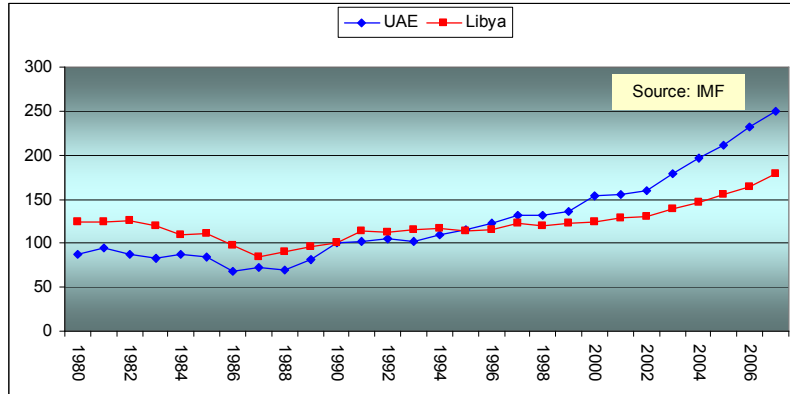


Figure 6: Saudi real GDP index during 1969-2007 (2007 = 100)

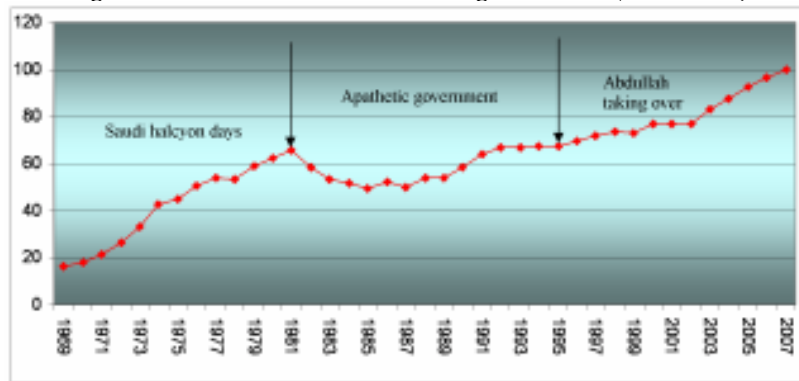


Figure 7: Iraqi oil production, export and oil revenues over the period 1960-2007

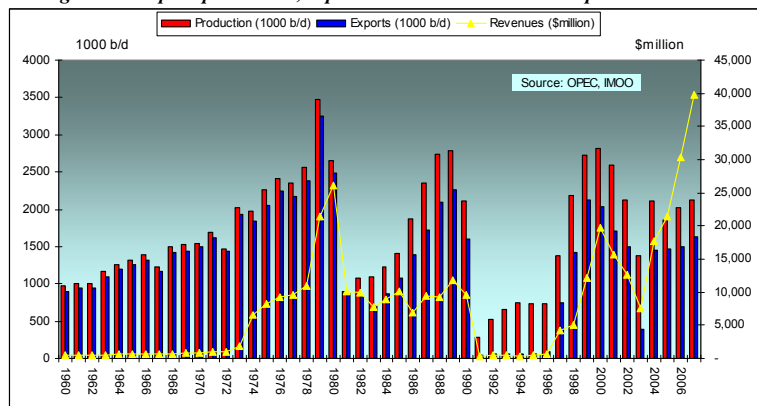


Table 3: Real annual growth of the Iraqi GDP during 1960-80 (%)

Agriculture, fishing & forestry	2.6
Mining & quarrying	7.6
Manufacturing industries	10.8
Electricity, water & gas	12.5
Construction	16.7
Total Commodity sectors	7.6
Total distributive sectors	8.6
Total services sectors	11.5
Total GDP at factor cost	8.0

Source: Iraqi CSO

Figure 8: Iraqi real GDP index during 1969-2007 (2007 = 100)

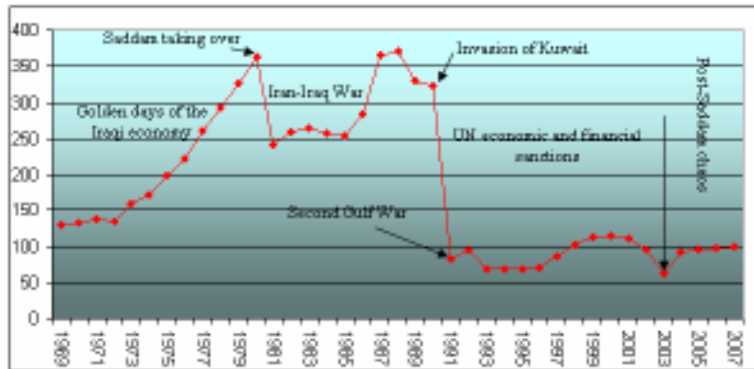


Figure 9: Iraqi GDP in real 1980 prices (1960 – 2007)

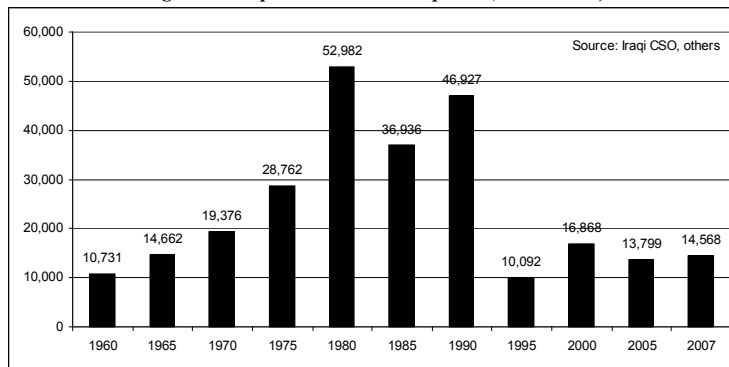


Figure 10: Iraqi per capita income in real 1980 prices (1960-2007)

