

Challenges Facing the Iraqi Economy

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Brief Analysis

As Iraqi elections rapidly approach despite an entrenched and violent insurgency, the country's economic challenges are extensive. The government is faced with the momentous task of transforming a war torn, state-dominated economy into a transparent, investment-friendly institution, all during the course of daily political violence.

Problems Inherited from the Former Regime

The Interim Iraqi Government faced considerable economic challenges as it headed into the Second U.S.-Iraqi Joint Economic Commission in Washington, D.C. While the government transforms an economy dominated by a large and inefficient public sector, it is hampered by problems inherited from the former regime and exacerbated by a virulent insurgency.

The government faces debts and reparation obligations in the hundreds of billions of dollars. Iraq's debt materialized over two decades ago when Saddam borrowed heavily from sympathetic neighbors to finance a war against Iran's regime. Saddam's invasion of Kuwait two years after the conclusion of the Iran-Iraq War added to the regime's financial obligations, which then included war reparations on top of the debt accrued from borrowing.

The Paris Club of major industrial countries agreed that each country would forgive at least 80 percent of Iraqi debt. Building on this momentum, on December 17 the United States signed a 100 percent debt cancellation agreement with Iraq. While the government still owes billions of dollars in debt and reparation payments, these substantial agreements send a signal to Iraq's more demanding allies that compromise can and should be reached. There are hopeful indications that some other countries will follow the U.S. lead in granting Iraq more relief than the minimum dictated by the Paris Club accord; indeed, Russia, which was one of the last to agree to the Paris Club terms, has now proposed forgiving 90 percent of Iraqi debt. While Saudi Arabia and Kuwait, among others, are hesitant to make such hefty contributions to Iraq's financial well being, it is important to bear in mind the value of an economically healthy and stable partner rather than a crippled, indebted neighbor.

The oil infrastructure on which the economy is so dependent remains particularly vulnerable to sabotage. More than 95 percent of Iraq's budget comes from oil revenues. It is currently producing less than 2.2 million barrels per day while aiming for a long-term production goal of 4-6 million barrels per day. At present, Iraq is confronting both political and economic challenges to ensure continued profitability from its primary natural resource. The country is dependent on an oil infrastructure built in the 1950s and 1960s that is in need of significant repair if oil is to provide sustained revenue. Furthermore, the pipeline system is the target of disruptive sabotage attacks, and oil ministry officials are often targets of attack as well. The government must confront attacks against oil pipelines on two fronts, as the motivations for attack differ in the north and the south of the country. While attacks on northern pipelines are typically politically motivated and characteristic of the Sunni-led insurgency, attacks on southern pipelines usually occur when individuals sabotage the lines and siphon off oil to sell on the black market. It is noteworthy that the state produces over 2 million barrels of oil per day and exports just under 2 million barrels, despite suffering constant attack.

How Iraq Is Facing Its Challenges

The Iraqi Ministry of Finance is actively encouraging private investment as it seeks to limit the once-dominant public sector inherited from the former regime. The government instituted new laws governing investment and banking in an effort to increase transparency and create an independent central bank. The United States took the lead in injecting investment into Iraq by approving over \$18 billion to fund development and reconstruction projects. On December 6, the World Bank signed three grant agreements totaling \$145 million for similar projects. While foreign states and institutions are investing in Iraq's future, the insurgency guarantees that characteristically simple projects will take significant time and perhaps numerous attempts to complete.

In addition to negotiating solutions to external debt crises, the new government has successfully controlled inflation while rebuilding a devastated infrastructure. It has introduced a unified currency, the New Iraqi Dinar, which is circulating throughout the country; however, some counterfeit dinars appear to be in circulation, especially in the south of the country.

Article seven of the Transitional Administrative Law clearly states that the official religion of Iraq is Islam and that laws should not violate sharia. The aim is to avoid a government dictated by religion while simultaneously ensuring that laws are consistent with the spirit of sharia. One issue is the potential for conflicts of interest between the financial system and Islamic law as Iraq seeks to transform its economy and become a competitive international player. While the sharia text may be at odds with contemporary international financial practices, the government is determined to implement the values of Islamic law rather than every detail of the hard text.

Perhaps the country's most tangible problem is the Sunni-based insurgency that daily influences the lives and activities of all Iraqis. The primary sources of funding for the insurgency appear to be former Baath officials. Saddam withdrew about \$1.2 billion from the central bank prior to the U.S. invasion and distributed this money to finance a sustained insurgency. Money collected in mosques and contributions from neighboring Syria and Iran are only secondary and tertiary sources of financing. The fortunes of the former regime continue to finance operations to destroy infrastructure, intimidate Iraqi citizens, and target coalition forces.

The Iraqi Interim Government is determined to go forward with elections on January 30. Successful elections are essential to the establishment of a legitimate regime, one that can institute the changes necessary to ensure political and economic development. Despite misconceptions that Iraqis in Sunni regions are not registering to vote, election officials have witnessed overwhelming participation at registration in Baghdad, Mosul, and Tikrit, all of which contain majority Sunni populations. The election results will certainly be followed by complaints from various communities; Sunnis will be hesitant about a Shiite majority government and Shiites may be disappointed if the election results fail to meet their lofty expectations. While the results may very well establish a Shiite majority in the Assembly, Iraqi politicians are committed to a government that refuses to impose decisions on an unwilling minority. Much as the Interim Governing Council operated on the basis of consensus, so too there will be a strong commitment in the new Assembly to seeking a broad majority. Politicians in the Shiite community are fully sensitive to the need to reassure other Iraqis that their interests will be protected under the new government.

Iraq also faces a precarious situation with regard to its relationships with its neighbors. Iraqi cabinet members have accused Syria of protecting former regime members, financing insurgent activities, and providing border crossing for insurgents from a variety of Arab countries. Iran, too, has been accused of attempting to influence Iraq's political future by sending in thousands of Iranian officials and injecting substantial amounts of money into Shiite election campaigns. Despite current disputes and past accusations, the Iraqi government strives for cooperative relationships while avoiding interference in one another's affairs.

The Interim Iraqi Government has overcome substantial obstacles to establish a framework within which to

approach economic regeneration. New laws have been established in an effort to encourage investment and transparent banking. And while passing laws is relatively simple, the implementation of legislation requires patience and social acclimation.

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