KEY CHALLENGES FOR IRAQ: A WAY FORWARD FOR EU AND GULF INVOLVEMENT

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INTRODUCTION

Relations between the Gulf Cooperation Council (GCC) states and Iraq have been strained for the past 30 years, ever since Saddam Hussein ordered his forces to invade Kuwait in 1990. However, the election of Prime Minister Adel Abdul-Mahdi in 2018 and the eventual establishment of a new Iraqi government in October, has led to a distinct shift in the tenor of this previously tense relationship and, many believe, augurs well for the renewal of stronger and much more positive Gulf-Iraq relations at the same time that the European Union (EU) is similarly taking a closer interest in strengthening its involvement in Iraq.

In February 2018, the Gulf states pledged to invest substantial resources to help rebuild Iraq. A year later, the GCC and Iraq are continuing to pursue a comprehensive, strategic dialogue that, it is hoped, will lead to the agreement of a comprehensive GCC-Iraq Plan of Action. And in mid-April 2019, Prime Minister Abdul-Mahdi, at the head of a strong ministerial and business delegation, was warmly received in Riyadh by King Salman where economic agreements worth more than $1 billion were concluded. This series of top-level meetings seems to bode well for a decisive change in the Gulf’s relationship with Iraq that will be to the benefit of the wider international community, and chimes with the European Union’s parallel efforts to support the Abdul-Mahdi administration.

Despite continued political instability inside Iraq and chronic economic uncertainty, it is noteworthy that, over the past five years, Iraq has re-established its position as the world’s fourth largest oil producer, pumping 4.50 million barrels per day in March 2019 with an aspiration to produce more than 5 million bpd by the end of this year. Within the region, it is now second only to Saudi Arabia as an oil-producing nation in terms of both output and reserves. In contrast, despite being assessed as holding the world’s 13th largest reserves of gas, Iraq’s role as a gas producer remains negligible.

Table 1: Major Oil Producers

<table>
<thead>
<tr>
<th>Producer</th>
<th>Oil (barrels per day – [bpd])</th>
<th>Natural Gas (million cubic metres)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Saudi Arabia</td>
<td>9,794,000</td>
<td>102,300</td>
</tr>
<tr>
<td>Iraq</td>
<td>4,522,000</td>
<td>880</td>
</tr>
<tr>
<td>Iran</td>
<td>3,991,000</td>
<td>184,800</td>
</tr>
<tr>
<td>United Arab Emirates</td>
<td>3,059,000</td>
<td>54,240</td>
</tr>
<tr>
<td>Qatar</td>
<td>4,800,000</td>
<td>165,000</td>
</tr>
<tr>
<td>Kuwait</td>
<td>2,709,000</td>
<td>13,530</td>
</tr>
<tr>
<td>Oman</td>
<td>978,000</td>
<td>36,940</td>
</tr>
<tr>
<td>Bahrain</td>
<td>210,000</td>
<td>12,620</td>
</tr>
</tbody>
</table>
 Nonetheless, Iraq still faces uncertainty and will require support and assistance to build a sustainable economy, create new employment and spur the development of new trade and industry.

The new leadership has been generally portrayed as a ‘technocratic administration’. The 76-year-old Adel Abdul-Mahdi, widely seen as a non-sectarian politician, was nominated to form Iraq’s new government under the presidency of Barham Salih in October 2018. Abdul Mahdi was swift to acknowledge the need to ensure that there can be no resurgence of Islamic State (Daesh) (IS) and that Iranian influence be curbed.¹

The establishment of this non-sectarian and pragmatic new government, clearly offers the GCC states an opportunity not only to invest in the reconstruction and development of Iraq for future long-term economic advantage, but also to explore opportunities for drawing Iraq back into the fold of moderate Arab states so that extremism, sectarianism and corruption can be reduced as threats to the region.

The outcome of the May 2018 election has been interpreted as signalling a strong public appetite for change amongst ordinary Iraqi voters, weary after 15 years of conflict, uncertainty and violence. So politically and economically, it seems that Iraq should be poised for an upturn in its fortunes.

This moment of potential opportunity is not only significant for the GCC and its member states, but also for the European Union (EU). Tensions between Europe and Iraq predate the US-led invasion of 2003 and its unsatisfactory aftermath, but today it is evident that relations are again on an upward path. At the end of April 2019, Prime Minister Abdul-Mahdi visited Germany for meetings with Chancellor Angela Merkel. At the subsequent news conference, Mrs Merkel declared: “I have once again clearly expressed our support for the territorial integrity of Iraq. We have very intensive relations with the regional government in Erbil, but always as an integral part of Iraq, and we will continue to follow this approach.”² On the same day, the Iraqi government and Siemens agreed to contracts worth €700 million ($785 million) for the construction of a 500 megawatt gas-fired power plant, the upgrade of 40 gas turbines and the installation of 13 substations and 34 transformers across Iraq, arguably emphasising the economic importance of Iraq for Europe — and not just in the oil and gas sector. In March 2019, the Iraqi leadership also met with senior representatives from the EU, including the High Representative for Foreign Affairs and Security Federica Mogherini, in Tunis. In the wake of that meeting, a statement issued by the European External Action Service underscored the commitment of the EU “to continue investing in Iraq’s stability” and declared the EU’s determination “to deepen the EU-Iraq relationship. It concurred on the importance to sustain

the ongoing work of the Government on reconstruction and comprehensive reforms, focusing on priority issues and on the needs of all Iraqi citizens.”

Against this backdrop of cautious optimism, this paper examines how the Gulf States and Europe might seize the opportunities of this moment in order to cement the recent gains in Iraq’s political, economic and security environments while seeking to mitigate the threats and tensions that remain.

**Iraq: An Assessment of the Present Situation**

Ahead of the May 2018 elections in Iraq, Kuwait hosted a donor conference in February aiming to secure further international commitments for the reconstruction of Iraq. According to the then government, the war with IS had destroyed 70,000 houses and partially destroyed a further 140,000 in Mosul alone. Then Prime Minister Haider al-Abadi declared that to rebuild Mosul and other areas of Iraq destroyed by IS would require $88 billion. The donor conference resulted in commitments to Iraq of $30 billion in loans, credit and foreign direct investment (FDI).

However, once again, donor anxiety was strongly evident in the face of previous wasted effort and residual concerns over the high levels of corruption that are seen as endemic to Iraq. In particular, some observers suggested that reluctance on the part of the Gulf states to contribute to the rebuilding effort indicated continued concern regarding the outlook for Iraq and the extent of Iran’s influence over whichever government was in power in Baghdad. As Margaret Coker wrote in the *New York Times* at the time: “Given years of estranged relations between Iraq and its Gulf Arab neighbours, few companies have tried to penetrate the Iraqi economy, and it is unclear what sort of risks they would be willing to assume, even with government loan guarantees.” It is noteworthy that the EU seems similarly cautious, committing just €185 million to reconstruction and stabilisation in Iraq since 2016, and that mostly through investment in UN programmes.

The newly elected government of Iraq is widely regarded as offering the chance of a less sectarian and more technocratic administration that is expected to be less ideological in outlook, less likely to be influenced by Iran and one which recognises the urgency of delivering economic reform to lay the foundations for long-term stability. With the IS militarily defeated within the borders of Iraq and growing indications of Iraqi public disquiet over the extent of

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Iran’s influence over Iraq, the new government also faces pressure to deliver on its promise to rebuild the country as a stable, economically secure and, above all, Arab state.

The defeat of IS in May 2017 raised renewed questions that Iraq commentator Charles Dunne suggested have remained unanswered since the overthrow of Saddam Hussein in 2003:

- How best to settle Iraq’s own sense of its national identity? In this regard, the old question arises of how best to assimilate a Shia majority with its Sunni and Kurdish minority communities? And how to encourage some form of national consensus that avoids continued sectarian friction and accommodates Iraq’s ethnic and religious minorities?
- The second question that the defeat of IS poses is whether Iraq’s Sunni population can accept their religious minority status and relinquish the old politics of entitlement, grievance and, in the case of IS, violence?
- Thirdly, will Iraq’s Kurds be willing to accept their own place within a future greater Iraq, accepting that the Baghdad government has a role to play in the overall political and economic direction of the country?

Source: UN Office for the Coordination of Humanitarian Affairs, https://www.unocha.org/..
The scale of the challenge left by 15 years of post-invasion sectarian discord and violence remains considerable. The most recently available figures from the UN’s Office for the Coordination of Humanitarian Affairs (OCHA)\(^7\) show that in June 2018, out of a total population of 38.2 million, 8.7 million continued to be classified as ‘People in Need’; 3.4 million were ‘People Targeted for Assistance’; and there were 4.1 million ‘Children in Need.’ As of the end of August 2018, OCHA continued to classify 1.92 million people as ‘Internally Displaced’.

It is hardly surprising that the worst affected by the challenge of internal displacement are the governorates most directly affected by the onslaught of IS.

The distribution of the number of Sunni who remain internally displaced, particularly in the governorates of Ninewa and Sulaymaniyah, underscores one of the key challenges for Iraq’s Sunni communities: how best to align with the new government in Baghdad. The infrastructure in these provinces remains poor, and in some places almost non-existent. Moreover, OCHA research suggests that Sunni communities continue to be distrustful and disaffected with the central government.

That said, it now also seems clear that these same Sunni minority communities have little wish to repeat previous experiments of placing trust in extremist groups – notably Al-Qaeda in Iraq in 2005 and IS in 2014. The negative outcomes have been self-evident. Further complicating the situation inside Iraq is the influence of Iran, most obviously seen in the predominantly Shia Popular Mobilisation Forces (PMF) which were instrumental in the defeat of IS and the recapture of Mosul and Iraq’s northern territory.

The bottom line is that the choices currently facing the Abdul Mahdi government remain complex and interdependent. These choices can be summarised as follows:

- To what extent will the new government be more willing and successful than previous Iraqi administrations in working closely with international donors, both to rebuild Iraq’s infrastructure and address residual humanitarian challenges? It seems probable that this will continue to be seen as one of the key determinants of whether the Abdul Mahdi government is judged a success or failure.
- Secondly, even though the new administration is seen as “technocratic,” it will have to engage in a process of reconciliation as well as reconstruction. Any initiative, however, could still be dogged by suspicion among Iraq’s Sunni community and by Kurdish ambitions for further autonomy.
- Thirdly, the new administration has to address the high levels of corruption that have become endemic at all levels of the Iraqi government. If corruption is not significantly reduced, international donors are likely to remain wary of committing funds for reconstruction, while normalising economic activity will remain an

\(^7\) UN Office for the Coordination of Humanitarian Affairs (OCHA), Iraq, June 2018.  
unresolvable challenge. Corruption throughout Iraq has also eroded public trust and confidence in successive governments and again will be seen as a key test for the success or otherwise of the Abdul-Mahdi administration.

*While Iraq is once again producing significant quantities of oil, further infrastructure and economic reconstruction is vital if resulting revenues are to be capable of building a new economy for the benefit of all. Iraq’s refining capacity was adversely affected by IS damage to the country’s largest refinery at Baiji. Currently, only two refineries remain fully operational at Doura near Baghdad and Shuaiba near Basra.

Table 2: Iraqi Oil Production

![Graph showing Iraqi Oil Production](source)

*On the strategic side, how much Iraq is able to reset its relations with Iran will be critical to the success of the new government. Over the past 15 years, Iran has worked hard to build its influence within Iraq, most notoriously during the years of the determinedly sectarian leadership of Nouri al-Maliki. But it is too simplistic merely to dismiss Iraq as merely a Shia satellite of Tehran. Importantly, Iraq is first and foremost an Arab state and how Prime Minister Abdul-Mahdi is able to rebuild Iraq’s place in the community of Arab nations will be a vital component of any future success.

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*A further question concerning Iran’s residual influence will be the extent to which the new government is successful in incorporating the Iran-dominated PMF militia forces into the Iraq Security Forces (ISF). This too is likely to be a key determinant in rebuilding trust between the country’s Shia and Sunni communities.

*Continuing to build on support from both the United States and Europe will also be important to bolster international confidence. To this extent, Prime Minister Abdul Mahdi will need to reach a new agreement concerning the extent of US military collaboration. A continuing US presence in Iraq, currently comprising 5,200 troops, remains controversial with some elements of Iraq society, not least
the Shia PMF and Moqtada al-Sadr’s supporters. It also remains a source of friction with Iran, where the Supreme Leader Ayatollah Ali Khamenei recently told an audience: “You must make sure that the Americans withdraw their troops from Iraq as soon as possible.”

Equally, the presence of foreign forces, particularly from the US, is recognised as reassuring to both Sunni and Kurdish communities. At the end of March 2019, President Barham Salih observed there was "general consensus" that Iraq needed to maintain collaboration with US forces, which he said can go on "as long as it is necessary." He also warned that the threat from IS was far from over, despite its defeat in Syria earlier in 2019.

Finally, the extent of GCC and the EU’s involvement in Iraq seems likely to be defined by the extent to which the Abdul-Mahdi government will be successful in addressing many of the issues outlined previously. It is routinely argued that a root cause of the instability in the entire Arab region is Iran’s deliberate meddling which has encouraged the development of sectarianism and extremism. In 2005, in the wake of the US-led invasion of Iraq, Saudi Arabia’s then King Abdullah declared: “Whereas in the past the U.S., Saudi Arabia and Saddam Hussein had agreed on the need to contain Iran, U.S. policy has now given Iraq to Iran as a ‘gift on a golden platter.’”

And while the GCC states have begun to rebuild their ties with Baghdad, the overall relationship remains tentative – even under Iraq’s new leadership.

However, it would also be wrong to be overly pessimistic about the current situation inside Iraq. With the effective defeat of IS, the outlook for peace and stability is rising. Overall numbers of security incidents have been much reduced over the past decade. There are also clear signs that the Mahdi government is starting to attract support from around the world, helping to build confidence for Iraq’s long-term future. For the Gulf states, as for Europe, Iraq is therefore starting to be regarded as an opportunity, not only to roll back Iran’s influence in the region but also as a potential strategic and economic partner.

**Opportunities in Future Iraq**

In May 2012, the US-based Brookings Institution published an interview with long-time GCC observer, F. Gregory Gause. Together with Robert Tollast, he examined the extent to which the then Maliki government would be able to work with Gulf leaders to resolve Iraq’s still pre-IS levels of violence and take advantage of the estimated 43 billion barrels of oil still lying

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beneath the Iraqi desert. The year 2012 had already witnessed the reopening of the Saudi embassy in Baghdad, a reopened pipeline to the Saudi port of Yanbu was being actively considered, and hopes were high that GCC-Iraq rapprochement could underpin stabilisation and the restoration of peace in Iraq’s troubled land. It was not to be.

Gause pointed out that Saudi Arabia would require Maliki to show that his government was prepared to take “some very significant steps” to demonstrate independence from Tehran before Riyadh would consider closer relations with Baghdad.

Seven years on, it is evident that some fundamental shifts have occurred in Iraq that should allow for a deeper relationship with the GCC states to develop once more. Not only has Iraq emerged successfully from the challenges posed by IS, but it now appears that there is much less talk of a need to break up the nation along sectarian lines. Moreover, at the close of 2018, Iraq not only had new leadership with strong international support but Iran appeared more constrained in its ability to expand its influence further in the country because of its own economic challenges, exacerbated by the re-imposition of US sanctions in November 2018 following the Trump administration’s decision to withdraw from the 2015 nuclear accord – the Joint Comprehensive Plan of Action (JCPOA). It must be stressed that, similar to the situation in Syria, Tehran will not extend Baghdad the necessary economic assistance to help in recovery efforts but instead will focus its efforts almost exclusively on the type of security relations that Iran wants to see enacted. This, however, is not a medium-term stabilization strategy which in turn opens the door for the GCC states to contribute positively to the security environment in Iraq.

Accordingly, from the Arab Gulf’s perspective, it seems that Iraq is at a stage where its new government may be more warmly disposed to Gulf involvement and investment than it has been at any time over the past 15 years. This new aura of optimism was further underlined in April 2019 when Prime Minister Abdul-Mahdi made his first official visit to Saudi Arabia where he was received by both King Salman and the Crown Prince, Prince Mohammed bin Salman. The Iraqi leader declared on his Facebook page that his visit to the Kingdom “symbolizes the Iraqi government’s vision in aiming to bolster ties with the Kingdom in all fields.” The two countries signed 12 agreements and memorandums of understanding between their various ministries. The deals covered several sectors including energy, education, culture and political consultation.

The current situation, therefore, presents a key opportunity for the Gulf states not only to show increased willingness to solve the strategic challenges posed by Iraq, particularly in the context of Iran and Turkey, but also to help transform the country into a stable, economically productive and reliable member of the Middle Eastern region. Arguably, this is about much

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more than merely rebuilding infrastructure or developing new commercial opportunities. It is about seizing a unique and historic moment in Iraq and the Middle East’s history.

**Potential for Iraq Involvement in Pan-Gulf Initiatives**

Leaving aside the long list of political and economic challenges that continue to confront Iraq’s leadership, in the context of this paper, it is worth considering Iraq’s capacity and potential to be involved in several pan-GCC initiatives that would bring Iraq more closely into alignment with its neighbouring Gulf states.

*Energy Supply*

In June 2018, Iran severed electricity supply to the Iraqi provinces of Ziqar and Meysan, largely because of Iran’s domestic electricity requirements and also because of funding issues. In September 2018, German provider Siemens announced that it was in discussions with the Iraq government to rebuild the country’s power generation infrastructure. Siemens President Joe Kaeser told CNBC\(^\text{12}\) that his company’s proposal hoped to generate sufficient power within three months to meet the needs of 300,000 Iraqis. Siemens also said that it was ready to add 11 Gigawatts of power generating capacity to help rebuild Iraq – meeting the needs of 23 million Iraqis – more than half the country’s population. As has already been noted, the agreement for the first stage of this strategic project worth an estimated €700 million was signed during Prime Minister Abdul-Mahdi’s visit to Berlin at the end of April 2019.

In October 2018, the UAE government confirmed that it was in talks with both Saudi Arabia and Kuwait regarding proposals to link the GCC common grid to provide electricity to southern Iraq. Matar al-Neyadi, Under-Secretary for Energy and Industry, confirmed that “the GCC Interconnectivity Authority is examining with Iraqi authorities a grid link with the southern Iraqi province of Basra.”\(^\text{13}\) He also confirmed that the GCC produces around 100 Gigawatts annually leading to a 70 per cent surplus during the winter months.

The 2018 summer’s unrest due to electricity shortages across southern Iraq, and Iran’s evident lack of capacity to sustain its previous supply of power to its neighbour, suggest that a move to link Iraq to the GCC Interconnectivity grid would not only offer important, immediate support to the Iraq government but would also provide an early opportunity for the Gulf states to demonstrate their economic and humanitarian commitment, particularly to southern Iraq. Accordingly, this could be seen as a ‘quick win’ in consolidating new relations

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with Iraq while, at the same time, it would remain a contribution that could also be easily reversed, should progress not be made and the situation in Iraq deteriorate once more.

**Oil and Gas Infrastructure**

While Iraq may have regained its place as the world’s fourth largest oil producer, one of the greatest economic challenges still confronting the country is how to improve the movement of this oil to market. Over the past 35 years, conflict, sanctions and terrorist violence have cut supplies of Iraqi oil to its traditional markets. In 2017, then oil minister Jabar al-Luaibi announced a new plan for a pipeline network that would provide a more reliable alternative to expensive and hazardous reliance on road transport. Currently, the only long-distance pipeline still functioning in Iraq is the link from Kirkuk to Ceyhan in Turkey, which has a usable capacity of about 300,000 bpd. Previous plans to expand the capacity of this pipeline to more than 1 million bpd have never been realised.

In October 2018, the Basrah Oil Company (BOC) announced ambitious plans to reach 5 million bpd export capacity by 2025. However, to realise such strategic ambitions, BOC’s Director General Ihsan Ismaael explained that three new sub-sea export pipelines would be required that together would add 3 million bpd capacity by replacing the old pipeline connecting to the Khor al-Mayar and Basra oil terminals.

On the face of it, there is clear logic to the Gulf states investing in the development of this new pipeline infrastructure. Such a move would not only support the economic recovery of southern Iraq but also ensure that Iraq becomes more strongly focused on the Gulf waters as its safest and most secure outlet for its oil exports.

To facilitate inward investment, Iraq has established a National Investment Commission (NIC), presently led by Dr Sami al-Araj. The NIC offers encouragement and inducements to potential external investors by acting as a ‘one-stop shop’ for investment licensing, allocation of land, enabling tax exemptions and facilitating investors. The NIC also explains that “the Amendment of Iraq’s Investment Law 13 of 2006 guarantees the ownership of land by local, Arab and foreign investors for housing projects based on law No. 2 of 2010 and the amendment of the Statute (7) which organizes the lease rates for lands invested in the various fields.”

Iraq sees an urgent requirement to invest further in its energy sector. As the NIC puts it: “Iraq is blessed with vast reserves of oil and natural gas, and is one of the most underdeveloped sources of hydrocarbon resources in the world.” It is especially noteworthy that Iraq is looking to expand its crude production from 4.5 million bpd to 6 million bpd by 2020. This contrasts with refining capacity of just 500,000 bpd meaning that Iraq remains largely unable

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15 Ibid, p. 83.
to add value to its crude output and therefore remains heavily reliant on, and vulnerable to, the fluctuations of global markets. Again, in this regard, it is worth noting Iraq’s ambition to construct three new refineries: Al-Faw (300,000 bpd), Anbar (150,000 bpd) and Thi Qar (150,000 bpd). In addition, Iraq plans to rehabilitate and expand existing refineries at Doura and Basra. Overall, it is also noteworthy that 85 per cent of Iraq’s economy is dependent on oil earning 80 per cent of the country’s foreign exchange.

It also remains evident that Iraq sees its oil and gas resources not only as the foundation of its future economic development but also as the principal means of political leverage, both to attract the support of more powerful and wealthier nations but also as a means of buttressing political stability and countering Iran’s influence.

Previous Iraqi governments have already made determined efforts to resuscitate the national oil economy with previous bidding rounds giving major contracts to international companies. These bidding rounds concentrated primarily on development and reconstruction of Iraq’s existing oil fields with the aim of increasing the overall volumes of oil and gas being produced for international markets. To enable further development, the Ministry of Oil has announced an ambitious plan to increase both production and exports. Participation through direct investment is to be sought through future rounds of oil licensing. The Ministry wants to encourage participation as well as investment through standard BOOT (Build, Own, Operate and Transfer) and BOO (Build, Own, Operate) public funding mechanisms.

Accordingly, Gulf and EU participation in the development and expansion of Iraq’s oil and gas sector suggests an obvious opportunity where the GCC’s experience of ramping up its hydrocarbon sector in concert with the development of renewable sources of energy would seem to offer complementarity as well as a means of exerting stronger political influence over the direction of Iraq’s development and future role in the region.
It is again noteworthy that many of these projected oil initiatives are clustered in southern Iraq, particularly in Al-Basrah province, making them more geographically proximate to the waters of the northern Gulf.

**Other Opportunities for Investment in Iraq**

Given the widespread destruction across the country, Iraq is in need of large-scale foreign investment as one key element supporting its recovery. This was evident at the 2018 donor conference for Iraq and remains the top priority for Iraq’s government. However, the scale of this challenge remains immense, and reducing Iraq’s reliance on oil revenues is likely to remain a formidable obstacle to the development of a more balanced and sustainable economy.

**The High Demands of Iraqi Reconstruction**

Iraq officials are showcasing 177 repair, reconstruction and development projects with varying price tags. Some projects are vague and long term, like the plan to create 25,000 housing units in each of Iraq’s 19 provinces. Others are to rebuild areas devastated by fighting with the Islamic State. Most are new constructions. An estimated $188.2 billion is needed to pay for the projects, and most of the money will need to come from international donors and investors.

![Image of Iraqi Reconstruction Projects](image)

Iraq has also published a National Development Plan 2018-2022. The government emphasises that this is aimed at promoting economic diversity to improve and strengthen the private sector by raising competitiveness, encouraging export efficiency, expanding internal markets, reforming the tax system, establishing economic free zones, and developing a market economy. The Plan also emphasises that priority is to be given to the development of infrastructure projects – especially electricity, water, roads and bridges. It is noteworthy that
the National Development Plan avoids any reference to the elimination of corruption or even of new initiatives intended to stamp out ‘cronyism’ or sectarian bias.

Examination of the division of public sources of revenue reveals the extent of the Iraq government’s continued reliance on oil and minerals for most of its income.\(^\text{16}\)

### Public Revenue 2017

<table>
<thead>
<tr>
<th>No.</th>
<th>Classification</th>
<th>Amount (billion dinar)</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Oil and mineral revenues</td>
<td>67.950</td>
<td>86%</td>
</tr>
<tr>
<td>2</td>
<td>Taxes on incomes and wealth</td>
<td>3.451</td>
<td>4.3%</td>
</tr>
<tr>
<td>3</td>
<td>Commodity taxes and production fees</td>
<td>1.995</td>
<td>2.5%</td>
</tr>
<tr>
<td>4</td>
<td>Fees</td>
<td>688</td>
<td>0.8%</td>
</tr>
<tr>
<td>5</td>
<td>Budget share from public sector profits</td>
<td>886</td>
<td>1.1%</td>
</tr>
<tr>
<td>6</td>
<td>Capital income</td>
<td>125</td>
<td>0.1%</td>
</tr>
<tr>
<td>7</td>
<td>Transforming income</td>
<td>125</td>
<td>0.1%</td>
</tr>
<tr>
<td>8</td>
<td>Other incomes</td>
<td>1,104</td>
<td>103%</td>
</tr>
<tr>
<td><strong>Total revenues</strong></td>
<td><strong>79.011</strong></td>
<td><strong>100%</strong></td>
<td></td>
</tr>
</tbody>
</table>

1. Oil revenues were estimated 67 trillion dinars %86 from the total
2. Taxes revenues were estimated 6 trillion dinars %7 from the total while other revenues were %7

Analysis of the performance of Iraq’s stock exchange over the last two years shows mixed fortunes for different categories of Iraq’s private sector.\(^\text{17}\) While Insurance, Manufacturing Industry, Hospitality and Tourism, Agriculture and Telecommunications have all seen solid growth in 2016 and 2017, Banking, Investment and the Service Sector saw sharp declines:

### Table 13

<table>
<thead>
<tr>
<th>Sector</th>
<th>Rate to total %</th>
<th>Years</th>
<th>2016</th>
<th>2017</th>
<th>The change rate from 2016 %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking</td>
<td>79.0</td>
<td>1</td>
<td>312946.1</td>
<td>305821.5</td>
<td>-2.3</td>
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<tr>
<td>Insurance</td>
<td>0.3</td>
<td>7</td>
<td>436.9</td>
<td>1036.5</td>
<td>135.9</td>
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<tr>
<td>Investment</td>
<td>0.000001</td>
<td>8</td>
<td>24.8</td>
<td>0.005</td>
<td>-99.98</td>
</tr>
<tr>
<td>Services</td>
<td>2.1</td>
<td>5</td>
<td>16122.2</td>
<td>8311.3</td>
<td>-48.4</td>
</tr>
<tr>
<td>Industrial</td>
<td>9.8</td>
<td>2</td>
<td>55294.2</td>
<td>37899.1</td>
<td>31.5</td>
</tr>
<tr>
<td>Hotels &amp; Tourism</td>
<td>2.9</td>
<td>4</td>
<td>24727.3</td>
<td>11269.2</td>
<td>54.4</td>
</tr>
<tr>
<td>Agricultural</td>
<td>1.3</td>
<td>6</td>
<td>3453.7</td>
<td>4968.3</td>
<td>43.9</td>
</tr>
<tr>
<td>Telecommunication</td>
<td>4.6</td>
<td>3</td>
<td>13783.0</td>
<td>17609.2</td>
<td>27.8</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>425788.1</strong></td>
<td><strong>386879.1</strong></td>
<td></td>
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\(^\text{16}\) Ibid.
\(^\text{17}\) Ibid.
It is also noteworthy that Turkey similarly regards Iraq as an opportunity to take advantage of diminishing Iranian influence. And while Turkey’s President Erdogan remains at odds with both Saudi Arabia and the UAE, these countries share an interest in rebuilding those areas of Iraq that have been seriously damaged by IS. In this regard, at the February 2018 donors’ conference, Turkey made the largest pledge to Iraq of $5 billion in comparison to Kuwait’s commitment of $2 billion, Saudi Arabia’s $1.5 billion, Qatar’s $1 billion and the UAE’s $500 million – although most reports ignored the fact that the UAE pledged $5.5 billion of private investment in the Al-Rasheed base and Umm Qasr port.\(^\text{18}\)

**Non-Oil Sector Potential**

From the point of view of the Iraq government, there are four areas of economic activity that offer the greatest opportunity for the growth of Iraq’s non-oil sector: transportation, reconstruction, the development of a service industry and light manufacturing, combined with local integration and international connectivity.\(^\text{19}\)

In 2016, transport represented 7.7 per cent of Iraq’s overall GDP.\(^\text{20}\) The NIC Investment Map acknowledges that the country’s transportation sector represents one of its most important economic areas for development. This is because of public transport’s direct impact on the daily lives of people and businesses, and because wider economic transformation cannot be achieved without a developed and reliable transport infrastructure. GCC investment in the development of transport in Iraq would appear to align closely with the region’s own experience and expertise in developing public infrastructure through port facilities, roads and the soon to be launched, pan-Gulf rail network.

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Challenges to Inwards Investment

While the opportunities the current situation in Iraq offer the Gulf region may seem self-evident, it would be foolish not to acknowledge that there remain plenty of risks and challenges that will need to be overcome if success is to be achieved. Some of these risks are strategic, while others remain at a lesser, tactical level but retain the capacity to jeopardise any investment in Iraq.

The main strategic risks are four-fold:

- First, the newly appointed government must be protected from the influence of other regional powers with agendas that conflict with the interests of the Gulf; most obviously manifested in Iran and Turkey.
- Secondly, the new government must be able to operate free of the influence of sectarian discord that has done so much to doom previous Iraqi administrations. This risk is arguably amplified by Iraq’s present constitutional arrangements that enshrine sectarian division throughout all levels of government, starting at the very top.
- Thirdly, although IS has been vanquished in its former centre of power in Mosul, extremism, terrorism and violence still threaten to destabilise the country and make it especially hard to overturn past perceptions of danger, poor risk-reward outcomes and endemic instability.
- Finally, the perception of Iraq as a byword for government graft and corruption continues to act as a strong disincentive, both to would-be investors and to the Iraqi population as a whole. Iraq continues to suffer from weak regulatory control, limited rule of law and politicians and officials more interested in self-enrichment than commitment to the future and reconstruction of Iraqi society.

Iran’s Influence in Iraq

While Iran’s influence in Iraq, particularly in the south, is frequently seen as pervasive, there is recent evidence to suggest that this important strategic factor may becoming less prominent than it once was. Following the US-led invasion of Iraq in 2003, the coalition’s failure to plan effectively for the aftermath created a political void that Iran was only too well prepared and enthusiastic to fill. This paved the way for several Iranian proxies to develop in Iraq and it is generally perceived that Iran’s popularity amongst Shia Iraqis in particular, remained high until 2014. Iran’s strategy from the outset was to encourage and exploit Shia-Sunni sectarian divisions, notably encouraging the notion of Shia revenge for the years of Saddam’s Sunni dominance and his deliberate neglect and coercion of the Shia south.

However, the perception of Iranian popularity among ordinary Iraqis now appears to be shifting. Recent work by the Baghdad-based research group Almustakilla (IIACSS) reveals changing opinions in attitudes to Iran.²¹ Notably, in Almustkilla’s most recent survey,

researchers found that favourable attitudes towards Iran among Iraq’s Shia communities has fallen from 88 per cent in 2015 to 47 per cent while unfavourable attitudes over the same three-year period show a slight increase from 45 per cent to 51 per cent.

Writing in the *Washington Post* in November 2018, Almustkilla’s founder, Munqith Dagher, suggested several reasons why Iraq’s Shia appear to be showing growing disillusionment with Iran. On a political level, he argued that Iraqis now closely associate Iran with the succession of Shia-dominated administrations that have patently failed to improve standards of living, make Iraq safe and eradicate corruption among government and local officials. While the US and its allies might have originally been blamed for failing to improve the lives of Iraq’s Shia, it now seems that Iran, and particularly the government of Nouri al-Maliki, are being blamed for the failure to improve the lives of ordinary citizens in Iraq. This has also been evident in the waves of protests that have swept southern Iraq over the past year.

As Benedict Robin-D’Cruz, also writing in the *Washington Post* in July 2018,22 similarly pointed out, demonstrators have started to attack the centres of Iran’s once dominant local Iran-backed militias. Tribal fighting and violent criminality have also become a major source of grievance while parallel failures to provide even basic levels of public utilities has eroded confidence and support for Iran-dominated local government authorities. This grievance was further aggravated in the middle of summer 2018 when Iran cut off electricity supply to Iraq.23 Iran is also blamed for water shortages and water quality problems that have been especially prominent in and around Basra over the past year. The water situation has also been aggravated by the start of Turkey’s development in south-eastern Anatolia of a major water project involving 22 dams on the Tigris and Euphrates rivers that have traditionally provided 95 per cent of the water for Iraq’s businesses and agriculture and 80 per cent of the needs of Iraq’s population.24

It is evident that Iraqis have also become disenchanted with the way in which Iran appears to have used Iraq to circumvent international sanctions. As the long-time British observer of Iran, Con Coughlin explained in 2013,25 the Iranian government used the Maliki government as a means of acquiring much-needed foreign currency – particularly US dollars. He quoted an unnamed security official saying: “Iran is taking advantage of its good relations with neighbouring countries such as Turkey and Iraq to avoid the sanctions. It is a very effective way of making sure the Iranian economy can still continue to function.” This perception of

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Iraq providing Iran with a way of avoiding the full impact of US sanctions continues today. As Ellie Geranmayeh of the European Council on Foreign Relations put it in a commentary marking President Rouhani’s first official visit to Iraq in March 2019: “Tehran expects Iraq to stand by Iran in its economic hardship, in the same way that Iran was the first to stand by Iraq in its fight against ISIS.”

It should also be noted that Iran is being blamed for dumping cheap, low-quality goods onto Iraqi markets. This has had a negative impact on local economies across Iraq by damaging or even destroying many small and medium sized enterprises because of what is tantamount to unfair competition. Moreover, it remains evident that Iran continues to pursue a deliberate strategy of exacerbating weakness across Iraq, both so that Tehran can continue to wield political and economic influence over its potentially strong neighbour and to ensure that there is no restoration of the balance of power between the two countries that existed during the era of Saddam’s rule.

It would be premature to claim that Iran’s influence over Iraq is coming to an end. Iraq’s powerful neighbour is always likely to influence the country’s political direction and economic development. However, there appears enough evidence over the past two years to suggest that Iran now faces mounting resistance among ordinary Iraqis, even from within Iraq’s most entrenched Shia communities. It seems that the days of Iranian dominance in Iraq are diminishing and that the opportunity to reduce further Iranian influence in a key Arab heartland now exists.

Sectarian Discord

A particular challenge is the sharing and distribution of political positions according to ethno-sectarian quotas—the so-called *muhasasa* system. This means that the prime minister cannot make appointments or dismiss ministers independently but is instead dependent on often opaque deals between different sectarian groups within Iraq’s political space. Previous attempts to reform *muhasasa* have been thwarted by objections that the governing Da’wa party (Shia dominated) would seize the opportunity to tighten its grip on power. Given that Prime Minister Abdul-Mahdi, although Shia, is widely regarded as a non-sectarian politician, there is now renewed interest in whether his determinedly ‘technocratic’ government could be more successful in reforming the *muhasasa* system.

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27 The term *muhasasa* is used in Iraq to describe either of the interpretations of the inclusivity of the executive branch of the Iraqi State and consequently has come to have negative connotations. The word *muhasasa* is derived from the Arabic word for appointment. The *muhasasa* ethno-sectarian quota system has been used by successive Iraqi governments to distribute cabinet positions for so-called “National Unity” and “National Partnership” governments.
Eradicating Extremism and Violence

Nearly two years have passed since the liberation of Mosul by Iraqi government forces in July 2017. This victory was widely seen as marking a new stage in the fight against extremist violence and instability that has destabilised Iraq since the overthrow of Saddam Hussein in 2003. Some commentators have suggested that the breakthrough in July 2017 can be compared to the initial aftermath of the invasion in April 2003 until the insurgency transformed itself into a civil war in 2005 and also to the period following the US-led surge that started in February 2007 until the reconstitution of ISIS and the fall of Mosul in 2014. This outline chronology suggests an underlying cycle of violence in Iraq that must be broken if the country is to have any chance of achieving lasting stability and peace.

The underlying drivers of instability and violence in Iraq appear to be fairly obvious:

- A lengthy history of ethno-sectarian inequality that has led to discrimination and a lack of investment in Iraq’s civil society.
- Political sectarian agitation that has become institutionalised by the US-coordinated post-Saddam constitutional settlement.
- High levels of poverty coupled with widespread unemployment, especially among Iraq’s youth population.
- Deliberate meddling and agitation by Iran – and in the case of Iraq’s Kurdish provinces in the north, by Turkey.
- The stubbornly high levels of endemic corruption discussed previously.
- ISIS and al-Qaeda-associated extremism that, although much reduced, remains a lingering threat throughout Iraq.
- Prevailing public acceptance of violence and unrest as intrinsic to Iraq’s public discourse.

It is argued that each of these sources of violence need to be understood and addressed if the Iraqi government is to stand any chance of breaking a cycle of violence that has become endemic in Iraqi society, arguably since Saddam seized power in 1979. A brief analysis of the list of underlying causes of violence suggests, once again, that the biggest single factor that will determine the future outlook for Iraq lies in overcoming the country’s sectarian divisions and encouraging the development of a more secular society that is less susceptible to external influence and uses its inherent wealth to develop as a more prosperous and equal society.
Confronting and Overcoming Corruption

Corruption in Iraq is deep-seated and endemic. As Transparency International observed in 2015:

> Iraq continues to score among the worst countries on corruption and governance indicators. Corruption risks are exacerbated by the historical legacy of the previous authoritarian regime, lack of experience in the public administration, weak capacity to absorb the influx of aid money, sectarian issues and lack of political will for anti-corruption efforts. While Iraq has introduced a number of anti-corruption initiatives, these measures have so far failed to provide a sufficiently strong integrity framework. Political interference, lack of political will, a weak civil society, a confusing penal code, and a lack of resources limit the effectiveness of anti-corruption measures.  

More recent research suggests that little has changed and that Iraq remains one of the most corrupt countries in the world making the conduct and development of business especially challenging. Corruption in the public and private sectors carries very high risks for businesses and other entities investing in Iraq. Companies can expect to contend with several forms of corruption, including a deeply entrenched patronage network. Investors may also face pressure to take on well-connected local partners to avoid bureaucratic hurdles. The fact that the new government of Iraq is also facing security, political and humanitarian challenges renders the state very fragile.

Iraq’s main anti-corruption law is the Accountability Act, which criminalises active and passive bribery, attempted corruption, extortion, money laundering and abuse of office. However, past governments have not implemented this anti-corruption legislation effectively, and officials have continued to engage in corruption with seeming impunity. The weak enforcement of anti-corruption laws can be traced back to the lack of agreement on institutional roles, the absence of political will, unclear legislation and regulatory and poor transparency.

Money laundering is criminalised under Iraq’s Anti-Money Laundering/Counter-Terrorism Financing Law, which covers concealing and altering goods originating from trafficking, corruption, influence peddling and misappropriation of public and private property, but implementation has again been weak. Furthermore, the investigative powers of the Central Bank, which is supposed to work in cooperation with the judiciary and law enforcement authorities to detect and prosecute illicit financial transactions, remain limited.

The Commission of Integrity, mandated to prosecute money-laundering involving corrupt officials, has also suffered from a lack of investigatory authority and capacity. Under anti-corruption legislation, public officials are supposed to disclose their assets, the assets of their partners and minor children within two months of starting employment, however it is

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reported that these procedures are rarely followed. Article 136(b) of the Iraqi Criminal Procedure Code also allows ministers to shield officials from work-related prosecution for corrupt acts which has been widely used to give officials the cover to continue acts of corruption. In 2016, the Commission of Integrity investigated 13,226 corruption cases, of which 7,088 cases were adjudicated, while 1,891 were referred to the courts.

Iraq’s judicial system is also plagued by corruption and political interference. More than a quarter of Iraqis believe the judiciary is corrupt. Corruption has also influenced authorities’ willingness to respect court orders: Interior Ministry and Justice Ministry employees have often extorted bribes from detainees to secure their release; even if the courts had already determined their case and ordered their release from detention. On a more positive note, in 2015, the government appointed 34 new judges across the country and 19 so-called – ‘integrity judges’. While the Baghdad Integrity Court has announced that it has investigated several corruption cases involving high-ranking officials, no court decisions have been made public.

The Abadi administration entered into co-operation with UNDP in 2016 to train and assist Iraqi auditors. However, as civil servants’ salaries have been cut the problem of corruption only seems to have intensified. This has reached the highest levels of government, as even cabinet ministers have been accused of embezzling from government contracts and collecting the pay of factory ‘ghost workers’. In July 2016, Parliament’s Integrity Commission demanded the arrest of over 2,000 people on charges of bribery and embezzlement. It seems that strengthening this cohort of government auditors should now become a priority for Prime Minister Madhi’s administration.

While the Abadi government was credited with taking steps to bear down on institutional corruption, the challenge such corruption poses for the development of legitimate business continues to be significant. It seems probable that the new government will continue efforts to tackle corruption and the corrosive effects that it has in all walks of life in Iraq. Indeed, this approach has been strongly endorsed by the latest IMF assessment of the economic outlook for Iraq. At the beginning of May 2019, the IMF’s Gavin Gray declared: “Strengthening anti-money laundering and countering financing terrorism controls and oversight will help prevent Iraq’s financial sector from being misused for the laundering of criminal proceeds and terrorist financing.”29 However, for the Gulf states and the EU, confronting corruption seems likely to remain a significant deterrent suggesting that investment should only be pursued in projects that can be overseen and managed from top to bottom by trusted individuals and that are largely outside the realms of Iraqi officialdom.

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Fighting corruption has “officially” been at the top of successive Iraqi governments’ agendas since 2006. However, there has been no holistic anti-corruption approach at all administrative and political levels, nor in the business sector. In the absence of systematic prosecution of office abuse, officials have had no real incentive to give up the prospect of personal gains. Some isolated anti-corruption actions against influential political actors have been pursued, either to convince the public of the government’s commitment to fight corruption or to target opponents. A complaint was lodged by the former chief of the Iraqi Integrity Commission in late 2014 calling for the prosecution of former Prime Minister al-Maliki on various charges, including corruption and office abuse, but little progress has been made.

Notwithstanding the economic ambitions of the Iraq government, it remains important to recognise the considerable levels of risk inherent in all areas of Iraq’s plans for economic investment and recovery. The city of Basra and adjacent provinces continue to face a range of challenges that will pose risks to successful redevelopment in southern Iraq. These include a major problem of water pollution with the Norwegian Refugee Council recently warning that as many as 280,000 children are at risk from water-borne diseases. Public protests also continue in Al-Basrah province as people continue to make demands for improvements to public services and new employment opportunities. This results in local authorities regularly imposing curfews in Basra City.

Private companies working in southern Iraq are generally advised to use security provided by private contractors. Road travel continues to be rated as dangerous with continuing acts of terrorism, including the use of roadside bombs and direct attacks on vehicles. Although the threat from IS was effectively eliminated in Iraq in 2017, individual IS groups still pose a threat to internal security, particularly north of Baghdad. At this time, it is unclear how effective the ISF will be in countering these residual IS elements and whether terrorist violence will continue to pose a significant challenge to investment and development in Iraq. That said, it is noteworthy that, despite continuing public unrest and regular outbreaks of low-level violence, the threat posed by IS in southern Iraq is now assessed to be low and there seems to be broad public support for the kinds of investment and development now being pursued by the Iraqi leadership.

By far, the greatest risk to successful development in southern Iraq appears to lie in Iraq’s inherently weak position relative to Iran. Long-established commercial ties between Iranian business and southern Iraq have often allowed Iran access to the most favourable opportunities in areas south of Baghdad. It is therefore suggested that Iran’s influence in the southern Iraq sector should be viewed not only as a commercial threat but as a strategic challenge.

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Overall, it is clear that Iraq remains a difficult place in which to do business and the challenges and risks abound. Indeed, in the latest assessment of ‘Ease of Doing Business’ by the World Bank, Iraq was placed at a lowly 171 in the most recent rankings. But weighing the potential strategic and economic benefits against residual challenges suggests that this unique moment of opportunity should not be allowed to pass by without an attempt being made to improve the prospects for Iraq, not only for its own benefit, but also for the future stability of the region and to show the Gulf’s ability to exert influence and develop as a future pole of global power.

Conclusions and Recommendations

The government of Iraq led by Prime Minister Adel Abdul Mahdi is widely regarded as offering the chance of a less sectarian and more technocratic administration that will also be less ideological in outlook and less likely to be influenced by Iran while recognising the urgency of delivering economic reform to lay the foundations for long-term stability. With IS militarily defeated and evidence of mounting public disquiet concerning the extent of Iran’s influence over Iraq, the new government also faces pressure to deliver on its promise to rebuild the country as a stable, economically secure and, above all, Arab state.

In February 2018, the Gulf states took a first important step by pledging to invest substantial resources to help rebuild Iraq. Since then, other relevant initiatives have followed that have further highlighted the potential role that the GCC states can play in Iraq.

And despite continued instability inside Iraq and chronic economic uncertainty, it is noteworthy that last year, Iraq re-established its position as the world’s fourth largest oil producer. Nonetheless, Iraq still faces uncertainty and continues to seek support and assistance to build a sustainable economy, create new employment and spur the development of new trade and industry.

From the Gulf region and the EU’s perspective, it appears that Iraq is at a tipping point where the Mahdi government is likely to be more warmly disposed to Gulf involvement and investment than it has been at any time over the past 15 years, while at the same time, Iran may be less able to resist the expansion of Gulf influence across the whole of Iraq. For the EU, this is also an opportune moment as it begin to shift its support for the Iraqi state from humanitarian assistance to a greater emphasis on programs that support Iraq’s medium- and long-term economic development.

In short, the opportunities and potential benefits of Gulf engagement and investment in Iraq now can be summarised as follows:

- Taking advantage of a unique moment of strategic inflexion in Iraq, both to stabilise the country further and leverage the wider sense of international optimism for the success of the new government.
To harness strong international, particularly US and EU, support for the new government and for a new start for Iraq.

To reinforce the sense that Iraq is an Arab state and a vital constituent member of the Arab world.

To continue the process of eliminating the challenge of extremism from Iraq so that IS and other extremist groups are eradicated fully from Iraqi society. In turn, this would help to reduce extremist threats in the wider Middle East.

To take advantage of the many investment opportunities that are now on offer in Iraq and to consolidate Gulf influence through strategic investment.

To continue the process of expanding the ‘Arab Gulf’ to become the ‘Arab Peninsula’ with shared political vision, economic heft, shared cultural understanding and increased strategic cohesion.

To eliminate sectarian divisions once and for all within the borders of Iraq so that it can flourish as an economically robust community, enjoying full employment.

To show the international community that the Arab World has the capacity to resolve its own challenges, reconcile its differences and take its place as an emerging pole of influence in its own right.

About the Author

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