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IRAQ ECONOMIC ASSESSMENT

OVERALL ECONOMIC ASSESSMENT: MID-2011 UPDATE

TIJARA
PROVINCIAL ECONOMIC GROWTH PROGRAM

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USAID-*TIJARA* PROVINCIAL ECONOMIC GROWTH PROGRAM

JULY 2011

ECONOMIC ASSESSMENT DELIVERABLE REPORT

A MID-2011 ECONOMIC UPDATE PREPARED BY
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CONTENTS

CONTENTS i
ACRONYMS ii

1. INTRODUCTION 3

1.1 METHOD OF APPROACH 3

1.1.1 Deliverables 3

1.2 STRUCTURE OF THIS REPORT 3

2. RESEARCH AND WRITING 4

2.1 DATA AND INFORMATION GATHERING 4

2.2 ANALYSIS AND REPORT WRITING 4

3. SITUATION AND OUTLOOK 5

3.1 BACKGROUND 5

3.2 OUTLOOK AND WAY FORWARD 6

4. ANNEX A: ECONOMIC ASSESSMENT OF IRAQ 10

ACRONYMS

CIA	Central Intelligence Agency
FAO	Food and Agriculture Organization (of the United Nations)
FY	Fiscal Year
FAS	Foreign Agriculture Service (of USDA)
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GoI	Government of Iraq
IFC	International Finance Corporation
IMF	International Monetary Fund
IRG	Iraqi Regional Government (for Kurdistan)
Mb/d	Million Barrels per Day (oil production)
MoA	Ministry of Agriculture
MoH	Ministry of Health
MoT	Ministry of Trade
OPEC	Organization of Petroleum Exporting Countries
Ph. D.	Doctor of Philosophy
SOE	State Owned Enterprise
SUV	Sport Utility Vehicle
USAID	United States Agency for International Development
USDA	United States Department of Agriculture
WB	World Bank
WTO	World Trade Organization

1. INTRODUCTION

1.1 METHOD OF APPROACH

This report is identified as a deliverable in the *USAID/Tijara* International Trade/WTO Accession Year 4 Work Plan, Activity Reference 3.6: *Economic Assessment of Agricultural Reform Implementation, Economic Change and Outlook in the Iraqi General Economy.* The stated deliverables follow:

1.1.1 DELIVERABLES

- Research and Prepare a Report on the Overall Economic Assessment of Iraq
- Prepare and submit an activity/deliverable report.

The method of approach for this deliverable was to undertake research and data collection including discussions and requests for information from a broad range of sources. After data collection and analysis were completed a report entitled *Iraq Economic Assessment*; *"Overall Economic Assessment: Mid-2011 Update"* was prepared.

1.2 STRUCTURE OF THIS REPORT

Section 1 provides the Introduction, Method of Approach and Structure of this Report.

Section 2 provides includes discussions about Data & Information Gathering and Analysis & Report Writing.

Section 3 provides subsections regarding Background and Outlook & Way Forward. This material includes a summary of the main findings, conclusions and a commentary on the current status and projections for the Iraqi economy.

Appendix A reproduces "*Overall Economic Assessment: Mid-2011 Update*" in its entirety.

This is an update for the original report "Economic Assessment of Iraqi Agricultural Sector Reforms," produced last year by the *USAID/Tijara* International Trade/WTO Accession component.

The Mid-2011 Update attached as annex A includes current economic and security situation and outlook material and Iraqi macroeconomic data through May 2011. The report reviews current thinking about models for future development in Iraq and most likely scenarios once the drawdown of U.S. military forces is finalized.

The last part of the attached update includes a section titled, "*Cross-Country Comparisons: Implications from WTO Accession.*" Seventeen countries are included in a cross-country comparison and analysis of economic impacts before and after WTO accession. The countries include a mix of population size, median age, geographic location, net oil trade, literacy rate and time of WTO Accession.

2. RESEARCH AND WRITING

2.1 DATA AND INFORMATION GATHERING

The author conducted ongoing meetings and discussions with Government of Iraq (GoI) Ministry of Agriculture (MoA), Ministry of Health (MoH) and Ministry of Trade (MoT) officials in Baghdad and the Iraqi Regional Government (IRG) in Erbil. Discussions were also conducted with various officials at the U.S. Embassy including the Agricultural Minister Counselor, economists and various other U.S. Department of Agriculture (USDA) technical specialists in the Foreign Agriculture Service (FAS).

Data were collected from international data sources including the World Bank (WB), Central Intelligence Agency (CIA) and International Finance Corporation (IFC). During the course of discussions with GoI economists, information about data availability, general economic conditions in Iraq and internal GoI analyses of the economy and proposed trade policy changes was collected.

2.2 ANALYSIS AND REPORT WRITING

This activity concluded with data analysis, debriefing activities and production of a detailed report entitled *Iraq Economic Assessment*; *"Overall Economic Assessment: Mid-2011 Update."*

3. SITUATION AND OUTLOOK

3.1 BACKGROUND

Iraq's economy remains characterized by heavy dependence on oil exports and is evolving from historical emphasis on development through central planning. As one of the three most oil-rich countries in the world, Iraq has the resources to be a leading oil exporter and production costs for Iraqi oil are relatively low by world standards.

The aftermath of Saddam's ouster in 2003 saw reform undertaken by the new Iraqi government geared towards full economic and political recovery. From a tormenting four decades characterized by a ruthless dictatorship, a centrally planned economy, violence, terror and injustice, Iraq as of mid-2011 is on the verge of re-emerging as a major player in the oil-rich Middle East. Major policy reforms consistent with World Trade Organization (WTO) accession and resolute efforts to redevelop the country's massive natural reserves have potential to pave the way to a sustained increase in Iraqis' standard of living.

In an attempt to further attract foreign investment, the government has also amended its national investment law giving enough leeway for potential investors to consider Iraq as an investment alternative. While it still has a ways to go, Iraq now participates in international trade and investment forums and is seriously eyeing joint ventures with government and non-government owned enterprises.

Between June 2009 and February 2010 the Iraqi Oil Ministry tendered for the award of 'Service Contracts' to develop Iraq's existing oil fields. If all contracts awarded were to reach their stated target production, Iraqi oil production would experience a 3.75-fold increase. The U.S. Energy Information Administration is projecting a more conservative increase in Iraqi production to 6 million barrels a day by 2015. Even that level would represent a doubling of Iraq's current oil production and revenue.

An improved security environment and an initial wave of foreign investment are helping to spur economic activity, particularly in the energy, construction, and retail sectors. Broader economic improvement, long-term fiscal health, and sustained increases in the standard of living still depend on the government approving major policy reforms, turning back the recent increases in terrorist activities and on continued development of Iraq's massive oil reserves.

Although foreign investors viewed Iraq with increasing interest in 2010, most are still hampered by difficulties in acquiring land for projects and by other regulatory and bureaucratic impediments. Iraq's economy remains dominated by the oil sector that provides more than 90 percent of government revenue and foreign exchange earnings.

Legislative and regulatory reforms in WTO member countries have resulted in more friendly business enabling environments -- and that attracts investment. In the short term WTO accession and associated legislative reforms would assist Iraq in attracting increased foreign investment, particularly in the services sector. In the longer-term investment would move to the industrial and manufacturing sectors.

Iraq submitted the original application to join the WTO in December 2004. Initial momentum and progress for WTO membership was positive, but a combination of the insurgency, election of a new Parliament in March 2010 and formation of a new coalition government during the first quarter of 2011 has resulted in a loss of momentum and the need to renew institutional memory.

Iraqi officials are in a race against time and public patience to expand oil revenues -- and subsequently economic growth, availability of services (especially electricity supplies) and jobs. Visible progress is critical for maintaining public support, stability and security.

Iraqi demonstrations protesting corruption and lack of public services during early 2011 indicate that reform of electric utilities and increasing other public services will be critical to maintaining domestic security and continued support for existing government structures. Still, street protests by Iraqis demanding better services, less corruption and jobs were different from large scale demonstrations in other Middle-Eastern countries because they were not aimed at unseating the democratically elected Iraqi government.

After oil and gas -- the construction sector is seen as the most promising in the Iraqi economy -- followed by chemicals, consumer goods, healthcare & pharmaceuticals and agriculture & agribusiness. Iraq's untapped consumer market is seen as a major growth opportunity with the chance of achieving a *ground floor* advantage as a major attraction for early investors.

Violence, corruption and poor infrastructure are seen as the primary risks by potential investors. These are followed by credit risk, bureaucracy and lack of contract protection. Almost 70 percent of existing investors in Iraq expect the security situation to improve during the next two years. Conversely, those not currently investing in Iraq are less optimistic with 61 percent expecting the security situation to stay the same or get worse.

3.2 OUTLOOK AND WAY FORWARD

Iraq continued reviving economically during 2011 while Middle East neighbors suffered from an economic downturn due to demonstrations and ongoing political turmoil. Wracked in recent years by sectarian violence and economic collapse, Iraq has been enjoying a quiet resurgence this year even as other countries in the region are striving to hold off economic meltdowns in the face of political unrest.

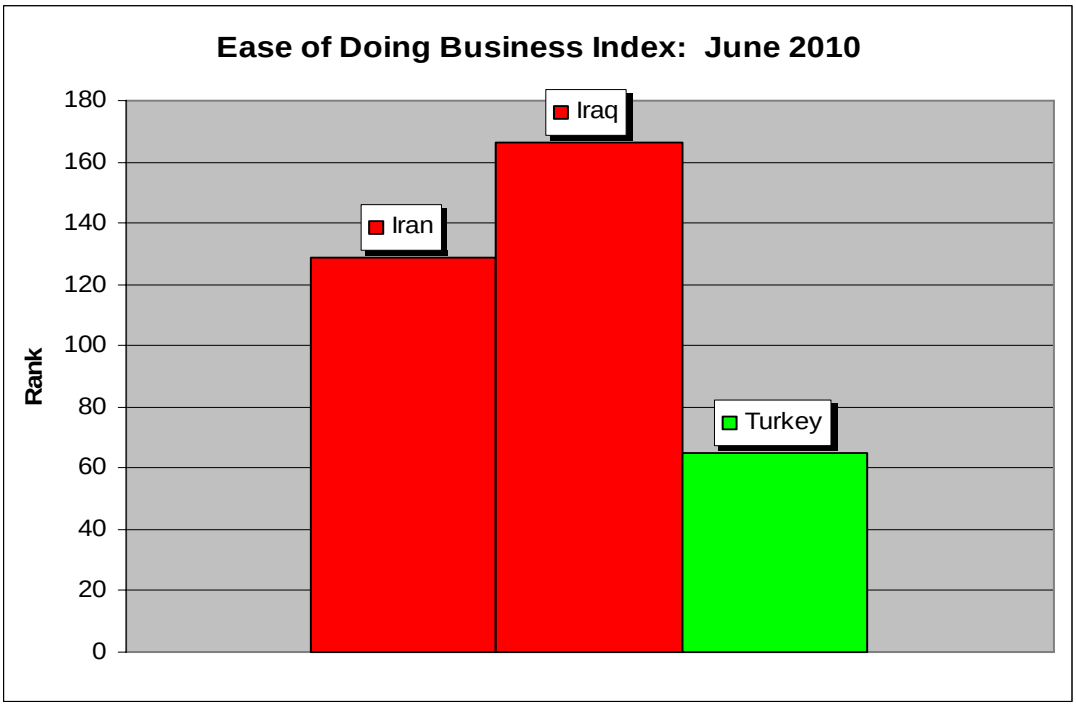
Risks remain in war-ravaged Iraq but emergence of an economic revival that could make it a beacon of stability and prosperity could be underway. Iraq could begin to prosper affter years of having the region's most stricken and violence-wracked economy. Some predict that "Iraq is a market that's at an historic bottom." *"Iraq is not out of the woods yet by any means, but it could be like being in China and Brazil 20 years ago" for businesses and investors willing to go out on a limb and tap into Iraq's potential growth.* [**Source:** *The Washington Times, "War-weary Iraq sees economic rebound: Stock market, investment surge," by Patrice Hill, April 10, 2011*]

Others see strong competition between Turkey and Iran for future influence in Iraq because the two countries have very different visions for the Middle East. As the U.S. continues the scheduled drawdown of forces in Iraq through the end 2011 (whether the drawdown is to zero or just significantly less than 45,000) Iran and Turkey will rapidly become the most influential external forces inside Iraq.

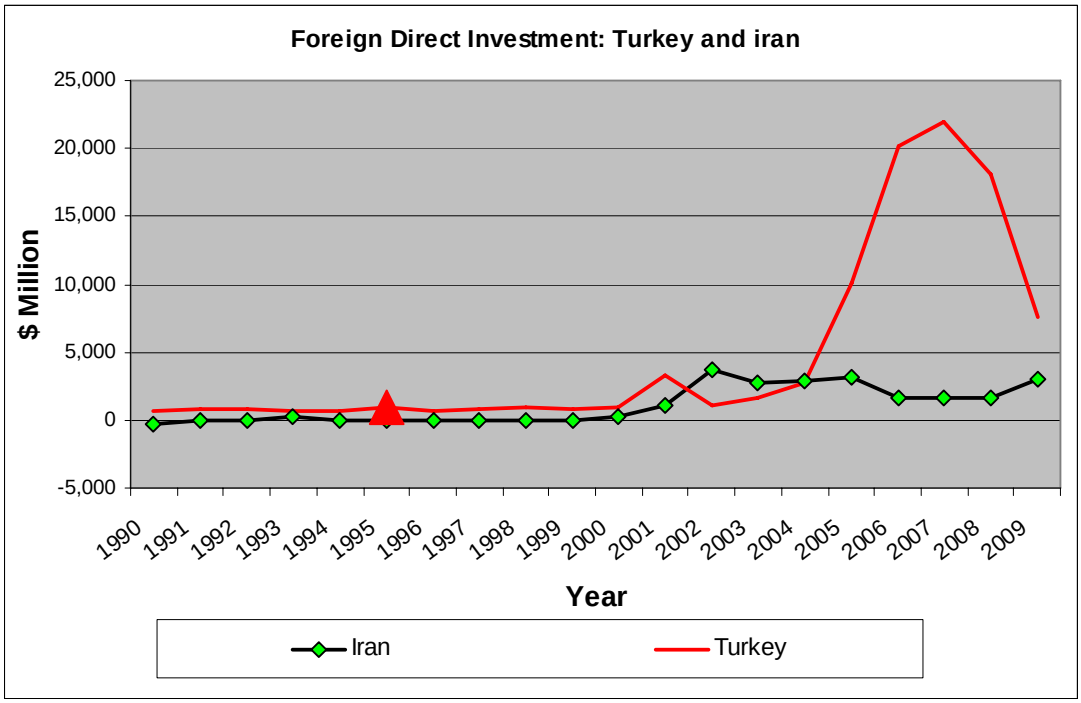
Turkey supported the secular Iraqiya list -- an alliance of Arab nationalists and Turkmen -- in the March 2010 Iraqi elections, while Iran supported a Shiite-dominated coalition to prevent Sunnis from taking power. Iran and Turkey tend to work at cross purposes in Iraqi politics, as seen in the protracted power struggle surrounding Iraq's 2010 election cycle.

The U.S. is concerned about the continuing Iranian influence in Iraq. American soldiers continue to be killed by suspected Iran-backed groups in Iraq with casualty rates for American troops reaching the highest levels in two years. As the deadline for the U.S. troop withdrawal approaches, Iran is increasingly pushing Iraqi authorities not to extend the presence of U.S. forces. It is now pushing strongly, most notably through the Sadrist Movement, to prevent any request by the Iraqi government for a continued U.S. troop presence after 2011.

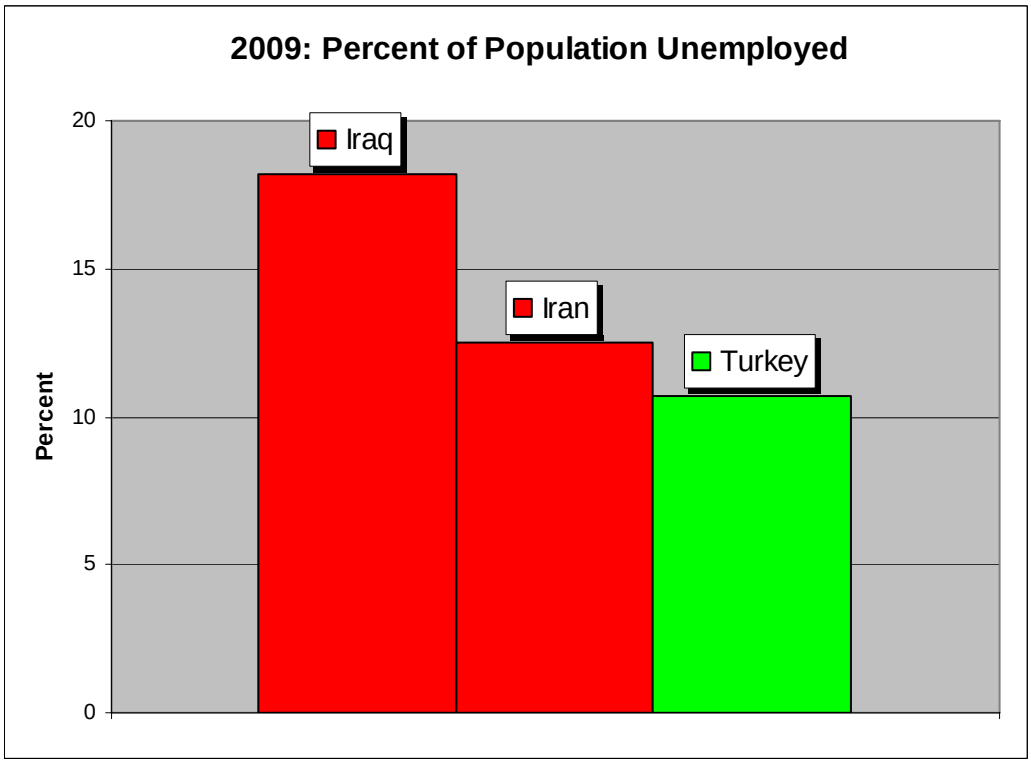
Many conclude that the Turkish blend of Islam, democracy, and soft power is a far more attractive regional model than the Iranian narrative of Islamic theocracy and hard power resistance. The United States should therefore continue to welcome increased Turkish-Iraqi economic development, trade, and energy ties -- and where possible -- support Turkey's development as a key part of U.S. post-2011 strategy for Iraq and the region.
[**Source***: "Turkey and Iran Vie for Control of Iraq, Wladimir van Wilgenburg,* http://www.rudaw.net/english/news/iraq/3792.html, *July 2, 2011*]



- Iraq and Iran are not WTO members and rank among the most difficult countries for doing business. Turkey became a WTO member in 1995 and economic reforms associated with WTO membership have made it among the top one-third of 183 countries for ease of doing business. [**Source**: *World Bank and International Finance Corporation, "Doing Business in 2011: Making a Difference for Entrepreneurs," http://www.doingbusiness.org/rankings*]

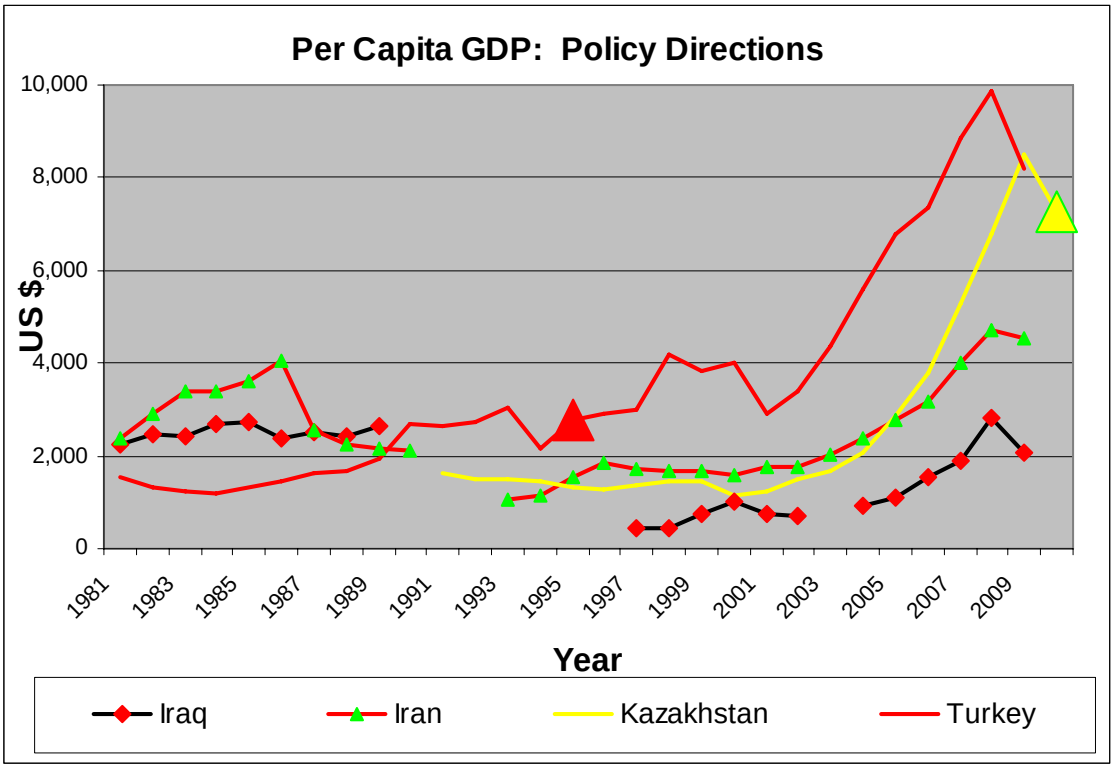


- An investment friendly business enabling environment attracts Foreign Direct Investment (FDI). WTO member Turkey has averaged between $5 billion and $20 billion annual FDI since 2005. Iran has averaged $3 billion or less annual FDI since 2001. [**Source:** *http://data.worldbank.org/data-catalog*]



- WTO member Turkey with higher FDI has a lower rate of unemployment than do non-members of WTO, Iraq and Iran. [**Source:** *http://www.indexmundi.com*]

Iran and Turkey are rapidly becoming the most influential external actors inside Iraq as the U.S. troop withdrawal proceeds. Many Iraqi officials share this view and have identified Iran and Turkey as "the biggest players and rivals in Iraq". [**Source:** *"Turkey and Iran Vie for Control of Iraq, Wladimir van Wilgenburg, http://www.rudaw.net/english/news/iraq/3792.html, July 2, 2011.*]



- Iran and Turkey offer clearly different policy alternatives. Turkey is a WTO member with a population – size, median age and literacy rate -- comparable to non-member Iran. Iran is a major oil exporter and Turkey is a net oil importer. Per capita GDP in WTO member Turkey is nearly twice per capita GDP in WTO non-member Iran and nearly four times per capita GDP in WTO non-member Iraq.

- Kazakhstan is nearing completion of bilateral negotiations for WTO accession and plans to be a WTO member before the end of 2012. Kazakhstan produces 70 percent as much oil as Iraq with a population about half the size. If Iraq implemented WTO reforms and achieved a 20 percent increase in oil exports current Iraqi per capita GDP would be expected to increase to per capita GDP in Kazakhstan – or nearly 3.5 times current per capita GDP in Iraq.

- The growth curve of per capita GDP in Kazakhstan demonstrates potential growth patterns for Iraq as it transitions from non-member of WTO to member and increases oil production. It is telling that Iraq and Kazakhstan had nearly the same level of per capita GDP in 2001 and less than 10 years later per capita GDP in Kazakhstan is $7,260, more than 3.5 times per capita GDP of $2,090 in Iraq.

- Either Iraq will pursue legislative reform and WTO accession and follow a growth path like Kazakhstan that will equal, then bypass, per capita GDP in oil importing Turkey; Or Iraq will remain an inward looking oil exporter with little foreign direct investment and high unemployment that resembles WTO non-member Iran. [**Source:** *http://data.worldbank.org/data-catalog*]

Annex A: **ECONOMIC ASSESSMENT OF IRAQ**

Overall Economic Assessment: Mid-2011 Update

Historical Perspective:

As indicated in the *USAID/Tijara 2010* report, *Chapter 1: Overall Economic Assessment,* prior to the outbreak of the war with Iran in September 1980, Iraq's economic prospects were bright. By the beginning of that war, Iraq had amassed an estimated $35 billion in foreign exchange reserves. The Iran–Iraq War depleted Iraq's foreign exchange surplus and devastated the economy. Iraq suffered economic losses of at least $80 billion from the war and the country was left saddled with a foreign debt of more than $40 billion.

Iraq's subsequent invasion of Kuwait during August 1990 again shattered the economy as international sanctions, and damage from military action by an international coalition during the Persian Gulf War of 1991 drastically reduced economic activity. Government policies of diverting income to key supporters of the Saddam regime while sustaining large military and internal security forces further impaired finances, leaving the average Iraqi citizen facing desperate hardships.

After hostilities ceased, oil exports gradually increased with the construction of new pipelines and the restoration of damaged facilities. However, three wars and 12 years of UN sanctions have left the oil industry's infrastructure in poor condition. Corruption is also having an impact as between 100,000 barrels per day and 300,000 barrels per day of Iraq's declared oil production have been siphoned off through corruption and smuggling.

As much as 90 percent of Iraq's power generating and distribution systems were destroyed during the Gulf War, and recovery has been slow. In mid-2004, Iraq had an estimated 5,000 megawatts of power-generating capacity, compared with 7,500 megawatts of demand. In 2004 plans called for construction of two new power plants, and restoration of existing plants and transmission lines to ease the blackouts and economic hardship caused by this shortfall. Sabotage and looting prevailed, however, and capacity remained below 6,000 megawatts.

In 2004 the World Bank estimated that $12 billion would be needed for near-term restoration, and the Ministry of Electricity estimated that $35 billion would be necessary to rebuild the system fully. Restoration of electric power and development of dependable water, sewage and trash infrastructure systems remain critical for Iraq's future commercial and agricultural development to be sustained. Contracts for expanded reconstruction have been signed as of 2011 and there is optimism that electricity production will adequately meet demand by mid- late-2013. [***Source**: Wikipedia: Iraq's Economy, 2010*]

Contemporary Conditions:

Iraq's economy remains characterized by heavy dependence on oil exports and is evolving from historical emphasis on development through central planning. Oil production currently averages about 2.6-2.7 million barrels per day, with about 2.1 million barrels per day being exported. As one of the three most oil-rich countries in the world, Iraq has the resources for complete energy independence and production costs for Iraqi oil are relatively low by world standards. [**Source***: Al Arabiya, Mustapha Ajbaili, editor, PUKmedia, May 15, 2011]*

The aftermath of Saddam's ouster in 2003 saw reform undertaken by the new Iraqi government geared towards full economic and political recovery. From a tormenting past characterized by violence, terror and injustice, Iraq is as of mid-2011 on the verge of re-emerging as a major player in the oil-rich Middle East. Major policy reforms and resolute efforts to redevelop the country's massive natural reserves pave the way to a sustained increase in Iraqis' standard of living.

Iraq is also making modest improvements in reviving and establishing institutions that are central for implementing a sound economic policy. During 2010, Iraq signed a new agreement with the International Monetary Fund (IMF) and World Bank (WB) for conditional aid programs that will boost its economic institutions. This has been reinforced by the passing and enactment of laws that are realistic and advantageous to the Iraqi government and to Iraqis in general.

Iraq's Parliament Speaker recently reported that the country's state budget for 2011 is approximately $85.7 billion ($US throughout this paper). Current policy is concentrated on reduction of commissioning costs, increasing infrastructure investment allocations and financial support for the government's "Rationing Card" which will be distributed fully to all Iraqi citizens. One unique change in appropriations is the cancellation of all social benefits for the government's top three posts -- the President, Prime Minister and Parliament Speaker.

In an attempt to further attract foreign investment, the government has also amended its national investment law giving enough leeway for potential investors to consider Iraq as an investment alternative. Iraq now participates in international trade and investment forums and is seriously eyeing joint ventures with government and non-government owned enterprises. Officials in the Ministries of Finance and Trade are sporadically focused on advancing Iraq's accession into the World Trade Organization (WTO) which would further indicate Iraq's intent to become a major participant in global trade. At the local level, provincial councils have also appropriated budgets to promote investments.

Iraq's economy is dominated by the petroleum sector, which has traditionally accounted for 95 percent of foreign exchange earnings. Some of the proposed and approved legislation includes a set of regulations that establish a legal framework that is consistent with modern times and modern demands for Iraq's largest economic sector. The country's long-term contracts with major oil companies have the potential to vastly expand oil revenues. Of course, expanded exports are also dependant on an upgrade in infrastructure, pipelines, and oil processing to enable these deals to realize their full potential.

In essence, Iraq is floating on a sea of oil and gas and is considered to have the third largest reserves in the world. The Iraqi Oil Ministry reported that Iraq is exploring more oil fields where drilling operations may intensify. In addition to exploration, the government plans to develop the country's infrastructure, increase education and training for the Iraqi workforce and form exploratory committees. Major oil companies have signed agreements to extract oil reserves with potential to boost production capacity to about 12 million barrels during the next six years. [**Source:** *Iraq's Economy in 2011 and Beyond*, http://www.DrDinar.com]

Oil Services Contracts: Between June 2009 and February 2010 the Iraqi Oil Ministry tendered for the award of 'Service Contracts' to develop Iraq's existing oil fields. If all contracts awarded reach their stated target production, Iraqi oil production will increase from today's 2.5 million barrels/day (mb/d) to a total 11.9 mb/d – an amount comparable to current Saudi declared capacity of 12.5 mb/d. If realized, production increases would amount to a 3.75-fold increase in Iraqi oil production. [***Source**: Wikipedia, Iraq's Economy, 2011.*]

Deputy Prime Minister Hussein al-Shahristani stated in mid-May 2011 that despite doubts by the International Monetary Fund (IMF) Iraq's petroleum infrastructure will have the capacity to boost oil production from the current 2.7 million barrels a day to 6.5 million barrels a day by 2014. Mr. Shahristani predicted that Iraq's oil production would increase from the current 2.6- 2.7 mb/d to 3 mb/d by the end of 2011; 3.3 mb/d in 2012, and 6.5 mb/d in 2014. He also indicated that there are no foreseeable obstacles to Iraq massively ramping up production to rival the 8.6 mb/d currently produced by Saudi Arabia.

"The government also believes that the oil companies are serious in carrying out their contractual obligations to reach production of 12.5 mb/d in 2017," Mr. Shahristani told a news conference in Baghdad's heavily fortified Green Zone. "We are comfortable that new (oil) export outlets will be ready to receive extra crude according to the plans to boost oil production with the contracted oil companies," he said as quoted by Reuters.

Mr. Shahristani's projections are somewhat more optimistic than projections published in March 2011 by the IMF that express less confidence about Iraq's ability to meet its long-term oil production targets. Based on IMF's more conservative assumptions oil production would still double to more than 5 mb/d by 2017. The IMF cited the need for huge investments in port facilities, pipelines, desalination plants, for water to be injected into oil fields, and storage facilities as constraints on increased production according to reports in the French press. Even this more conservative estimate, coupled with ongoing improvements in security, economic reform and WTO accession will dramatically improve the Iraqi economy.

Iraq, a member of the 12-nation Organization of Petroleum Exporting Countries (OPEC) needs to upgrade export facilities to benefit from the increase in production capacity. Plans to build new oil pipelines to carry crude from the southern oilfields to Syria and Turkey, and at least four new floating ports in the south will significantly boost export facilities.

"I am pleased to inform you that development plans for the oilfields are going ahead normally, and faster than contracted," Mr. Shahristani told a gathering of senior Iraqi and United Nations officials in Baghdad. **"**Foreign oil companies are expected to invest more than $150 billion to reach their targets in the fields being developed," he said.

Gas production contracts associated with increased oil production were also awarded in two auctions during 2009. Gas production is projected to reach about 8 billion cubic feet per day. ***[Source:*** *Al Arabiya, Mustapha Ajbaili, editor, PUKmedia, May 15, 2011]*
Shares by region of expected increase in Iraqi oil production:

Table 1: Share of Increased Iraqi Oil Production

Region	Production Share mb/d	Percent of total
Iraq	1.462	25
Asia	1.900	20
UK	1.810	19
U.S.	1.462	16
Russia	1.064	11
Europe (excl UK)	0.865	9

[***Source***: *Wikipedia: Iraq's Economy, 2010*]

Security and Legal Framework: Other reports agree that Iraq's recent contracts with major oil companies have the potential to greatly expand oil revenues. They also concur that Iraq will need to upgrade oil processing, pipelines, and export infrastructure to enable these deals to reach full potential.

An improved security environment until recently and an initial wave of foreign investment are helping to spur economic activity, particularly in the energy, construction, and retail sectors. Broader economic improvement, long-term fiscal health, and sustained increases in the standard of living still depend on the government approving major policy reforms, rolling back the recent increases in violence and on continued development of Iraq's massive oil reserves.

Although foreign investors viewed Iraq with increasing interest in 2010, most are still hampered by difficulties in acquiring land for projects and by other regulatory impediments. Iraq's economy is dominated by the oil sector, which provides over 90 percent of government revenue and 80 percent of foreign exchange earnings.

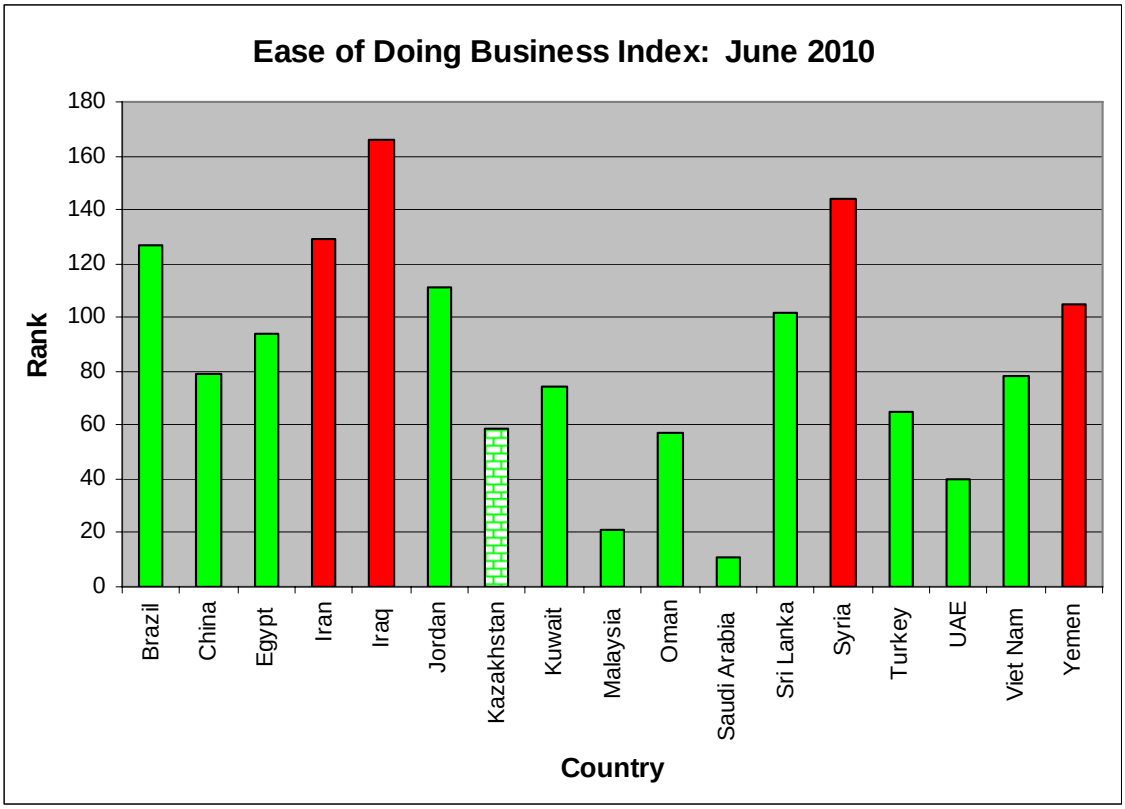
In 2010, Baghdad signed a new agreement with both the IMF and World Bank for conditional aid programs that will help strengthen Iraq's economic institutions. Some reform-minded leaders within the Iraqi government are seeking to pass laws to strengthen the economy. This legislation includes a package of laws to establish a modern legal framework for the oil sector and a mechanism to equitably divide oil revenues within the nation, although these and other important reforms are still under contentious and sporadic negotiation.

The Government of Iraq is pursuing a strategy to gain additional foreign investment in the economy. This includes an amendment to the National Investment Law, multiple international trade and investment events, as well as potential participation in joint ventures with state-owned enterprises.
Provincial Councils also are also using their budgets to promote and facilitate investment at the local level. However, widespread corruption, inadequate infrastructure, insufficient essential services, and antiquated commercial laws and regulations stifle investment and continue to constrain the growth of private, non-energy sectors.

Inflation has decreased consistently since 2006 as the security situation has improved. The Central Bank has successfully held the exchange rate at approximately 1,170 Iraqi dinars/$US since January 2009. However, Iraqi leaders remain hard pressed to translate macroeconomic gains into improved lives for ordinary citizens. Unemployment remains a problem throughout the country. Reducing corruption and implementing reforms - such as bank restructuring and developing the private sector - would be important steps in this direction. [**Source***: CIA online World Factbook updated bi-weekly, 2011,* ISSN 1553-8133]

Business Enabling Environment: Economies are ranked from 1 to 183 by the World Bank and International Finance Corporation for their ease of doing business. As shown in the following bar graph a higher ranking (highest rank = 1, lowest rank =183) on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm. Green bars denote WTO members and red bars denote non-members of WTO. For example, non-member of WTO Iraq (red bar) has the most difficult business environment with a rank of 166 for ease of doing business. WTO members Saudi Arabia (rank 11) and Malaysia (rank 21) (green bars) are among the top countries for ease of doing business as of June 2010.

In the short term WTO accession and associated legislative reforms will assist Iraq in attracting increased foreign investment, particularly in the services sector. Legislative and regulatory reforms in WTO member countries have resulted in a more friendly business climate and that attracts investment. The rankings for 17 WTO member and non-member economies are benchmarked to June 2010 and shown in the bar graph below. WTO-member countries generally rank higher for ease of doing business and attract more domestic and foreign investment than do non-members of WTO.



[**Source:** *World Bank and International Finance Corporation, "Doing Business in 2011: Making a Difference for Entrepreneurs,"* http://www.doingbusiness.org/rankings]

A Work in Progress: Iraqi officials are in a race against time and public patience for expanding oil revenues -- and subsequently economic growth, availability of services (especially electricity supplies) and jobs on one hand, and maintaining public support, stability and security on the other.

Iraqi demonstrations protesting corruption and lack of public services during the spring of 2011 indicate that reform of electric utilities and increasing other public services will be critical to maintaining domestic security and continued support for existing government structures. On February 27, 2011 Prime Minister Nuri Al Maliki gave the government's ministries and provincial administrations a 100-day deadline to assess their work and evaluate their capacity to succeed or fail. "Iraq's ministries will be subject to major changes according to the evaluation results," Maliki said.

During an April 26, 2011 press conference Al-Maliki reiterated the message of reform. "The government might ask to dismiss a minister if we deem that his ministry is incapable of accomplishing its projects." [**Source:** *http://www.alsumaria.tv/, "Malilki threatens to dissolve Iraq government after 100 day deadline," Iraq News, April 27, 2011*]

The oil sector continues to be constrained by the ongoing unreliable electricity grid, the outdated infrastructure for storing and transporting oil and rampant corruption. Government oil revenues are being supported as much by higher oil prices than by increasing capacity.

Other sectors of the economy are in even worse condition than the oil sector. The agricultural sector, which generally has adequate water supplies, is hampered by primitive irrigation techniques that contribute to soil salinization -- and by government controls. As a result, according to one government minister, Iraq imports about 80 percent of its food. One Iraqi expert explained that a frozen chicken from Brazil costs less in the Baghdad market than a fresh chicken raised a few miles away in the suburbs.

The industrial sector also barely exists. Most (government owned) Iraqi factories are still closed. Attempts to auction off state-owned firms have mostly failed, resulting in only a handful of privatizations. In large part the government is unwilling to really liberalize if it includes even a short-term risk of higher unemployment. Looking at the demonstrations in other Arab countries this year, some of which were at least partially fueled by liberalizing measures, this is not surprising.

Unwillingness to reform is crippling. No investor will buy a factory if the government demands -- as it apparently has in some cases – that the facility remain overstaffed by a factor of ten. Even a very basic good like cement, which is relatively simple to produce and critical to rebuilding Iraq's infrastructure, is mostly being imported.

The Iraqi banking sector is also state-owned and inefficient. Banking is not really in the business of providing either loans or services to most Iraqis. Iraqis still have to carry tens of thousands of dollars worth of cash to put on a conference, because hotels are not equipped to take checks or credit cards. This antiquated system hampers business and tourism. Large volumes of capital fled Iraq during the invasion and the insurgency that followed. This capital has remained out of Iraq in more secure investment and savings environments.

Niches like retail that are usually filled by small businesses are hampered by excess regulation, corruption and poor infrastructure. Three-fourths of Iraqi business owners surveyed during 2007 reported that corruption added at least 10 percent to their cost of doing business; And 20 percent said that the added cost was 40 percent or more. Corruption is not necessarily the most immediate concern among business owners, who are often more concerned about current issues including adequate electricity, but corruption may very well be the biggest long-term restriction on investment and economic recovery.

Iraq is focused on rebuilding the infrastructure and at least until recently violence is declining. The major issues now may be creating political and social institutions that support a vibrant, entrepreneurial business culture. That's not just absent now -- it actively may be going in the wrong direction. Freedom and democracy, which seem to have worked so well in the West, may actually have promoted more corruption and rent-seeking in Iraq than the hard-line controlling dictatorship that it replaced. [**Source**: *The Atlantic, "The Post-Saddam Economy Of Iraq Is Bleak," Megan McArdle, Business and Economics Editor, Feb. 11, 2011*]

Corruption, a common complaint, is not unique to Iraq, however. Corruption is also found in many other developing, transitioning and even developed economies. Through experience companies have learned to manage corruption and to build the cost into margins. Other factors -- an unreformed bureaucracy, an unclear regulatory framework, and the absence of social protections -- may create policy instabilities that are even more unique and detrimental to investment in Iraq than corruption.

The following major sources of uncertainty may be more unique to Iraq and more difficult to overcome than corruption:

1) A ministerial apparatus that maintains discretion over companies and that can change business and financing plans without going through a board of directors;

2) Contradictory laws that give leeway for regulations to be interpreted inconsistently; and

3) Absence of long-term worker protections that result in the Iraqi government and investors facing protests among the newly unemployed and resulting in regional officials pressuring investors to retain redundant workers.

Addressing these problems will be critical to implementing a business enabling environment and convincing investors that Iraq is truly "open for business." [**Source***: The Brookings Institute, Wolfensohn Center for Development, by Raj M. Desai, Nonresident Senior Fellow, July 2010*.]

Non-Petroleum Opportunities: Other reports are more optimistic about Iraq's future. A report from a survey of 367 senior executives from 52 countries by *The Economist* reinforces findings that revenue from expanded oil production will be the engine for growth in other sectors of the Iraqi economy. The report points to 11 technical service contracts with international oil companies as primary factors that will bring Iraqi oil production to more than 6 million bpd by 2016.

The report also states that "opportunities abound for enterprising businesses looking to enter the Iraqi market." The report also points to lack of publicly available information to potential global investors about opportunities in Iraq as a significant impediment on investment and growth. "Companies wishing to consider investment in Iraq often do not have sufficient information necessary to make informed business decisions."

The report also points to uncertain security and ongoing violence as a primary concern by many companies considering investment in Iraq. Other firms, however, see the security situation as improving and more than one-third of respondents now see Iraq as "a country with significant opportunities for those who are willing to accept risks in the short term." Nearly 30 percent of respondents see Iraq as "a fledgling economy with a promising long-term political and economic future."

After oil and gas, construction is seen as the most promising sector with 45 percent of survey respondents seeing opportunities. Following construction the most promising sectors in Iraq are seen as chemicals (25 percent), consumer goods, healthcare and pharmaceuticals (tied at 22 percent); then agriculture and agribusiness (20 percent). Iraq's untapped consumer market is seen as a major growth opportunity by nearly half of all survey respondents with "the chance of achieving a *first player* advantage as a major attraction.

Violence (69 percent), corruption (45 percent) and poor infrastructure (38 percent) are seen as the primary risks by survey respondents. These are followed by credit risk, bureaucracy and lack of contract protection. Almost 70 percent of existing investors in Iraq expect the security situation to improve during the next two years. Conversely, respondents not currently investing in Iraq are less optimistic with 61 percent expecting the security situation to stay the same or get worse.

Surveyed investors emphasized the following secrets to success when investing in Iraq:

- Local knowledge and understanding of the different regions;
- The right local partner (who understands compliance requirements for Western companies);

- Access to foreign capital;
- Some appetite for risk;
- Understanding importance of community integration and corporate social responsibility in a country where attitudes about foreign companies can be mixed;
- A long-term view – and patience.
  [**Source:** *The Economist, "Iraq through Investors' Eyes: Perspectives on Risks and Rewards," a white paper by the Economist Intelligence Unit, September 2010.]*

Agriculture: In addition to oil production and development, agriculture/agribusiness was listed by 20 percent of the respondents to the previously discussed survey as a promising Iraqi growth sector. Agriculture is Iraq's second largest economic sector but it trails a distant second to the oil sector in terms of revenues producing about 12 percent of GDP. Agriculture is the largest sector for employment in Iraq after government and employs at least 15-20 percent of the labor force. Historically, 50 to 60 percent of Iraq's arable land has been under cultivation.

Ethnic politics and inconsistent agricultural policies under the Saddam regime discouraged domestic agricultural production. Obstacles to agricultural development, most of which existed prior to 2003, include: 1) government policies and subsidies that distort the market and undermine productivity and competition; 2) outdated technology in plant and animal genetics, fertilizers, irrigation and drainage systems, and farm equipment; 3) inadequate and unstable electricity supplies; 4) degradation of irrigation-management systems; 5) insufficient credit and private capital; and 6) inadequate market information and networks.

Iraq is increasing investment in agriculture in an attempt to alleviate some of these deficiencies. Most funding is primarily through government investment, however, with very little private sector participation. An eight-year irrigation program costing $700 million has been funded and will start during the fourth quarter of 2011. A Deputy Minister of Agriculture recently announced that the government had allocated $34 million to purchase three thousand irrigation sprinklers for the project during 2011 and a tender to procure 500 irrigation systems from western firms has been accepted. Investment in agricultural infrastructure including water pumps is essential, not only for agriculture, but also for the oil sector.

Irrigation investment is projected to increase wheat production by more than 60 percent. Unrest, anger and civilian protests related to rising food prices in neighboring regions -- including Egypt, Libya and Tunisia -- were primary drivers for Iraqi policymakers to initiate this program. The eight-year irrigation investment program aims to calm concerns about food security by increasing production from 1.86 million tons of wheat in 2010 to 3 million tons by 2019. Iraqis consume at least 4.5 tons of wheat annually and a large portion of imported wheat and rice go to the massive public food rationing program. The project will also update Iraq's water irrigation systems and contribute to increased production of other more profitable crops.

To stimulate private investment in agriculture the Iraqi government has also created an annual fund of $500 million within the federal budget to provide interest free soft loans to farmers and investors. This initiative is focused on all crops, but the government has emphasized production of strategic crops – including wheat and rice. Another approximately $75 million has been allocated to provide interest-free soft loans to livestock farmers and investors. With agricultural initiatives and increased investment the Iraqi government hopes to fine-tune its agricultural sector and boost production and efficiency. [**Source:** *Iraq's Economy in 2011 and Beyond*, http://www.DrDinar.com]

Trade: With the lifting of UN sanctions after removal of the Saddam regime in 2003, Iraq has gradually resumed trade relations with the international community, including the U.S. The United States designated Iraq as a beneficiary developing country under the Generalized System of Preferences (GSP) program in September 2004. As post-war recovery continued Iraq has emerged as a transitioning economy.

Iraq was granted observer status at the World Trade Organization (WTO) in February 2004, and began its WTO accession process in December 2004. Iraq has participated in two Working Party meetings as part of the accession process, one on May 25, 2007, and the other on April 2, 2008. During this long-term WTO accession process, Iraq must align its trade regime with the rules-based, multilateral international trade system.

Through USAID technical assistance, the U.S. is continuing to support Iraq's accession to the WTO. Completion of the requirements for WTO membership will help Iraq establish a proven framework for fostering a more stable and transparent economy that will encourage both domestic and foreign investment. [**Source***: U.S. Department of State, Travel Document Systems, 2010*]

Table 2: Latest Available Macroeconomic Data for Iraq

GDP (2010 est. total): $117.7 billion (2010 est.)
GDP components: industry 63%; govt. services 27.3%; agriculture 9.7%
GDP per capita (2010 est. per person): $3,600.
GDP real growth rate (2010 est.): 5.5%.
Rate of inflation (2010 est.): 4.2%.
Labor Force (2009 est.): 8.5 million
Unemployment rate (2009 official): 15.3%.
Labor Force Occupation: govt. services 59.8%, agriculture 21.6%; industry 18.7%;
Budget (FY 2010): *Revenues*--$52.8 billion; *expenditures*--$72.4 billion.
Public debt (Dec. 2010): $52.58 billion.
Natural resources: Oil, natural gas, phosphates, sulfur.
Agriculture: *Products*--wheat, barley, rice, vegetables, dates, cotton, cattle, sheep, and poultry.
Industry: *Types*--petroleum, chemicals, textiles, leather, construction materials, food processing, fertilizer, metal fabrication/processing.
Trade:
Exports (2010)--$49.1 billion
Export commodities (2010)--crude oil (84%), crude materials excluding fuels (8%), food and live animals (5%).
Export partners--US 27.62%, India 14.45%, Italy 10.14%, South Korea 8.62%, Taiwan 5.61%, China 4.23%, Netherlands 4.13% and Japan 3.99%.

Imports (2010)--$42.56 billion
Import commodities--food, medicine, manufactures.
Import partners--Turkey 24.99%, Syria 17.36%, US 8.66%, China 6.79%, Jordan 4.71%, Italy 3.98% and Germany 3.97%
[***Main Data Source:*** *CIA World Fact Book, January 12, 2011*]. *All values, unless otherwise stated, are in U.S. dollars*

Signs of Progress: Eight years after the ouster of Saddam Hussein Iraq is in the process of change, but everything has not returned to normal. Convoys of Sports Utility Vehicles (SUVs) packed with heavily armed security still roar down Baghdad's busy streets. Bombings and assassinations with silenced weapons occur nearly daily.

Ordinary Iraqis, however, are living more normally than they have in years. Shops on Saadoun and Karrada Streets are filled with flat-screen TVs, computers, and clothing from China, Turkey, Iran, and Korea. Pedestrians have to step around the Turkish and Iranian refrigerators and stoves piled outside. At night many Baghdadis relax watching one of the privately owned television channels that have sprung up, or checking the latest Iraqi Web sites.

Oil money from increasing production is powering growth, in addition to pent-up demand for housing and better infrastructure. Now that the government has awarded oil-field contracts worth billions of dollars to international oil companies, foreign clients are requesting assistance to finance everything from pipelines to power grids to workers' camps. Suppliers are following in the major oil companies' footsteps requesting loans for drilling equipment, pumps, valves and other supplies.

Lafarge, a French building-materials manufacturer obtained two Iraqi cement plants, both located near Sulaymania in Kurdistan, through acquisition of Egypt's Orascom Cement in 2007. Lafarge has never experienced a security incident in Kurdistan and is expanding into the more unstable center and south of the country. Lafarge now sells almost half its 5-million-ton annual output in Iraq to construction companies in the Baghdad area. The company may next buy outdated state-owned plants, refurbish them, and boost production. Construction is projected to continue increasing and new government contracts for housing projects throughout Iraq have been signed.

The historical fixation on oil has done little to encourage private investment according to some former Iraqi officials. There are still many government officials who were raised in a centrally planning government environment. These traditionalists still don't see the connection between private-sector investment and reducing unemployment and that has slowed momentum towards WTO accession.

Iraqi entrepreneurs who don’t have access to funds for modernization struggle against better-financed international rivals. Demand is growing but local manufacturers can’t compete with lower cost imports. The National Investment Commission is trying to refocus government managers to emphasize support for the domestic private investor.

There are encouraging signs that outside investors are continuing to expand. One oil services company is quickly moving $100 million into Iraq, in part to build a base camp that will employ 300 workers. The oil fields are expected to eventually generate up to 100,000 Iraqi jobs and the company’s management is primed to hire additional workers. Iraq is viewed as a Saudi-size opportunity and up to 100 drilling rigs will be needed for what could be the biggest oil boom ever. The Iraqi people and foreign investors are getting positioned to participate. [***Source**:* Bloomberg Businessweek, *Global Economics, April 22, 2010.*]

China and Brazil as Models: Iraq continued reviving economically during 2011 when neighboring countries in the Middle East suffered from an economic downturn due to demonstrations and ongoing political turmoil. Wracked in recent years by sectarian violence, insurgency and economic collapse, Iraq has been enjoying a quiet resurgence this year even as its neighbors in the Middle East are striving to stave off economic meltdowns in the face of political unrest.

Iraq’s stock market surged nearly 25 percent in the first two months of the year, and a record $20 million of investment funds flooded into the country from the U.S., Europe and other Persian Gulf states, even as other Arab stock exchanges fell by a collective 15 percent.

Iraq's economic renaissance began with little fanfare in December 2010 after the United Nations voted to recognize its newly formed government and lift long-standing sanctions against the country, said Kenneth Kuhn, president of Global Capital Investments, a Chicago investment firm that specializes in Iraqi stocks. With some of the biggest untapped reserves of oil in the world, Iraq also is benefiting from the surge in oil prices to more than $100 per barrel on worries ignited by the Middle East unrest.

Despite an outbreak of street protests in February by Iraqis demanding better services, less corruption and jobs, Mr. Kuhn said, the demonstrations were different from those in other countries because they were not aimed at unseating the democratically elected government.

Risks remain in the war-ravaged nation, Mr. Kuhn said, but he thinks Iraq is at the beginning of an economic revival that could make it a beacon of stability and prosperity after years of having the region's most stricken and violence-wracked economy. "It's a market that's at an historic bottom," he said. *"They're not out of the woods yet by any means, but it could be like being in China and Brazil 20 years ago" for businesses and investors willing to go out on a limb and tap into Iraq's potential growth.*

Although memories of the years of war and violence linger, Iraq has several reasons for optimism, Mr. Kuhn said:

- The U.S. and other Western powers, after spending hundreds of billions of dollars and sacrificing thousands of lives to liberate the country from dictator Saddam Hussein and establish a fledgling democracy, now want Iraq to succeed.
- With violence down by 90 percent since 2007, the International Monetary Fund last month found that Iraq had achieved economic stability with declining inflation and projected that its economy would maintain superlative annual growth rates of more than 10 percent in coming years.
- Fifty power plants are being constructed to meet Iraq's soaring demand for electricity, and other major projects include a big sports complex in the southern city of Basra and a Disney World-like park in the northern city of Mosul.
- Iraq's citizens are war-weary and want to put aside the decades of turmoil and establish a peaceful and prosperous society, Mr. Kuhn said, contending that the cycle of insurgency and violence has essentially run its course.
- Perhaps most important, Iraq with its oil wealth has the wherewithal to quickly reconstruct its economy and raise the standard of living. Iraq has 143 billion barrels of proven conventional oil reserves — the second largest in the world — and its production of oil reached a postwar high of 3 million barrels a day in February.

But the biggest gains lie ahead. Iraq has only begun to work with major oil companies to unlock potentially billions more dollars in conventional oil reserves. Iraq's oil minister says these measures will enable Iraq to rival top oil producer Saudi Arabia for oil exports within a decade.

The U.S. Energy Information Administration is projecting a smaller increase in Iraqi production to 6 million barrels a day by 2015. But even that level would represent a doubling of the country's current production and revenue. Iraq's potential to become an even bigger oil exporter as it ramps up its devastated oil sector is one reason the U.S. energy forecaster does not foresee a major worldwide crunch in oil supplies on the horizon.

Despite its significant assets, Iraq still faces severe problems and risks that could derail its fledgling economic recovery. Outbreaks of violence, while much lower than during the war years, still recur at times along with occasional sabotage of Iraq's critical oil facilities.

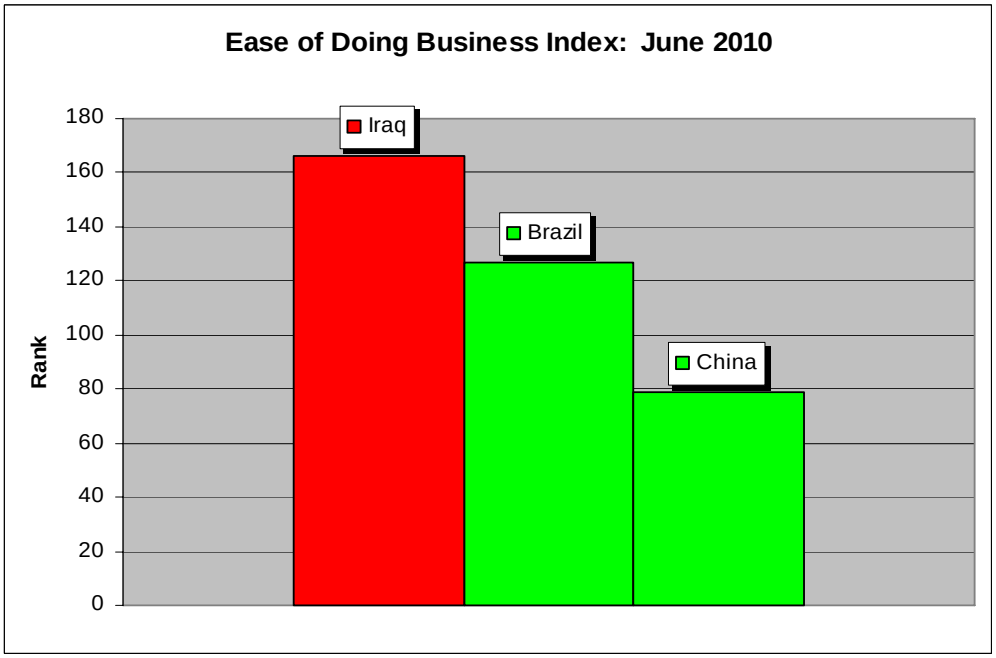
The ruling government coalition of Prime Minister Nouri al-Maliki, which took a record nine months to form last year, remains fragile and could be sorely tested if violence and sectarian strife pick up next year after most U.S. troops are scheduled to depart.

Gala Riani, an analyst at IHS Global Insight, said the protests that broke out in February, which forced the resignation of several provincial governors viewed as corrupt, may still pose dangers for the al-Maliki government, which has promised to improve government services within 100 days. "The challenge is that if protests continue, the government has few tricks up its sleeve that it could pull to placate anger, as many of the grievances expressed will take years to address," she said. "The government is newly formed; dissolving it is not a realistic option," she said. "If the situation escalates, the government may fall apart over internal disagreements."

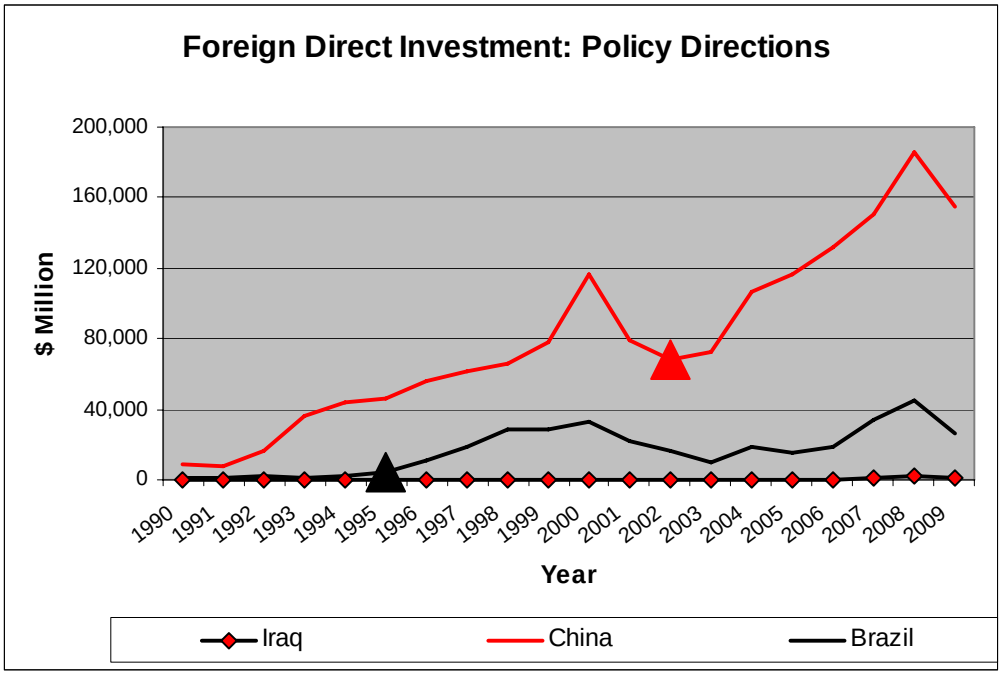
But the surge in growth and investment has nevertheless sparked hope and optimism that these obstacles can be overcome. David Hamod, president of the National U.S.-Arab Chamber of Commerce, said Iraq is on track to build more than $150 billion in infrastructure projects, and U.S. companies — which provide about a quarter of service exports to Iraq — stand to gain handsomely from the trend.

"Nowhere else in the Middle East and North Africa region do we see this level of exponential growth," Hamod said. "If the economy continues to grow at this pace, Iraq will become America's fourth-largest market in the Arab world within three years." The chamber co-sponsored an Iraq development conference along with the U.S. Commerce Department and U.S. State Department in February that drew a standing-room-only crowd of U.S. and Iraqi businessmen.

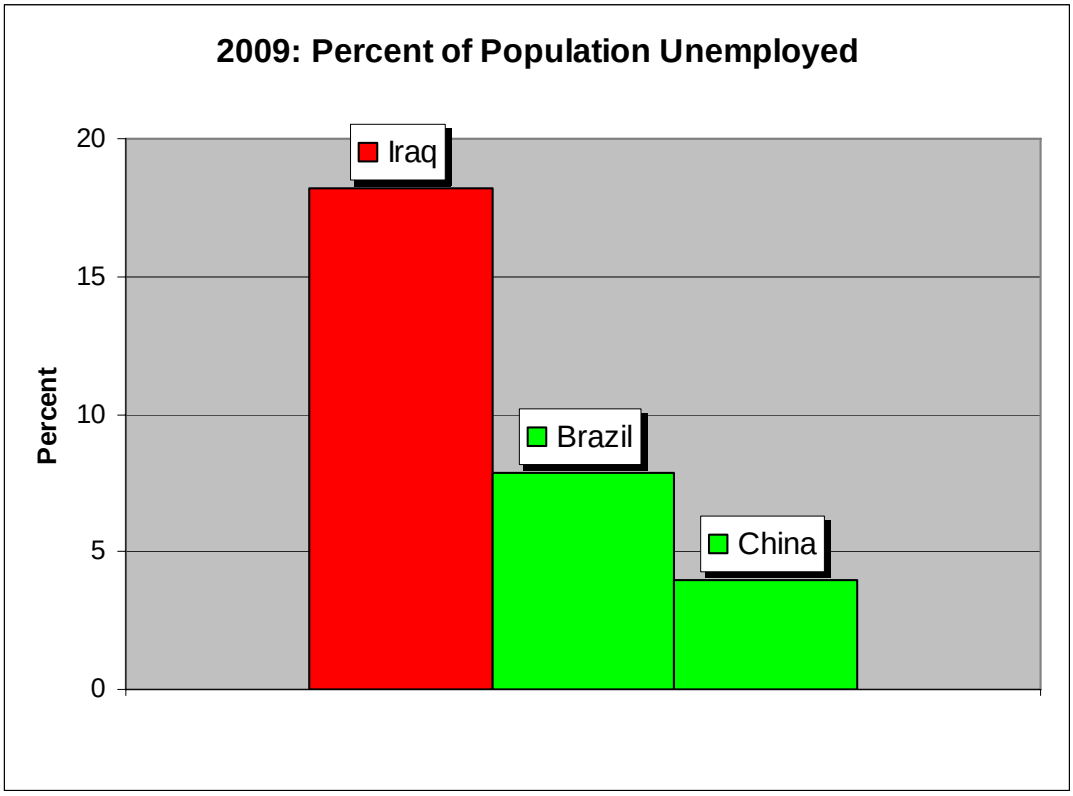
Naufel Alhassan, an Iraqi Embassy official, said that Iraq's goal is to create 3 million to 4.5 million jobs for its growing population and increase private-sector participation in the economy by 46 percent. He said Iraq is still emerging from a controlled economy "run by dead dictatorships," with high unemployment, heavy dependency on oil and a weak private sector. But he was optimistic about the road ahead. "We foresee excellent opportunities for American companies — large, medium, and small — to create joint ventures with new Iraqi companies in all sectors." [**Source:** *The Washington Times, "War-weary Iraq sees economic rebound: Stock market, investment surge," by Patrice Hill, April 10, 2011*]



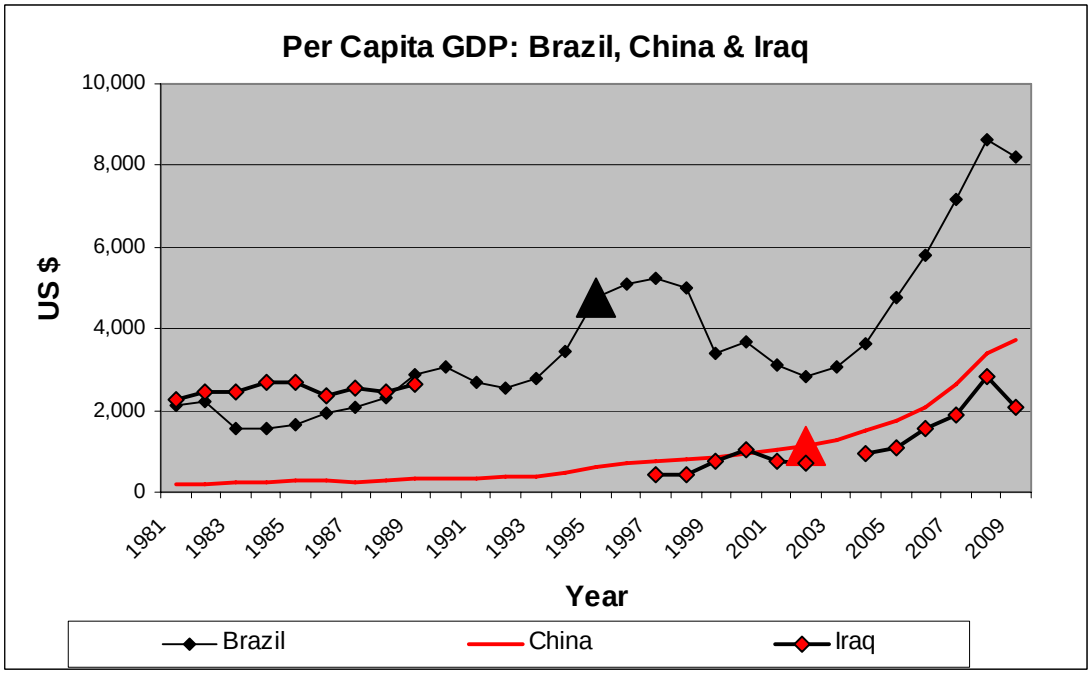
- Legislative and regulatory reforms in China and Brazil – both WTO members -- have resulted in a more investment friendly business enabling environment. Iraq is not a WTO member ranks 166 out of 183 and is among the most difficult countries for ease of doing business. [**Source:** *World Bank and International Finance Corporation, "Doing Business in 2011: Making a Difference for Entrepreneurs,"* http://www.doingbusiness.org/rankings]



- An investment friendly business enabling environment attracts Foreign Direct Investment (FDI). Brazil has averaged between $20 billion and $40 billion annual FDI since the mid-1990s. China's annual FDI has generally been more than $80 billion since joining the WTO December 11, 2001 with a peak of $195 billion FDI in 2008. In the short term WTO accession and associated legislative reforms will assist Iraq in attracting increased foreign investment, particularly in the services sector.
[**Source:** http://data.worldbank.org/data-catalog]



- WTO members Brazil and China have attracted investment throughout more economic sectors resulting in broader based economies and stronger economic growth. Economic growth results in lower unemployment. [**Source:** http://www.indexmundi.com]



- China is among the world's largest oil importers and Brazil is a net importer of oil. With large oil reserves and strong oil export potential, Iraq has the long-run potential for much higher economic growth and per capita Gross Domestic Product (GDP) than either China or Brazil – if it joins the WTO and follows through on related economic reform. [**Source:** http://data.worldbank.org/data-catalog]

China's Five Year Plan:
During nearly four decades under the Saddam regime Iraq was managed as a Soviet-style centrally planned economy. Iraq now faces a policy decision of reforming State Owned Enterprises and transitioning to a market-based economy. If it continues, this transition will not be unlike the transition by China as it evolved from being a Communist-run centrally planned economy prior to the 1970s to a much stronger market orientation and global competitor today.

China's plan for the next five years is likely prophetic for changes that lie ahead during the next few decades in Iraq if it continues the path towards economic reform and WTO accession. The China five-year plan (the plan) aims to transform the world's second largest economy from an investment driven dynamo into a global powerhouse with a steadier and more stable trajectory. The plan affects domestic and foreign companies in all industries.

Five groups emerged from an analysis of China's five year plan as follows:

- New strategic industries are singled out for global leadership;
- Domestic consumption engines drive consumer growth in the homeland;
- Restructurers are under government mandate to change;
- Re-inventors are mature industries that must innovate and reinvest to close the gap with global leaders; and
- Social utilities are large state-owned enterprises managing significant components of the national infrastructure.

New strategic industries: The plan characterizes a handful of industries as emerging battlegrounds where countries will be competing for technological leadership during the next wave of development. These industries, including new energy sources and biotechnology, are distinguished by high profit growth potential and moderate state oversight. In these areas, the government has dedicated itself to incubating national and global champions by helping them gain leading technologies and expanding commercial capabilities.

China's government aspires to increase the share of GDP these industries contribute from about one percent today to eight percent by 2015; and to 15 percent by 2020. These industries present huge market potential for domestic and foreign businesses. Although significant uncertainties remain in such young markets, companies that compete should focus on building core competitiveness in technological and commercial capabilities, as well as gaining recognition as local innovators. Domestic players should concentrate on acquiring leading technologies and building relationships with local governments. Foreign companies must bring advanced technology and be viewed as trusted partners for local innovation.

Domestic consumption engines: Industries that will benefit most from the government's efforts to retool the Chinese economy and boost domestic consumption are consumer based industries including airlines, fast-moving consumer goods, food, pharmaceuticals, shipping, and tourism. These domestic consumption engines have a favorable environment for profit growth and reasonably free markets. They also benefit from the government's attention to social harmony and "green" development.

To capture the greatest growth opportunities, companies must increase their market penetration and offer tailored products for core customer segments. They should also closely monitor development of specific consumption enhancing government policies -- encouraging urbanization, optimizing the investment structure, strengthening the social

safety net, increasing household income, and developing the retail infrastructure. Opportunities in newly urbanized areas and the countryside should be explored vigorously. In addition, the government's push to assure higher product safety and quality and to encourage environmentally friendly consumption habits will present further openings for early adapters.

While government efforts to increase household incomes and wages will help spur private spending, they also present companies with the challenge of keeping expenses competitive amid rising labor costs. The plan targets a 13 percent increase in minimum wages each year, along with a more modest annual increase in household income (about 7 percent). Construction, consumer electronics, logistics, retailing, and other industries will feel the pinch. Further, costs will probably increase as a result of new policies for pricing energy, raw materials, and water; tighter environmental regulations; and enhanced consumer protection. Intense concern over inflation means that the government is unlikely to favor fully passing these cost increases on to consumers.

The government is also shaping the competitive environment in other ways. Industries including education, financial services, health care, and logistics are being deregulated, further opening the market to foreign companies. Increased attention to food and drug safety and to quality gives companies with a solid reputation for high standards an opportunity.

Restructurers: Real estate and commercial banking, two industries fundamental to China's economic and social well-being, face significant structural risks and follow shaky business models. The government has given these sectors a clear mandate to clean up their act.
China's real-estate industry has enjoyed rapid growth during the past five years, contributing strongly to overall GDP and local government budgets. The overheated market has raised fears of speculative bubbles and social instability linked to rising housing costs. The government sets a target of 36 million affordable living units and promises strict oversight of housing loans and the residential market.

For fundamental reform, however, the industry must create a profitable and sustainable business model — for instance in retail real estate or affordable housing projects. The central government must find new income sources for municipalities that have used proceeds from lucrative property sales to finance local industry development projects, as well as establish alternative investment channels.

Commercial banks also expanded rapidly during the surging real-estate market, primarily by lending to developers. Commercial banks now face their own obligation to reform. To maintain profit growth rates banks must identify the plan's new revenue streams — support for small- and medium-sized businesses, digital banking, and wealth management, for example — and build capabilities in managing risk and talent and other value-added roles. Banks must also become adept at interpreting and balancing contradictory government policies including the drive to control inflation while at the same time financing small- and medium-sized enterprises and stimulating private consumption.

After much-needed reform, Chinese banks will be free to offer more sophisticated and diversified services, and the sector may enter a new era of competition. These developments will require know how, talent, well-structured processes, and management. Chinese banks currently suffer from a capability gap, opening opportunities for leading foreign institutions. The size of the opportunity depends on the direction and depth of reform. Foreign banks might also be able to provide assistance with regulatory reform.

Re-inventors: Many mature manufacturers in China lag behind their global competitors in technology and suffer from overcapacity, low efficiency, and high pollution. These companies account for most of the re-inventors. The government aims to transform industries through innovation and upgrades.

This group generally benefits from the drive to stimulate domestic demand. The plan reserves the best opportunities for producers that use advanced technology, add greater value, boast higher energy efficiency, and offer more protection for the environment. Fiscal and tax policies, as well capacity and export regulations, collectively encourage these players to improve and consolidate. The plan encourages local innovation to develop domestic brand equity and intellectual property.

China's mature industries are particularly vulnerable to the new focus on green development –expected to drive up costs related to environmental protection, energy conservation, reduced pollution, and even raw materials -- in addition to pressures linked to rising labor costs. Energy efficiency and carbon dioxide emission targets, for example, will add to demands on industries including nonferrous metals, power, and steel. Success will depend on a company's ability to maintain margins while accumulating green equity.

In a drive to create national champions, the government has set clear guidelines encouraging accelerated industry consolidation, especially in automotive, industrial machinery, nonferrous metals, and steel. Prominent domestic players can acquire high-quality assets, strengthen leadership positions, and build credentials as national champions. Foreign companies can also take advantage of this drive by completing strategic mergers and acquisitions and becoming more competitive in the local market.

Social Utilities: State-owned enterprises (SOEs) that manage national infrastructure networks -- the power grid, railways, and telecommunications -- will grow steadily thanks to urbanization and strong support from the government. With no real competition, the main responsibility of these social utilities will be to use scale and procurement power to deliver successful planned domestic projects at global standards of quality and cost.

Improved infrastructure is critical to the country's urban-development program, and the central government has laid out clear plans for expanding the penetration and capacity of China's rail, power, and communications networks. These expansion plans will enjoy significant government investment, ensuring that SOEs and their suppliers (in industries such as construction, equipment, and steel) have secure revenue streams.

However, China's natural monopolies must work to contain rising construction and operational costs related to new energy and environmental regulations and from rising wages. SOEs will also feel pressure to innovate and improve their business models for the sake of profitability and high quality. These companies have enormous procurement power and can expect to receive help in their efforts from global technology leaders and, ultimately, to set worldwide industry standards. Foreign companies are quite interested in selling to the national infrastructure networks that clearly offer big opportunities as expansion continues.

China's ambitious five-year plan builds on decades of unprecedented economic growth. The plan is to transform the economy from an investment led powerhouse focused exclusively on growth in GDP to a sustainable model that balances growth with social harmony, and innovation with environmental protection. The direction China's leaders hope to move is clear. Domestic and foreign companies must understand implications so they can identify opportunities and risks in their business plans. [**Source:** *McKinsey Quarterly*, *"What China's five-year plan means for business," Guangyu Li and Jonathan Woetzel, July 2011*]

Turkey and Iran Compete to Fill the Void: A recent report by the United States Institute of Peace suggests that Washington should be less concerned about increased cooperation between Turkey and Iran because the two countries have different visions for the Middle East. The U.S. is scheduled to withdraw all forces in Iraq by December 2011. "Iran and Turkey are rapidly becoming the most influential external actors inside the country as the U.S. troop withdrawal proceeds," United States Institute of Peace (USIP) Iraq program officer Sean Kane wrote in his report "*The Coming Turkish-Iranian Competition in Iraq*."

"From the sixteenth century until the collapse of the Ottoman Empire after World War I, Iraqi history was largely determined by the ebb and flow of conflict between Ottoman Turks and the Safavid Persians," the report said. The U.S. withdrawal could result in the resumption of the competition between Iran and Turkey, the heirs of the Ottoman and Persian empires.

In 2010, Iraq's Foreign Minister identified Iran and Turkey as "the biggest players and rivals in Iraq." "When in August 2010, Iran opened its first trade center in Sulaymania, Iran's deputy minister of commerce, complained that Turkey, described as 'Iran's rival,' had already opened twelve such centers." A Kurdish official also indicated that Iran was not very happy when the Turkish prime minister visited Kurdistan at the end of April. "Turkey and Iran compete in Kurdistan," he said.

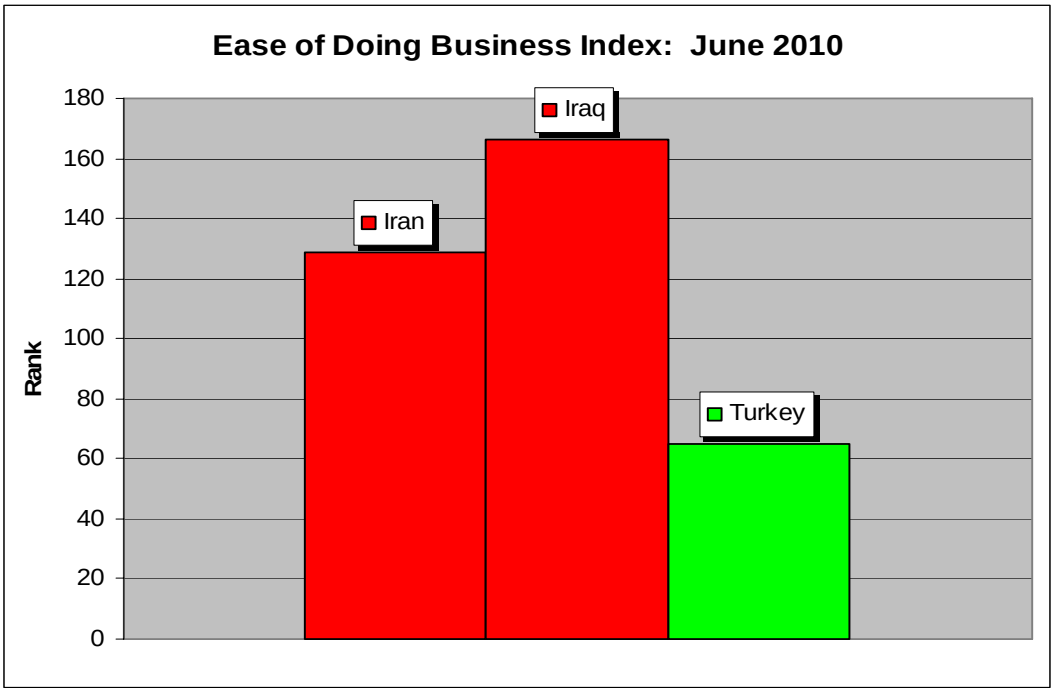
A Deputy Program Director for the International Crisis Group told Reuters that the October 2009 opening of the Turkish consulate in Basra was meant to curb Iranian influence in Iraq through investments and trade. The report suggests that Turkey should use its "successful" outreach such as the Foreign Minister's visit and Turkey's economic relations with the Kurdistan region to improve relations with Shiite parties in Iraq. "A similar strategic outreach to Shiite parties based on economic integration and Ankara's and Baghdad's common interest in a stable and strong Iraq could have similar mutual benefits," the report said.

Turkey supported the secular Iraqiya list -- an alliance of Arab nationalists and Turkmen -- in the March 2010 Iraqi elections, while Iran supported a Shiite-dominated coalition to prevent Sunnis from taking power. "Iran and Turkey tend to work at cross purposes in Iraqi politics, as seen in the protracted power struggle surrounding Iraq's 2010 election cycle."

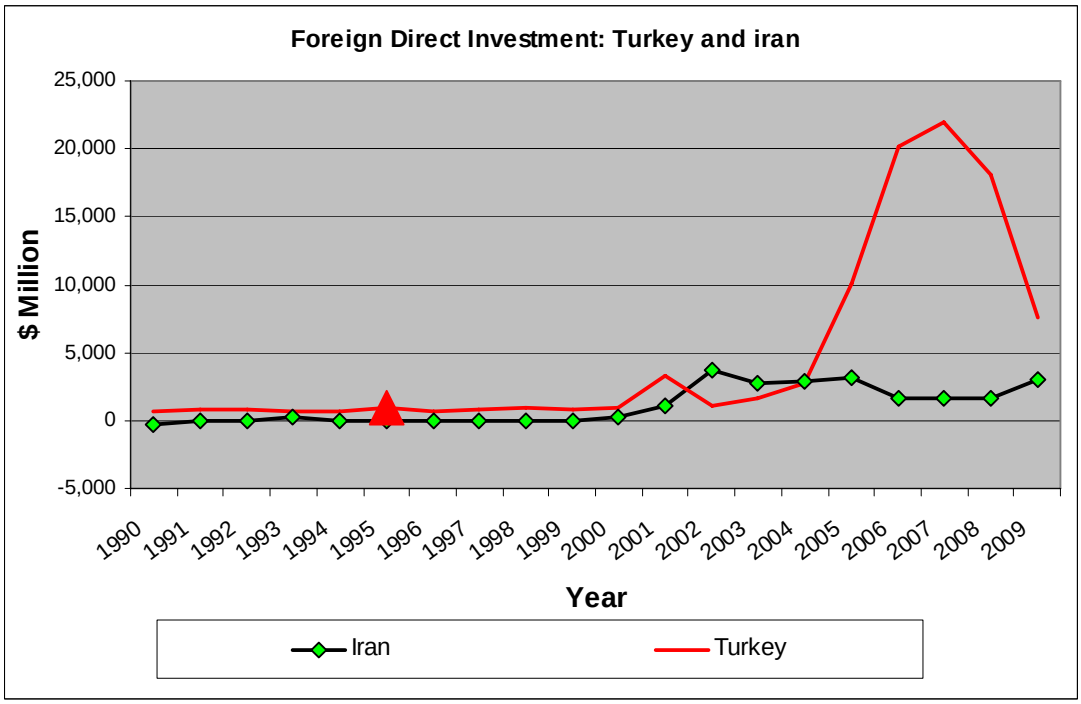
The U.S. is concerned about the continuing Iranian influence in Iraq. American soldiers continue to be killed by suspected Iran-backed groups in Iraq, reaching the highest casualty rates for American troops in two years. Major General Jeffrey Buchanan, chief spokesman for the U.S. military in Iraq, told the *Washington Post* that the biggest threat to U.S. troops comes from some Iran-backed Shiite groups in Iraq.

As the deadline for the U.S. troop withdrawal approaches, Iran is increasingly pushing Iraqi authorities not to extend the presence of U.S. forces. "It is now pushing strongly, most notably through the Sadrist Movement and its leader to prevent any request by the Iraqi government for a continued U.S. troop presence after 2011," the report said.

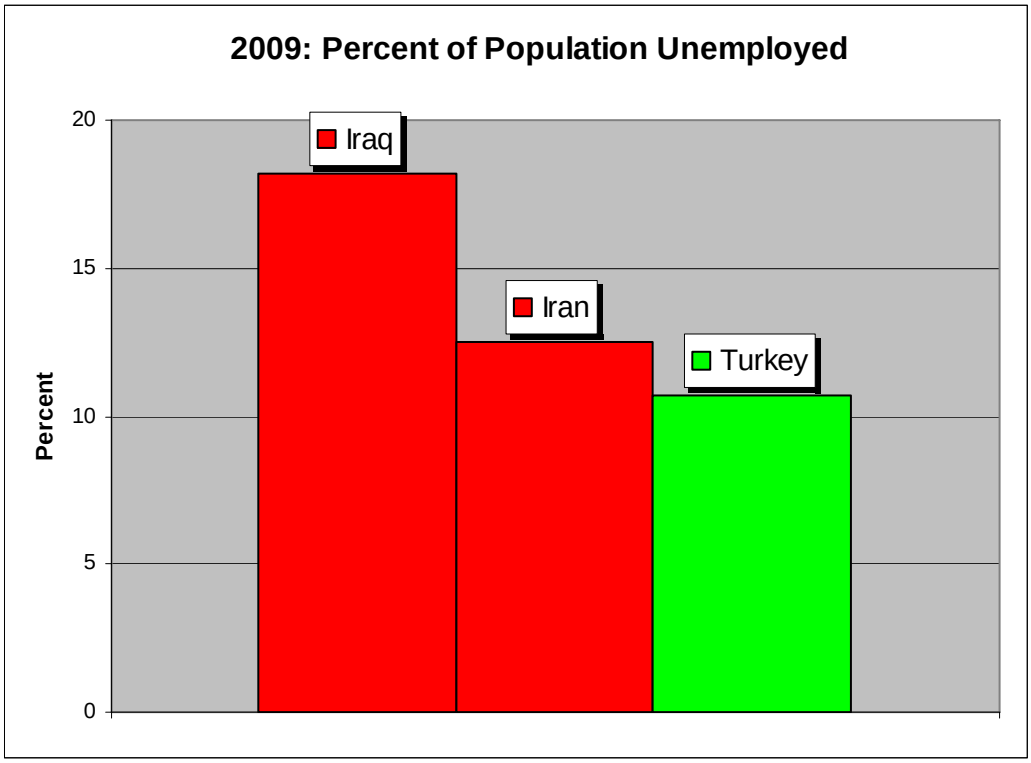
The report concluded that the Turkish "blend of Islam, democracy, and soft power is a far more attractive regional template than the Iranian narrative of Islamic theocracy and hard power resistance." "The United States should therefore continue to welcome increased Turkish-Iraqi economic development, trade, and energy ties, and where possible, support Turkey's development as a key part of its post-2011 strategy for Iraq and the region."
[**Source***: "Turkey and Iran Vie for Control of Iraq, Wladimir van Wilgenburg,* http://www.rudaw.net/english/news/iraq/3792.html, *July 2, 2011*]



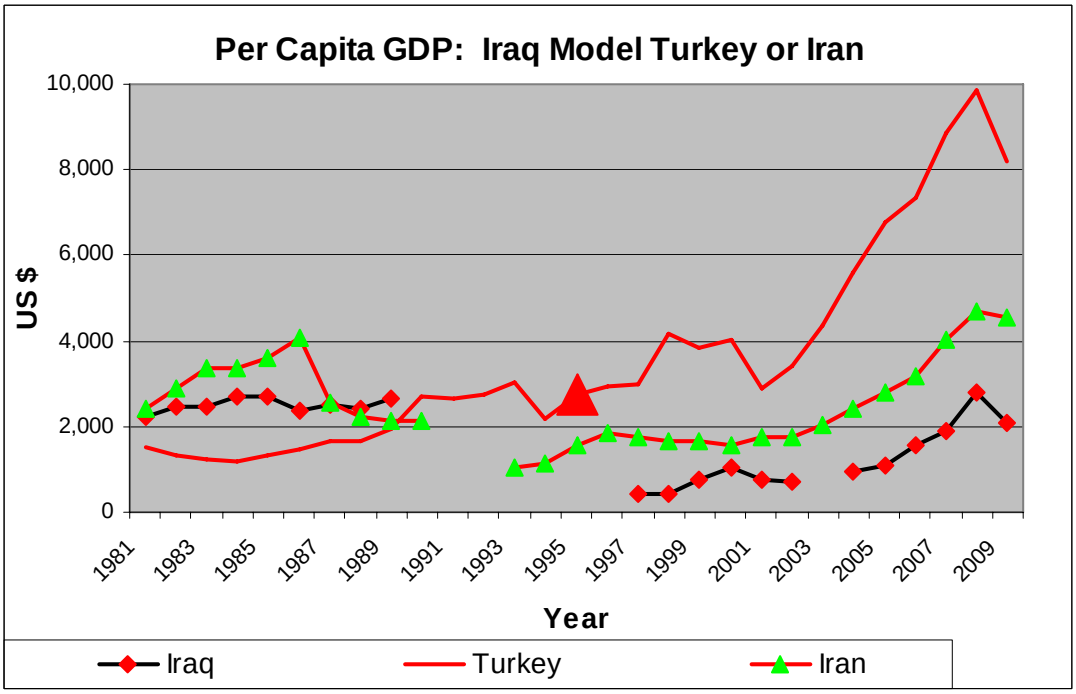
- Iraq and Iran are not WTO members and rank among the most difficult countries for doing business. Turkey became a WTO member in 1995 and economic reforms associated with WTO membership have made it among the top one-third of 183 countries for ease of doing business. [**Source:** *World Bank and International Finance Corporation, "Doing Business in 2011: Making a Difference for Entrepreneurs,"* http://www.doingbusiness.org/rankings]



- An investment friendly business enabling environment attracts Foreign Direct Investment (FDI). WTO member Turkey (the large triangle indicates year of WTO membership) has averaged between $5 billion and $20 billion annual FDI since 2005. Iran has averaged $3 billion or less annual FDI since 2001. [**Source:** http://data.worldbank.org/data-catalog]



- WTO member Turkey with higher FDI has a lower rate of unemployment than do non-members of WTO, Iraq and Iran. [**Source:** http://www.indexmundi.com]



- Turkey is a net importer of oil but has higher per capita GDP than do oil exporters Iraq and Iran who are non-members of WTO. With large oil reserves and strong oil export potential, Iraq has the long-run potential for much higher economic growth and per capita GDP than Turkey (GDP) – if it joins the WTO and follows through on related economic reform. Gaps in data for Iraq and Iran reflect years of war and sanctions when no data were reported. [**Source:** http://data.worldbank.org/data-catalog]

Cross-Country Comparisons: Implications from WTO Accession

Foreword: The main function of the WTO is to ensure that trade and investment flow as smoothly, predictably and freely as possible. Consumers and producers in 153 WTO-member countries have reasonable assurance of secure supplies and greater choice among finished products, components, raw materials and services. Producers and exporters know that foreign markets will remain open and that they can develop production and marketing plans with minimal risk that the rules of the game will change.

By reducing trade barriers, the WTO's system contributes to a more prosperous, peaceful and accountable economic world and reduces other barriers between people and nations. Virtually all decisions in the WTO are taken by consensus among member countries. Trade friction is channeled into the WTO's dispute settlement process where the focus is on interpreting agreements and commitments, and how to ensure that countries' trade policies conform to international norms. The risk of disputes spilling over into political or military conflict is reduced through negotiation and arbitration.

At the heart of the multilateral trading system are the WTO agreements. These agreements are negotiated and signed by a large majority of the world's trading nations (153 WTO members to date), and ratified by individual members' parliaments. Essentially, these agreements are contracts, guaranteeing member countries important trade rights and serve as the legal ground-rules for international commerce. They bind governments to accept consistent trade policies within agreed limits so all trading partners benefit. The agreements were negotiated and signed by governments who have completed the WTO accession process. Their purpose is to help producers of goods and services, exporters, and importers conduct day-to-day global business.

Iraq submitted the original application to join the WTO in December 2004. Initial momentum and progress for WTO membership was positive, but a combination of the insurgency, election of a new Parliament in March 2010 and formation of a new coalition government during the first quarter of 2011 has resulted in a loss of momentum and the need to renew institutional memory.

Many members of the new Iraqi government and many in the evolving private sector are unaware of the WTO and potential gains from accession. In particular, most traders are not informed as to how Iraq may benefit from WTO membership through increased international trade. In the short term WTO accession and associated legislative reforms will assist Iraq in attracting increased foreign investment, particularly in the services sector.

Purpose: Officials at the Ministry of Trade (MoT) have indicated the need for updated materials to educate newly appointed members of the Cabinet, new Parliamentarians and members of the Iraqi business community. The request was for material to demonstrate impacts on trade, investment and the overall economies of other countries that have completed WTO accession. Specifically, the need for cross-country comparisons was emphasized.

USAID/Tijara has responded to this request by providing the following comparative analysis. Seventeen countries were selected for a cross-country comparison of economic impacts before and after WTO accession. Countries evaluated include a mix of population size, median age, geographic location, net oil trade, percent literacy and time of WTO Accession.
In the final analysis, the issue of whether to proceed with WTO accession -- or not – will be an internal Iraqi political decision and will be determined by Iraqis educating and negotiating with Iraqis.

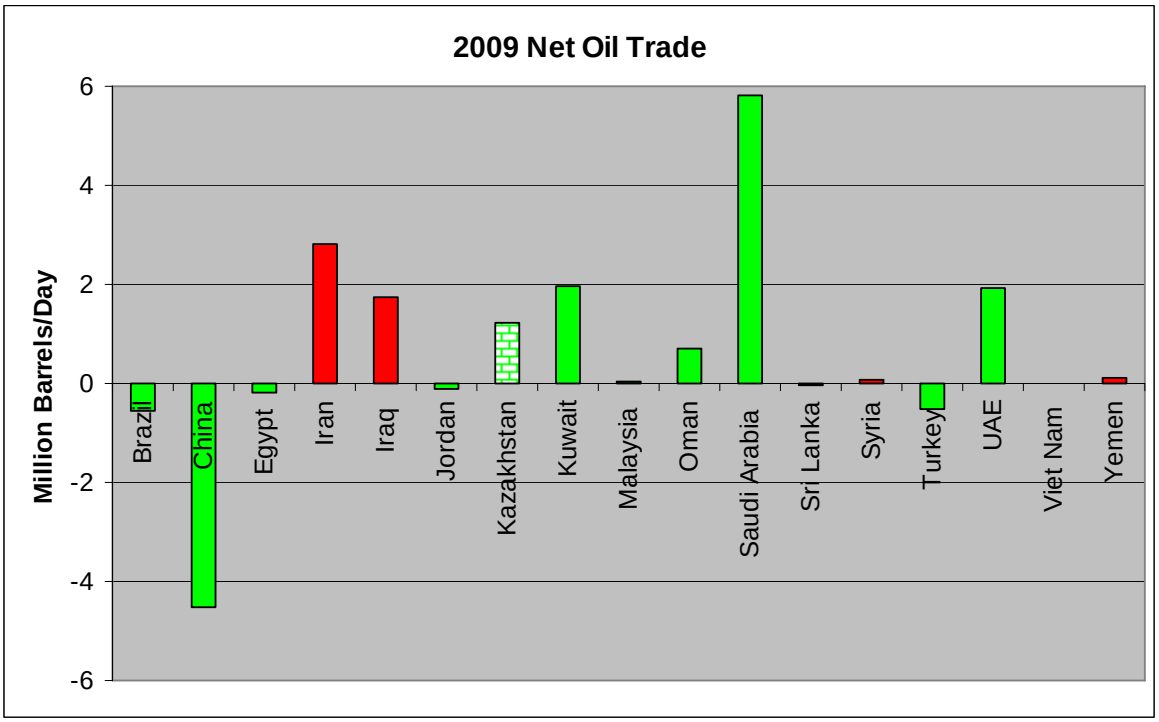
Country Statistics: Previous discussions with MoT and at Workshops conducted but the Senior Services Advisor indicated interest by Iraqi officials in countries with a mix of characteristics. Based on this input *USAID/Tijara* selected seventeen countries for a cross-country comparison of economic impacts before and after WTO accession. The countries include a mix of population size, median age, geographic location, net oil trade, literacy rate and time of WTO Accession.

Country	Population million	Median Age years	Literacy*	Oil Production mb/d**	Net Oil Trade*** mb/d	WTO Accession date
Brazil	203.43	29.3	88.6	1.95	-0.57	Jan. 1, 1995
China	1336.72	35.5	91.6	3.80	-4.53	Dec. 11, 2001
Egypt	80.08	24.3	71.4	0.54	-0.18	June 30, 1995
Iran	77.89	26.8	77.0	4.04	2.81	
Iraq	30.40	20.1	74.1	2.39	1.76	
Jordan	6.51	22.1	89.9	0.02	-0.09	Apr. 11, 2000
Kazakhstan	15.52	30.2	99.5	1.46	1.24	Dec. 31, 2012 proj
Kuwait	2.60	28.5	93.3	2.35	1.98	Jan. 1, 1995
Malaysia	28.73	26.8	88.7	0.58	0.02	Jan. 1, 1995
Oman	3.03	24.1	81.4	0.81	0.70	Nov. 9, 2000
Saudi Arabia	26.13	25.3	78.8	8.25	5.81	Dec. 11, 2005
Sri Lanka	21.28	30.8	90.7	0.00	-0.02	Jan. 1, 1995
Syria	22.52	21.9	79.6	0.37	0.09	
Turkey	78.79	28.5	87.4	0.05	-0.53	Mar. 26, 1995
UAE	5.15	30.2	77.9	2.41	1.92	Apr. 10, 1996
Viet Nam	90.55	27.8	90.3	0.30	-0.01	Jan. 11, 2007
Yemen	24.13	18.1	50.2	0.29	0.12	

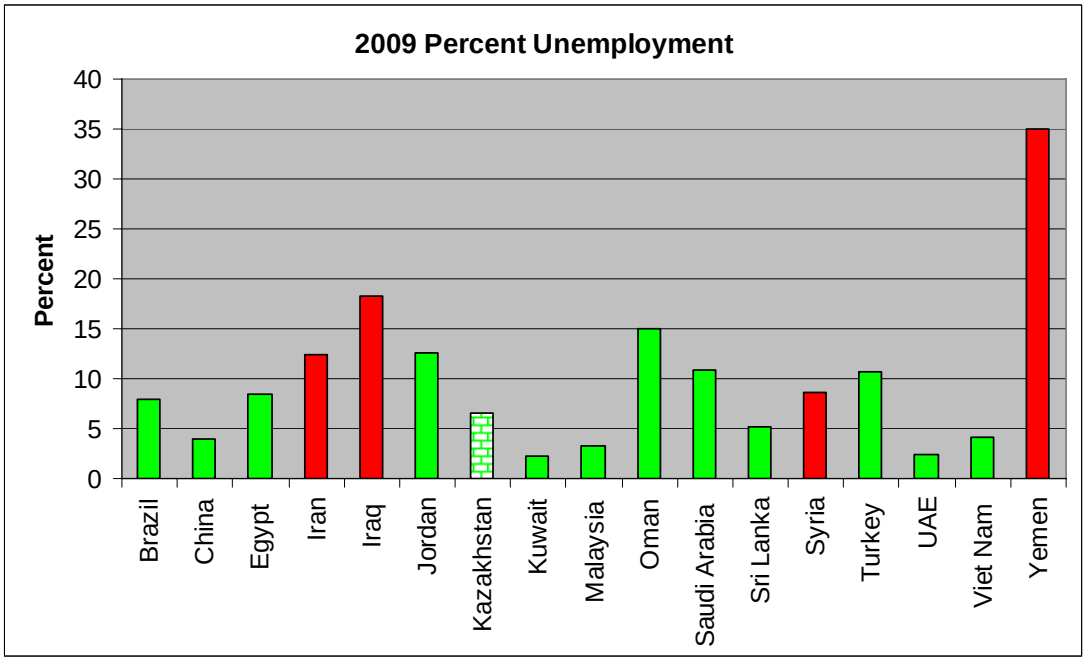
* Percent of population > 15 years who can read and write
** mb/d = million barrels per day
*** Net Oil Trade = production - domestic utilization. A negative sign means net importer

[**Source:** *All data in the above table from* http://www.indexmundi.com]

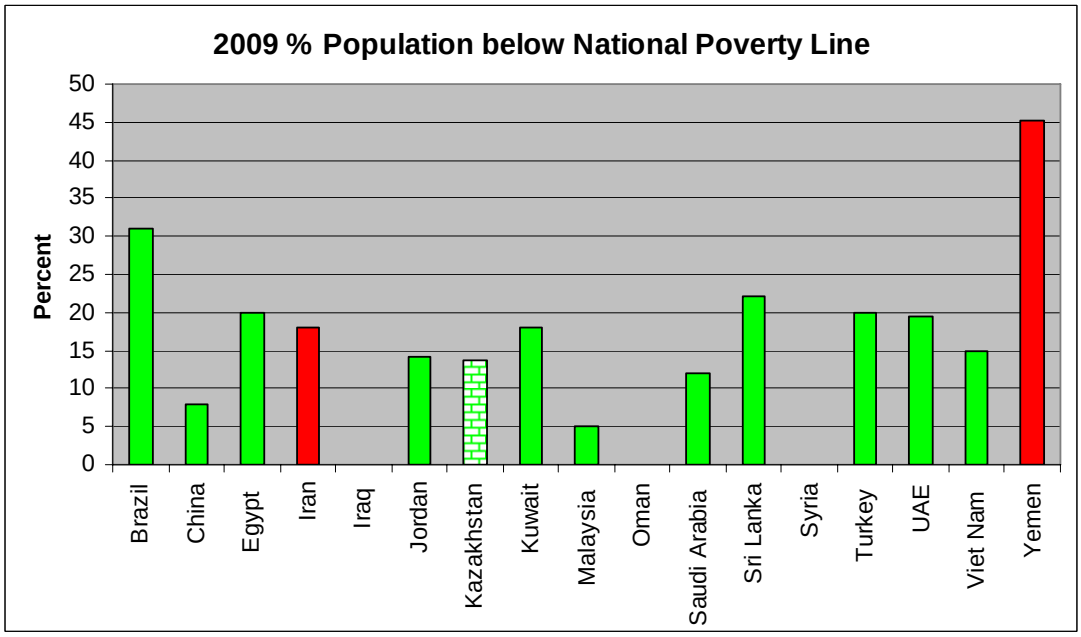
Note: It is historically relevant that the WTO replaced the General Agreement on Tariffs and Trade (GATT) on January 1, 1995. The 128 GATT signatories by the end of 1994 became WTO members as of January 1, 1995 with exceptions -- Turkey signed the GATT in October 1951 but WTO membership was delayed until March 26, 1995. Similarly, Egypt signed the GATT in May 1970 but WTO membership was delayed until June 30, 1995 and the UAE signed the GATT in March 1994 but WTO accession was not finalized until April 10, 1996.



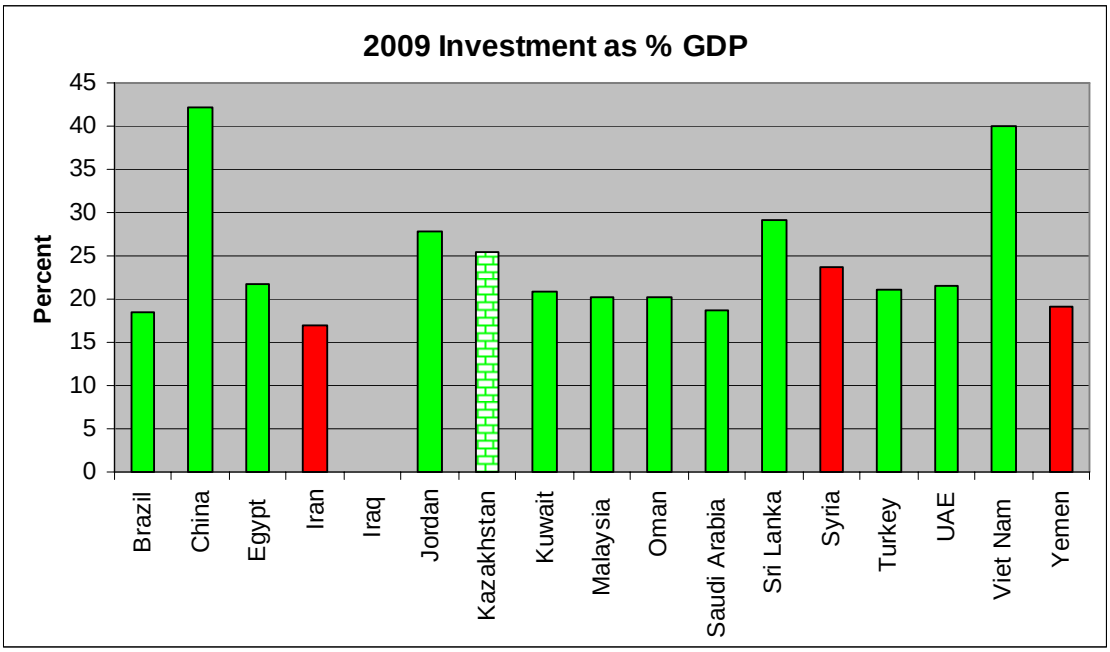
- This bar graph shows whether each country is a net importer or exporter of oil during 2009. Countries with bars below zero are importers and those with bars above zero are exporters.
- Green bars denote WTO members and red bars denote WTO non-members. For example: China, a WTO member (green bar) imports more than 4.5 million barrels of oil per day (bar below 0). Iran, a non-member of WTO (red bar) exports about 2.8 million barrels of oil per day (bar above 0).
- Kazakhstan gained independence from Russia in 1991 and oil exports more than tripled between 1991 and 2009. *Kazakhstan is also in the final stages of bi-lateral negotiations for joining the WTO and has made the legislative and regulatory changes necessary for WTO accession. It hopes to complete the WTO accession process by the end of 2012*. The bar for Kazakhstan is therefore denoted by green building blocks.



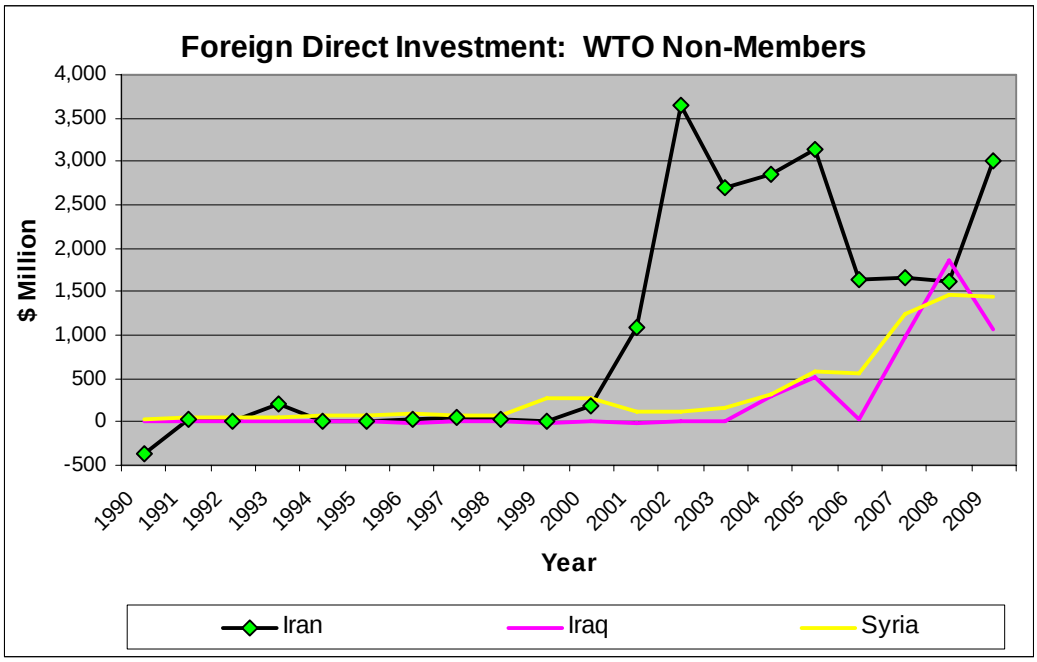
- WTO members also have unemployment – Oman, Jordan, Saudi Arabia and Turkey all exceeded 10 percent unemployment rates during 2009. *WTO non-members, however, generally show higher unemployment than most WTO member countries. This is true whether or not the country is a net oil exporter*



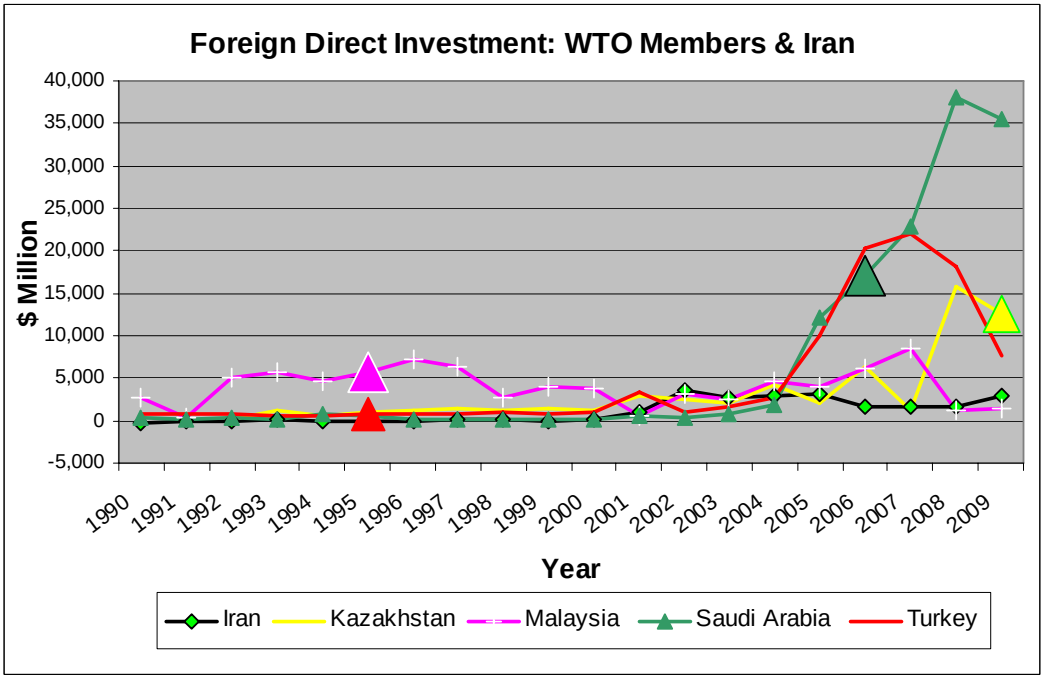
- Definitions of poverty vary considerably among nations depending on conditions within the country. Iraq, Oman and Syria do not report this economic statistic and there are no bars for those countries.
- WTO members also have a percent of population below the poverty line – both Brazil and Sri Lanka report more than 25 percent of the population living in poverty during 2009. *Generally, however, countries that are not WTO members have a larger percent of the population below the poverty level than do WTO member countries.*



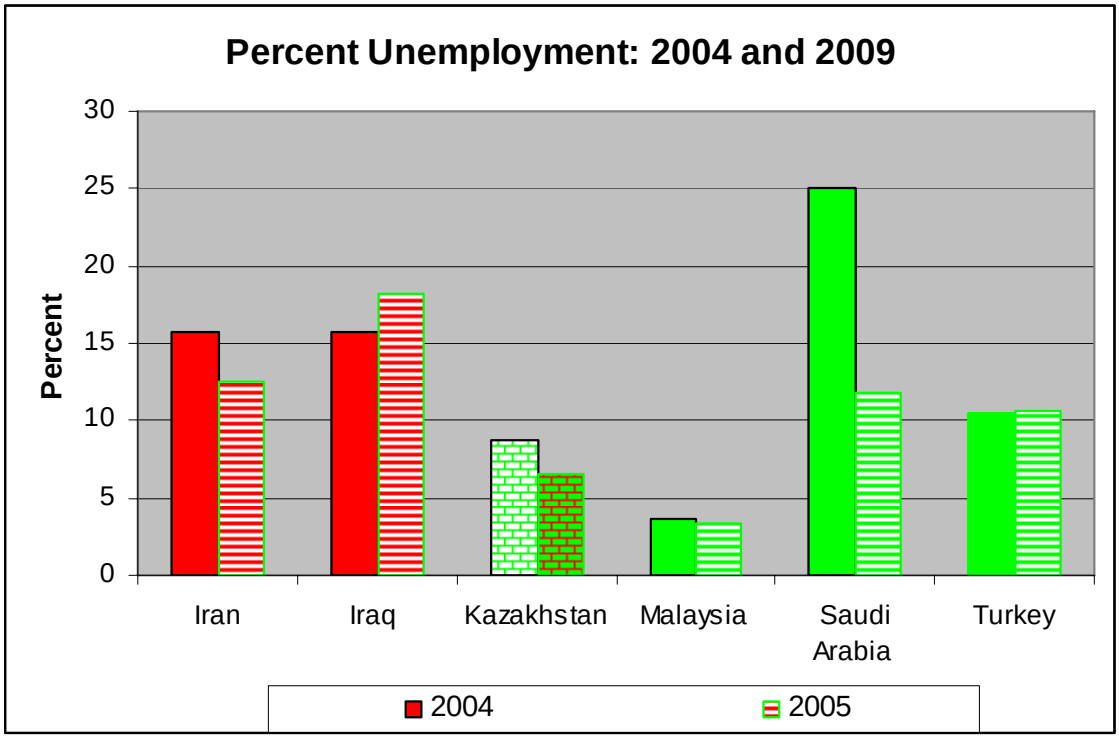
- Oil exporting countries, whether or not they are WTO members, rely less on total investment as a percent of GDP. Because of oil revenues they focus less on growth and employment in non-oil sectors than do oil importing countries. *Exporters of relatively large quantities of oil, especially those with relatively small populations (Kuwait, UAE and Oman) tend to have lower investment rates as a percent of the overall economy.*
- *Countries with relatively large populations and that are not large oil exporters (China, Sri Lanka and Vietnam, for example) rely heavily on investment as a percent of GDP and focus on growth and employment in all sectors of the economy.* Countries with higher investment levels (China and Vietnam, for example) also reported lower levels of unemployment and poverty in 2009 than some major oil producing countries with lower levels of investment.
- Kazakhstan is a relatively new net oil exporter and continues to attract a relatively high level of investment. *With WTO accession and associated changes in legislation and investment policy Iraq can also increase domestic and foreign investment, particularly in the services sector.*
- *Generally WTO members tend to attract more investment as a percent of GDP than do non-members.* [**Source:** *All data this section from* http://www.indexmundi.com]



- WTO non-members that export oil attracted very little foreign direct investment (FDI) prior to 2000. Between 2000 and 2009 Iran had FDI in three years of $3 billion or more. The peak years in Iraq and Syria during that period generated about $1.5 billion FDI.



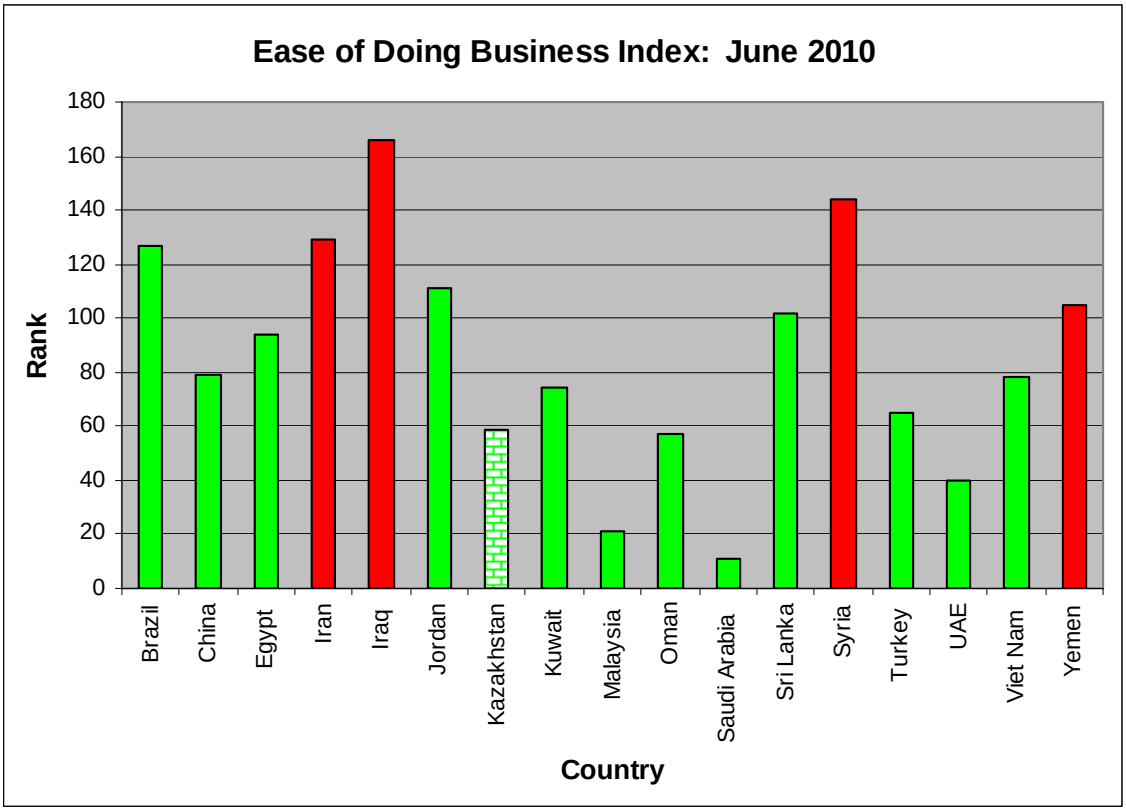
- WTO members that export oil attracted much more FDI than WTO non-members. The same is true for Turkey that is an oil importing WTO member and neighbors both Iraq and Iran. *The peak years for FDI in Saudi Arabia generated more than $35 billion, in Turkey more than $20 billion and in WTO near-member Kazakhstan $15 billion. The peak FDI in WTO member Malaysia was $ 8 billion -- and Malaysia also generated more than $5 billion FDI annually during most of the 1990s*.
[**Source:** http://data.worldbank.org/data-catalog]



- *Malaysia and Turkey have been WTO members since GATT became WTO in 1995 and unemployment remained at about the same level in 2009 as it was five years earlier in 2004*
- *Saudi Arabia experienced rapid growth in FDI at the time of its WTO accession and related changes in the business enabling environment. This translated into a 50 percent reduction in unemployment from 25 percent to the 12 percent range.*
- *Kazakhstan is in the final stages of bi-lateral negotiations for joining the WTO and has made the legislative and regulatory changes necessary for WTO accession. Kazakhstan generated $15 billion annual FDI during the post-2005 peak and also experienced a decline in unemployment between 2004 and 2009.*
- WTO non-members Iraq and Iran show mixed experiences in unemployment as might be expected in economies largely dependent on the oil sector, and in the case of Iraq, still in post-insurgency normalization. [**Source:** http://www.indexmundi.com]

Ease of Doing Business:

Economies are ranked from 1 to 183 by the World Bank and International Finance Corporation for their ease of doing business. A higher ranking (highest rank = 1, lowest rank = 183) on the ease of doing business index means the regulatory environment is more conducive to the starting and operation of a local firm. For example, WTO non-member Iraq has the most difficult business environment among these seventeen countries with a rank of 166 for ease of doing business. WTO members Saudi Arabia (rank 11) and Malaysia (rank 21) are among the top countries for ease of doing business as of June 2010.

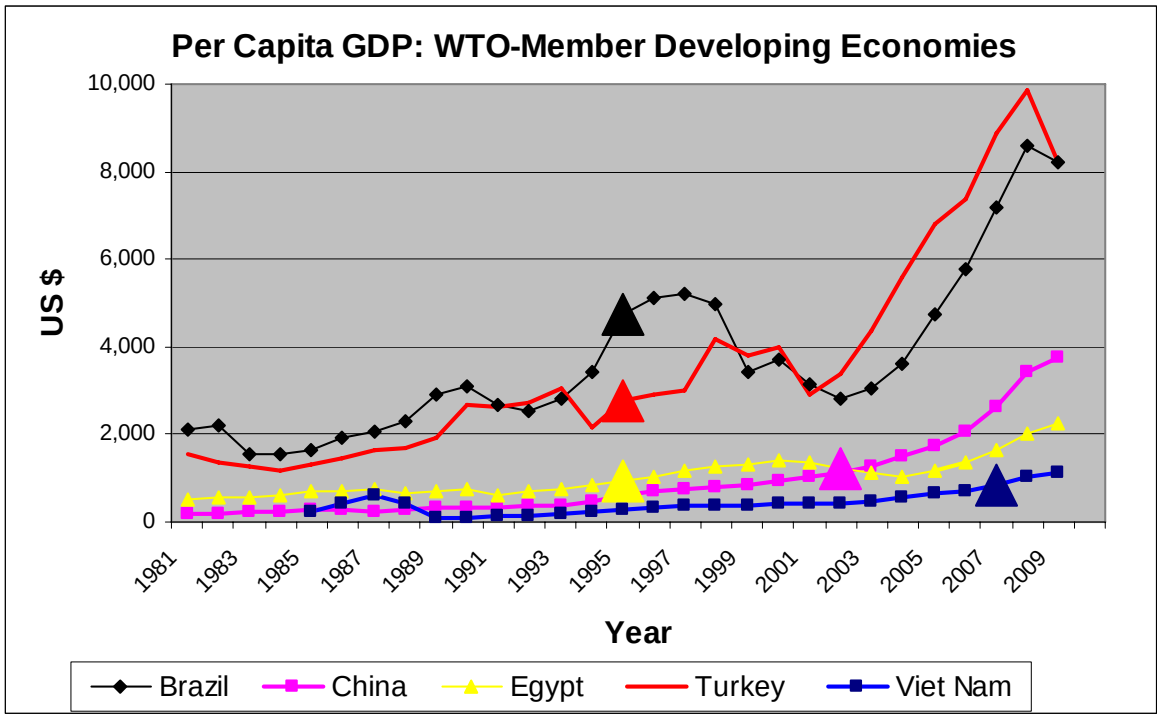


- *Legislative and regulatory reforms in WTO member countries have resulted in a more friendly business enabling environment -- and that attracts investment. This is consistent with investment as a percent of GDP and Direct Foreign Investment in WTO member countries shown earlier*. The rankings for all 17 economies in this evaluation are benchmarked to June 2010 and shown in the bar graph. *WTO members generally rank higher for ease of doing business and attract more domestic and foreign direct investment than do WTO non-members.*
- Movements in rankings during a five-year period provide an indication for how the regulatory environment of an economy changes over time. The ten economies that made the largest *improvements in the regulatory environment for businesses during the last five years include WTO member Saudi Arabia and WTO near-member Kazakhstan. Both implemented more than a dozen reforms during the past five years to improve the ease for doing business.*
- *Saudi Arabia completed WTO accession in December 2005 and the current ranking for ease of doing business resulted in more than $35 billion annual peak FDI as shown before.*
- *Kazakhstan plans to finalize WTO accession before the end of 2012 and has also been recognized among the top 10 reformers for ease of doing business during recent years. Kazakhstan attracted $15 billion of FDI during the recent peak investment year.*

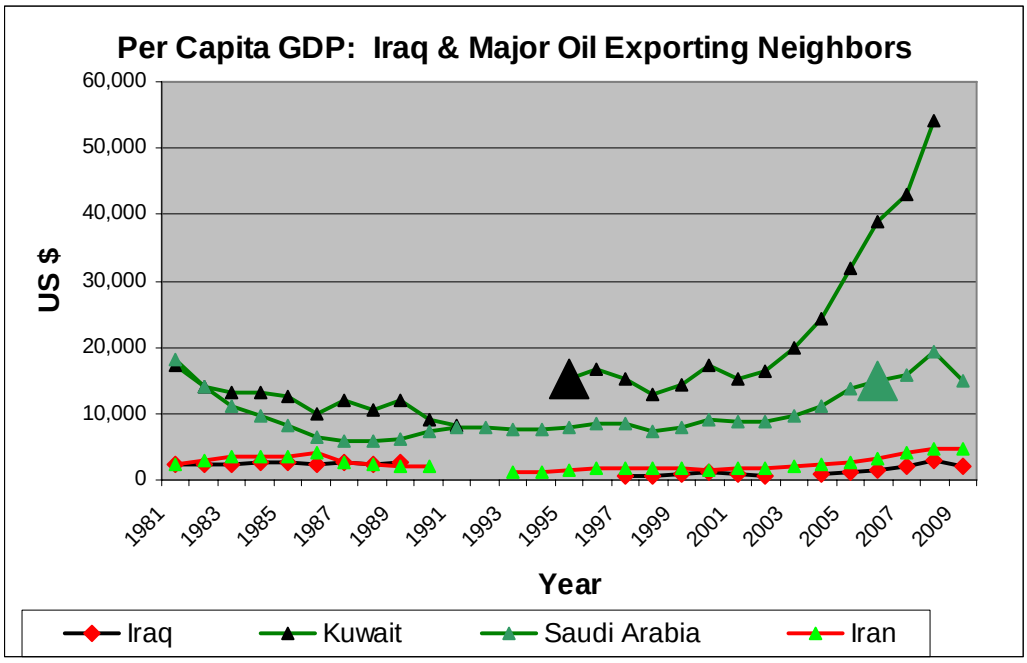
[**Source:** *World Bank and International Finance Corporation, "Doing Business in 2011: Making a Difference for Entrepreneurs,"* http://www.doingbusiness.org/rankings]

Per Capita Gross Domestic Product (GDP):

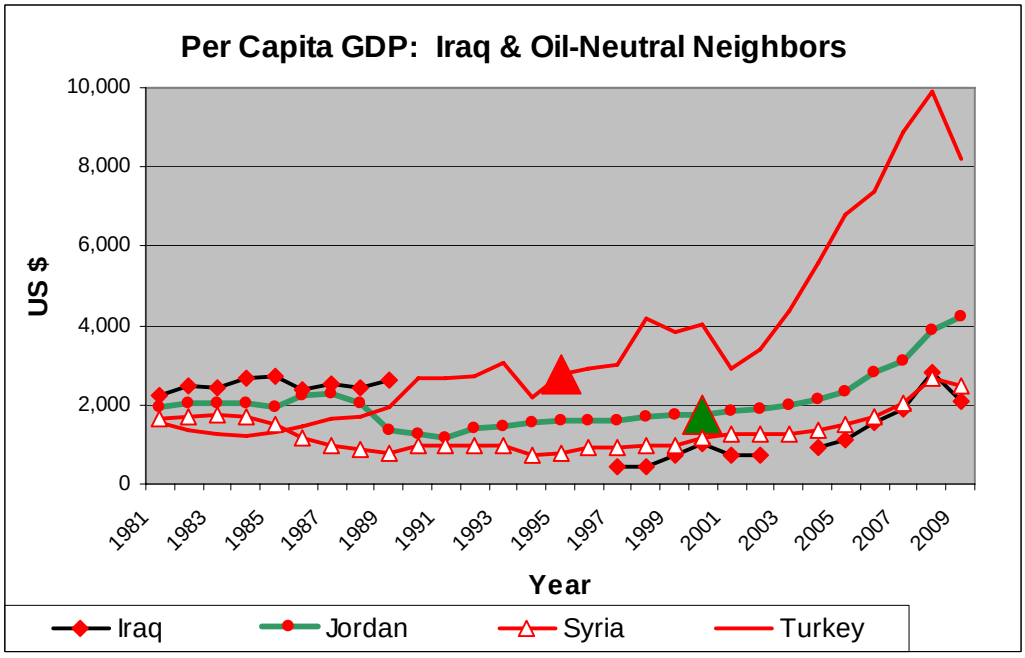
Per capita GDP is defined as the approximate value of goods produced per person in a country. It is calculated by dividing the total value of goods produced by the total population of the country. Per capita GDP is an indicator of average income per person, but says nothing about the distribution of that income. Unemployment and percent of the population below the poverty line (shown in earlier graphs) are better indicators of income distribution. [**Source:** *All per capita GDP, exports as % GDP and imports as % GDP data presented in the following sections from* http://data.worldbank.org/data-catalog]



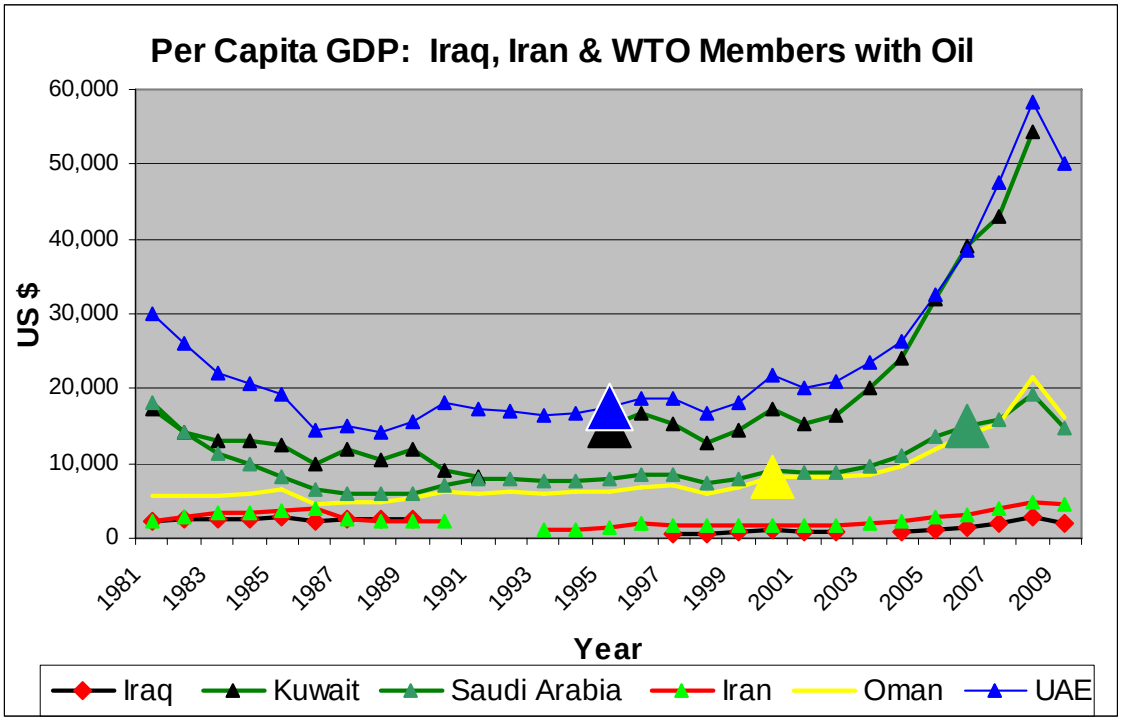
- Per capita GDP for non-oil exporting WTO members with relatively large populations is shown from 1981 through 2009. The large triangle indicates the approximate time the country completed WTO accession. (See table on page one for exact date).
- *Generally per capita GDP increased and at a faster rate after WTO accession than before. In no case does a country have a lower per capita GDP now than it had before accession.*



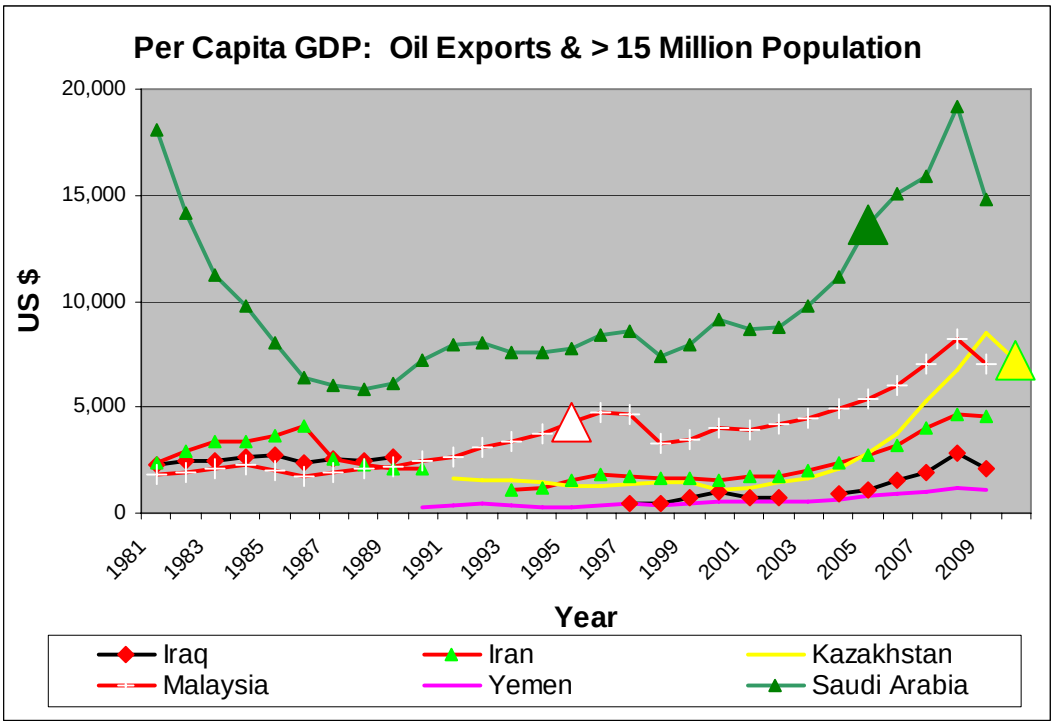
- Iraq and three neighboring countries – Iran, Kuwait and Saudi Arabia – are among the largest oil exporters in the world and each exports 1.75 mb/d or more oil.
- Gaps in data indicate years of war when no data were reported. Kuwait is missing 1992-94 when invaded by Iraq, Iran is missing 1991-92 and Iraq is missing 1990 through 1997 and data for Iraq were again interrupted in 2003-04 by the invasion.
- Kuwait is among the original WTO members and per capita GDP recovered rapidly after the Gulf War. With a population of 2.6 million Kuwait's per capita GDP has increased faster than per capita GDP in Saudi Arabia with a population 10 times larger at 26.13 million. Saudi Arabia joined the WTO in December 2005.
- *WTO members Saudi Arabia and Kuwait have experienced higher and faster growth in per capita GDP than WTO non-members Iran and Iraq.*



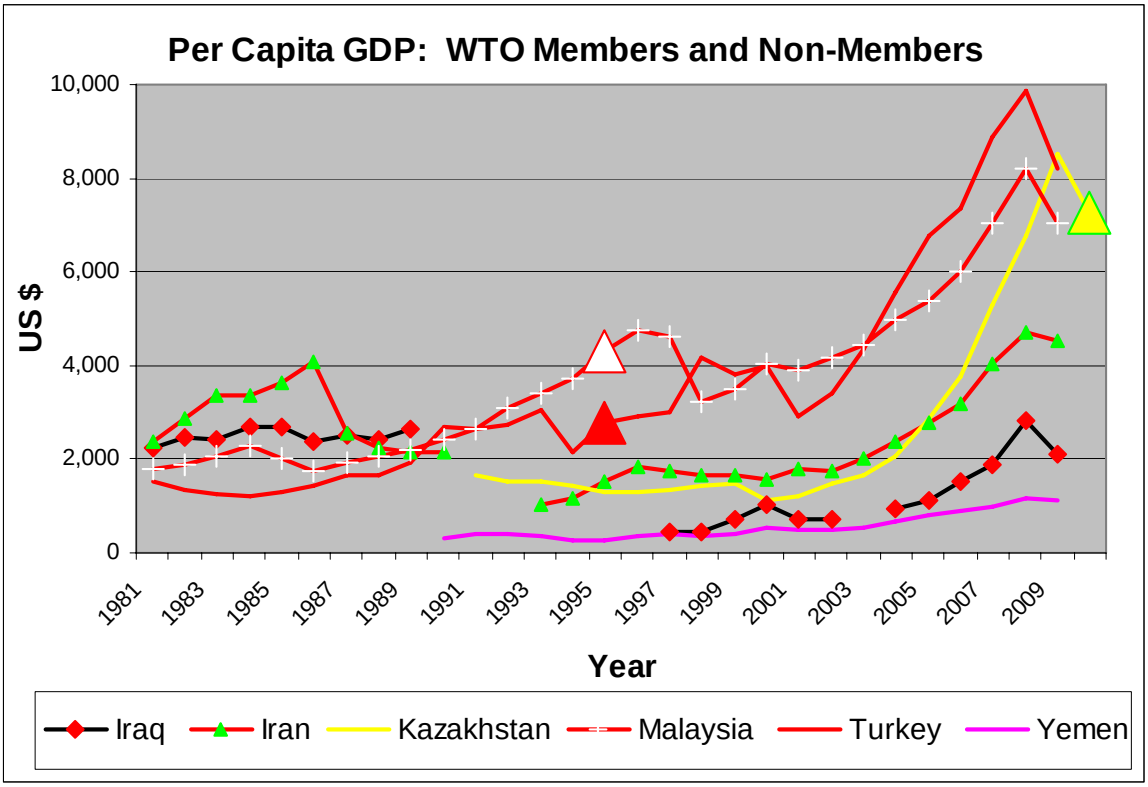
- Iraq (oil exports of 1.76 mb/d) is compared to three neighboring countries – Syria (exports .09 mb/d), Jordan, (imports .09 mb/d), and Turkey (imports .53 mb/d).
- *Oil importing WTO non-members Jordan and Turkey have higher per capita GDP than do oil exporting WTO non-members Iraq and Iran.*
- Per capita GDP in Iraq exceeded that of all three neighbors prior to the 1991 invasion of Kuwait. Since 1997 (when data resumed for Iraq) per capita GDP in Iraq has remained less than that of the three neighboring countries.



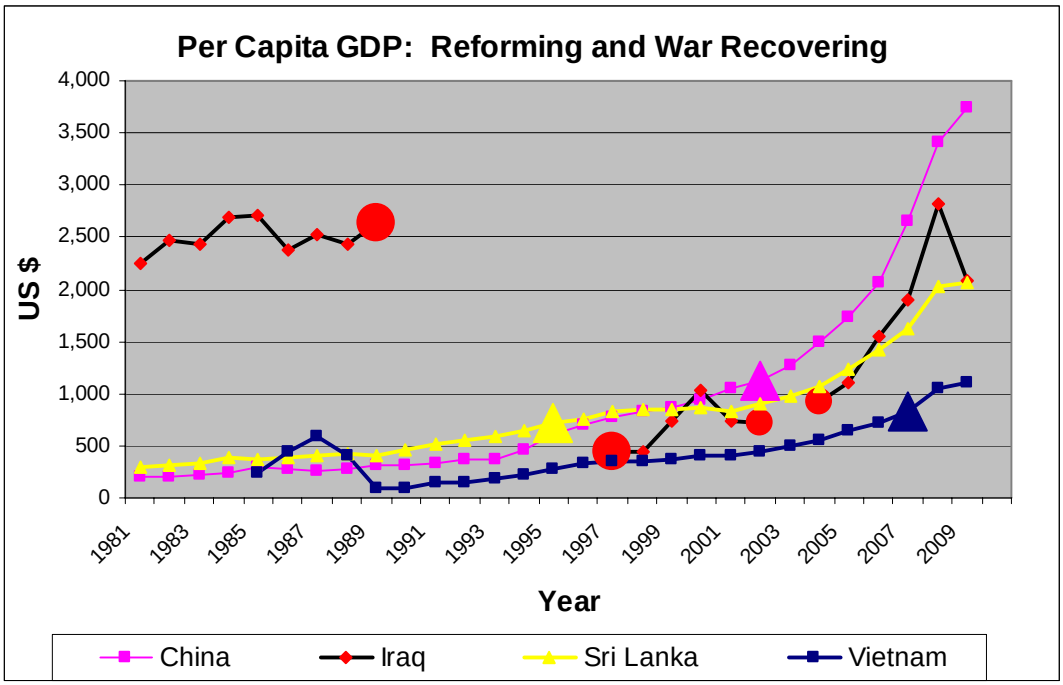
- The six countries shown are all Middle Eastern major oil exporters. Kuwait, Oman and UAE have populations of 5.2 million or less while Iraq and Saudi Arabia have populations of 25-30 million and Iran has a population of approximately 78 million.
- *WTO-member countries Kuwait and UAE have per capita GDP nearly 20 times larger than per capita GDP in Iraq*. These countries have populations of 5.2 million or less and are large oil exporters. Per capita GDP is closely related to oil production and price. Because OPEC allocates oil production and populations remain relatively stable over the course of a 30 year period, increased per capita GDP is primarily reflecting higher oil prices in these countries.
- *Per capita GDP in WTO-members Saudi Arabia and Oman is approximately 7 times larger than per capita GDP in Iraq. Growth in per capita GDP continued and accelerated after WTO accession.*
- Iraq's per capita GDP is 40 percent less than the per capita GDP in WTO non-member Iran.
- *Oil exporting WTO members have experienced higher levels of per capita GDP than WTO non-members and growth in per capita GDP increased at a faster pace after WTO accession.*



- Six countries with populations more than 15 million export at least a small amount of oil. Malaysia and Saudi Arabia are WTO members; Kazakhstan is close to concluding WTO accession and three -- Iraq, Iran and Yemen are WTO non-members.
- Comparing these countries is likely more realistic when evaluating Iraq's future for the next decade. Saudi Arabia is a WTO member and exports the most oil in the group with net exports of 5.8 mb/d and has a population of 26.1 million. Iran is not a WTO member and exports 2.8 mb/d. It also has the largest population of the group at nearly 78 million.
- Iraq exports 1.76 mb/d of oil with a population of 30.4 million. Officially reported Iraqi oil reserves indicate that Iraq has potential to produce at the level of Saudi Arabia within a decade. *Saudi Arabia and Iraq have comparable populations – in size, median age and literacy rates. Indications are that if Iraq joins the WTO and triples oil exports to the size of Saudi Arabia, Iraq's per capita GDP would be close to current per capita GDP in Saudi Arabia -- or nearly seven times current per capita GDP in Iraq.*
- Kazakhstan is nearing completion of bilateral negotiations for WTO accession and plans to be a WTO member by the end of next year. Kazakhstan produces 70% as much oil as Iraq with a population about half the size. *If Iraq implemented WTO reforms and achieved a 20 percent increase in oil exports current Iraqi per capita GDP would be expected to increase to per capita GDP in Kazakhstan – or nearly 3.5 times current per capita GDP in Iraq.*
- *With WTO membership and related economic reforms and sustained security Iraq could reach per capita GDP levels in Kazakhstan, Turkey and Malaysia within five to ten years.*
- The remaining two countries also represent some interesting contrasts. Malaysia has a population of 25.7 million and is basically self-sufficient in oil, exporting .02 mb/d. Malaysia is a WTO member and has the highest literacy rate of the six countries at nearly 88.7 percent. Yemen has a comparable population of 24.1 million and has small oil exports of .12 mb/d. Yemen has the youngest median age, the lowest literacy rate of the six countries at just over 50 percent and is not a WTO member. The line graph clearly shows differences in per capita GDP between these two countries.



- For Iraq to reach per capita GDP levels in Saudi Arabia will require a tripling of Iraq's oil production and that will remain a longer-term objective of a decade or more. Shorter-term possibilities are more likely reflected in the line graph above.
- Turkey is a WTO member with a population – size, median age and literacy rate -- comparable to non-member Iran. *Iran is a major oil exporter and Turkey is a net oil importer. Per capita GDP in Turkey is nearly twice per capita GDP in Iran and nearly four times per capita GDP in Iraq.*
- Malaysia is a WTO member with a population – size, median age and literacy rate -- comparable to non-member Iraq. *Iraq is a major oil exporter and Malaysia exports a small amount of oil. Per capita GDP in Malaysia is more than three times per capita GDP in Iraq.*
- *The growth curve of per capita GDP in Kazakhstan demonstrates potential growth patterns for Iraq as it transitions from non-member of WTO to member and increases oil production. It is telling that Iraq and Kazakhstan had nearly the same level of per capita GDP in 2001 and less than 10 years later per capita GDP in Kazakhstan is $7,260, more than 3.5 times per capita GDP of $2,090 in Iraq.*
- Yemen likely demonstrates a worse-case scenario and shows that oil exports by themselves do not assure economic growth and prosperity. Of the six countries Yemen has the youngest population, the lowest literacy rate (at just over 50 percent) and is not a WTO member. Yemen is a net oil exporter of .12 mb/d, but has the lowest per capita GDP of the countries shown.

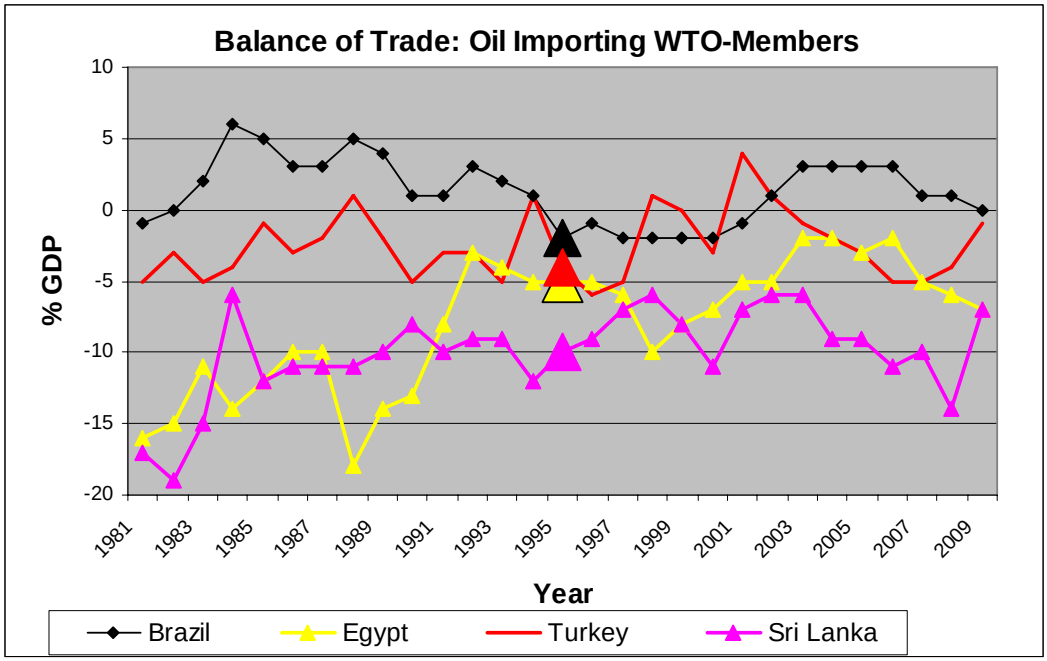


- During nearly four decades under the Saddam regime Iraq was managed as a Soviet-style centrally planned economy. Iraq now faces a policy decision of transitioning to a market-based economy. If it continues, this transition will not be unlike the transitions by China and Vietnam that have evolved from Communist-run centrally planned economies to a much stronger market orientation. China is a net oil importer of more than 4.5 mb/d and Vietnam is essentially self sufficient.
- Iraq is also just starting to recover from the invasion in 2003 and seven years of insurgency and conflict that followed. Iraq's challenge is comparable to Vietnam's recovery after 20 years of conflict from November 1955 through April 30, 1975. Like Iraq, Vietnam has faced simultaneous challenges -- transitioning from a centrally planned economy and post-war recovery. The population in Vietnam is three times as large as the population of Iraq. Unlike Iraq, Vietnam is not blessed with large oil reserves and must rely on an educated population and high investment levels to generate economic growth and employment – and Vietnam has completed accession to WTO.
- Sri Lanka also suffered through more than 25 years of civil war from June 1983 until May 2009 when the leader of the Tamil Tigers was killed by government forces. Like China and Vietnam, Sri Lanka is a WTO member. Sri Lanka produces no oil and must rely on investment and an educated population to generate economic growth and employment. Population of Sri Lanka is about two-thirds the population of Iraq.
- The line graph shows how other countries have prospered during WTO accession, economic reform and post-war recovery, *but without oil revenue for support*. The large red dots indicate per capita GDP before and after Iraq's invasion of Kuwait, the Gulf War and related sanctions and the small dots show interruptions from the 2003 invasion.
- *With WTO accession, economic reform and increasing oil production, Iraq's post-war recovery and growth in per capita GDP will be much steeper than recoveries in China, Sri Lanka and Vietnam that do not have Iraq's oil reserves.*

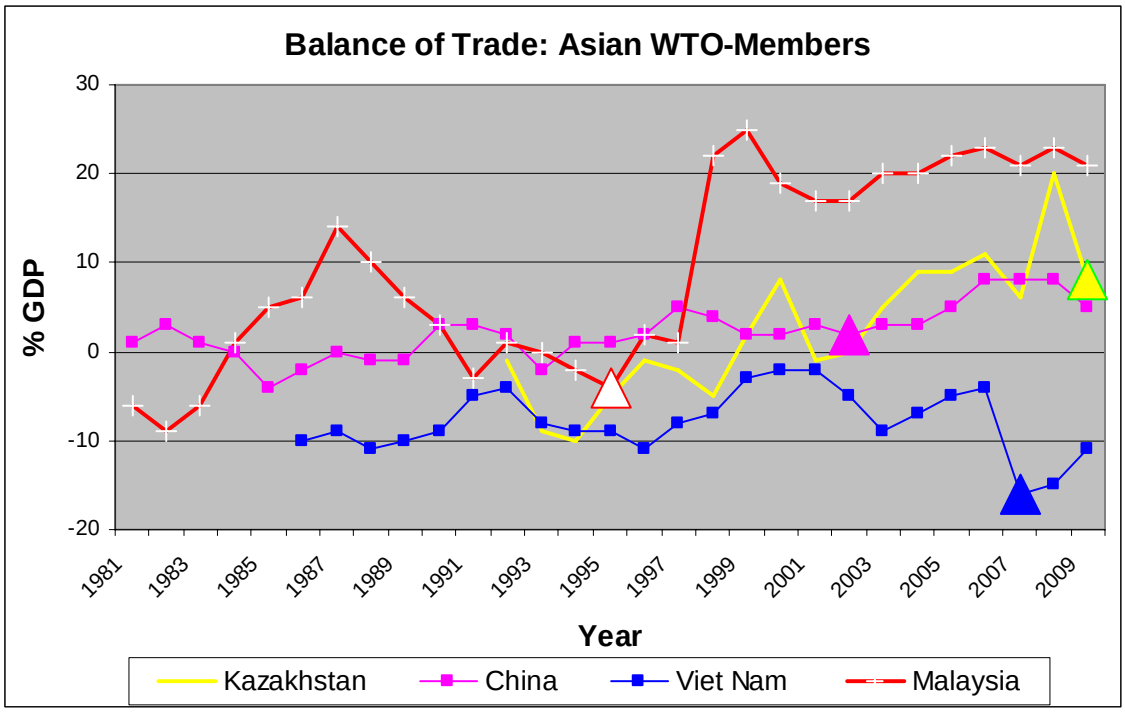
Balance of Trade:

Balance of trade is defined as the difference in value over a period of time of a country's merchandise imports and exports; "a nation's balance of trade is favorable (above 0) when its exports exceed its imports." One of the arguments often presented in Iraq is that WTO membership will require a reduction in protection and subsidies. Reduced protection, so the argument goes, will subsequently result in a collapse of Iraqi production and services and imports will increase to replace current Iraqi (subsidized and inefficient) production.

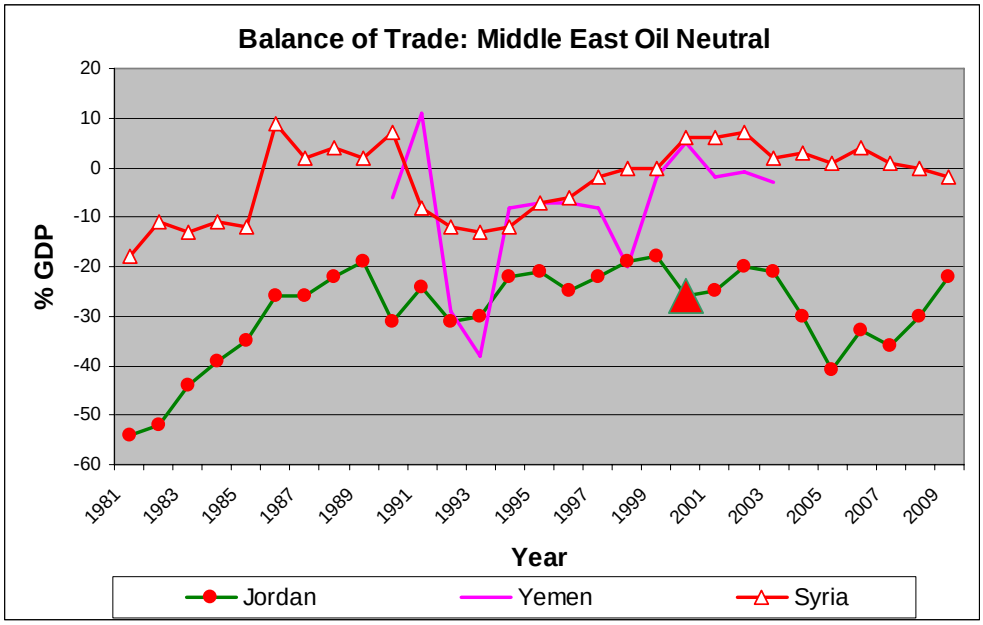
The following line graphs track the balance of trade (as a percent of GDP) for the same countries evaluated above. No trade data are reported for Iraq so the following graphs are presented by type of economy with WTO members and non-members shown within the categories. A balance of trade above zero means that the country is a net exporter (exports are larger than imports) and a balance of trade less than zero means that the country is a net importer (imports are larger than exports).



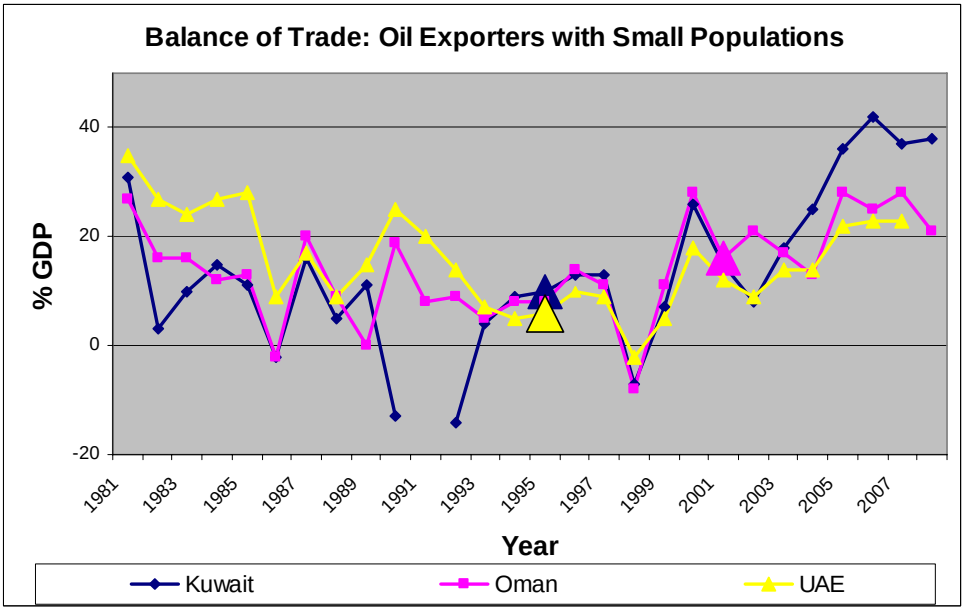
- Balance of trade for WTO members with relatively large populations is shown from 1981 through 2009. The large triangle indicates the year of WTO accession. As global oil prices have increased, these countries have had to increase exports of non-oil commodities and value added products to off-set increased costs of oil imports -- or trade watch their trade deficits increase.
- *Brazil exports machinery & transport equipment; food & live animals; manufactured goods and inedible raw materials and has shown both trade deficits and trade surpluses of less than 5 percent of GDP since WTO accession.*
- *Turkey exports machinery & transport equipment and manufactured goods and has shown trade deficits of 5 percent and even two years of trade surplus since WTO accession.*
- *Egypt and Sri Lanka continued to show trade deficits after WTO accession, but generally the deficits have been smaller since accession.* Egypt exports refinery products (from imported oil) and manufactured goods. Sri Lanka exports food & live animals and manufactured goods. The recent increases in trade deficits reflect the increased cost of imported oil. Sri Lanka has also been in post-war recovery since 2009.



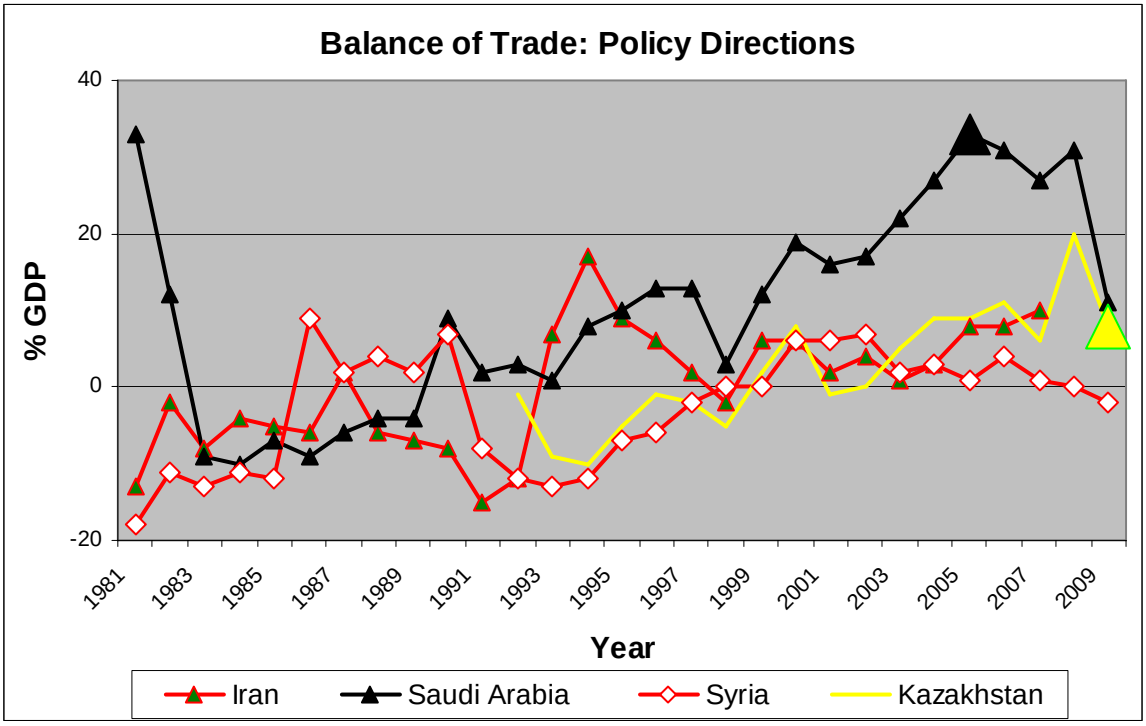
- Asian and Southeast Asian WTO members are a mix of oil importers (China), oil exporters (Kazakhstan and, to a lesser degree, Malaysia) and oil self-sufficient (Vietnam).
- China is among the world's largest oil importers and exports machinery & transport equipment and manufactured goods & articles. *Even with higher costs for oil imports China's trade surplus has continued to increase since WTO accession.*
- Vietnam exports miscellaneous manufactured articles, food & live animals and mineral fuels & lubricants and has shown trade deficits during the post-war recovery and economic transition period since 1981. *Vietnam's trade deficit has again started to decline after surging due to higher oil prices during the year of WTO accession in 2007.*
- Malaysia exports machinery & transport equipment; mineral fuels & lubricants; manufactured goods & articles and vegetable (palm) oil. *Trade surpluses in Malaysia have been in the 20 percent of GDP range since WTO accession.*
- Kazakhstan is an oil exporter but also exports manufactured goods. Kazakhstan is in the final stages of bilateral negotiations for WTO accession and has made most legislative and structural changes necessary for WTO accession -- likely to be concluded in 2012. *The growth in trade surplus as exports of oil and manufactured goods increased in Kazakhstan indicates the potential that could be achieved in Iraq with continued increases in oil production and economic reform associated with WTO accession.*



- *WTO non-members Syria and Yemen primarily export refined mineral fuels & lubricants followed by food & live animals. Both have populations of more than 25 million and have seen their balance of trade fluctuate between deficits and surpluses because investment and employment in non-oil sectors is relatively low*. Yemen also has a poorly trained workforce with a literacy rate at 50 percent.
- WTO member Jordan exports miscellaneous manufactured articles; chemicals & related products and a mix of other manufactured goods but imports oil and consistently runs trade deficits of 20 percent of GDP or higher. *Jordan also has a difficult investment environment as indicated by the ease of doing business index shown earlier.*

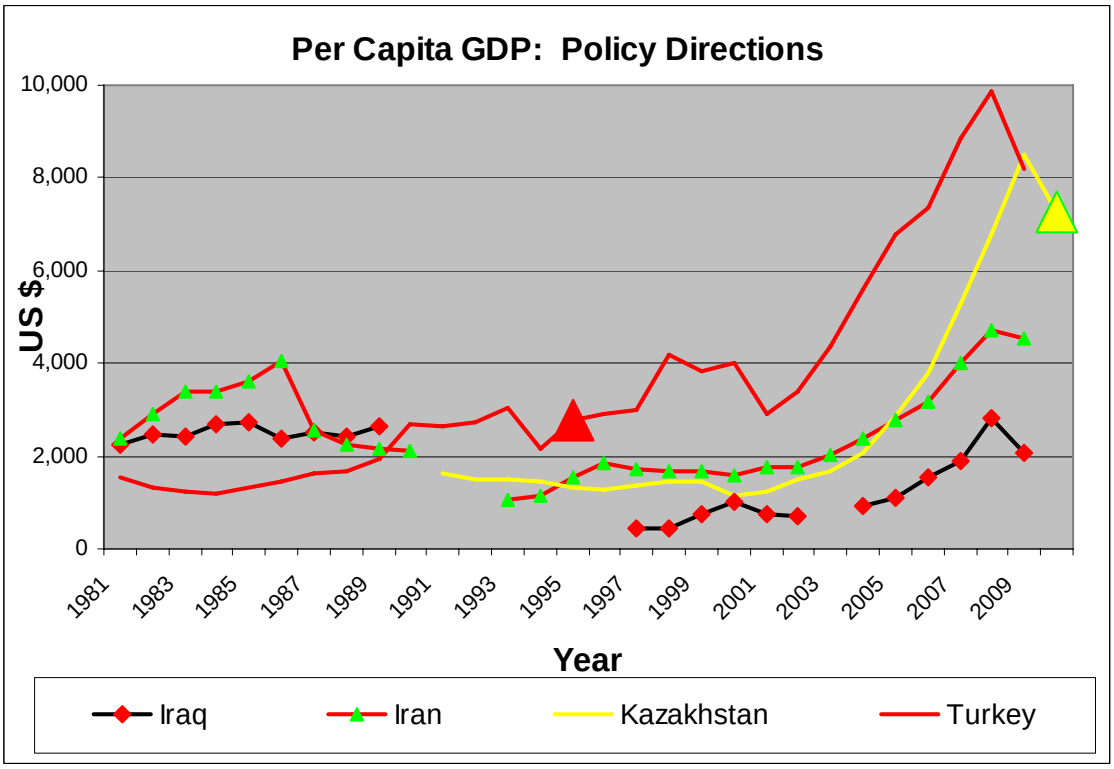


- Kuwait, Oman and UAE have populations of 5.2 million or less and large oil exports. *All are WTO members, and other than 1990-1994 when Kuwait's oil exports were interrupted by the Gulf War and when large supplies of war materials were imported, all countries have shown net trade surpluses that increased after WTO accession and as oil prices increased*. The UAE also exports manufactured goods and machinery.

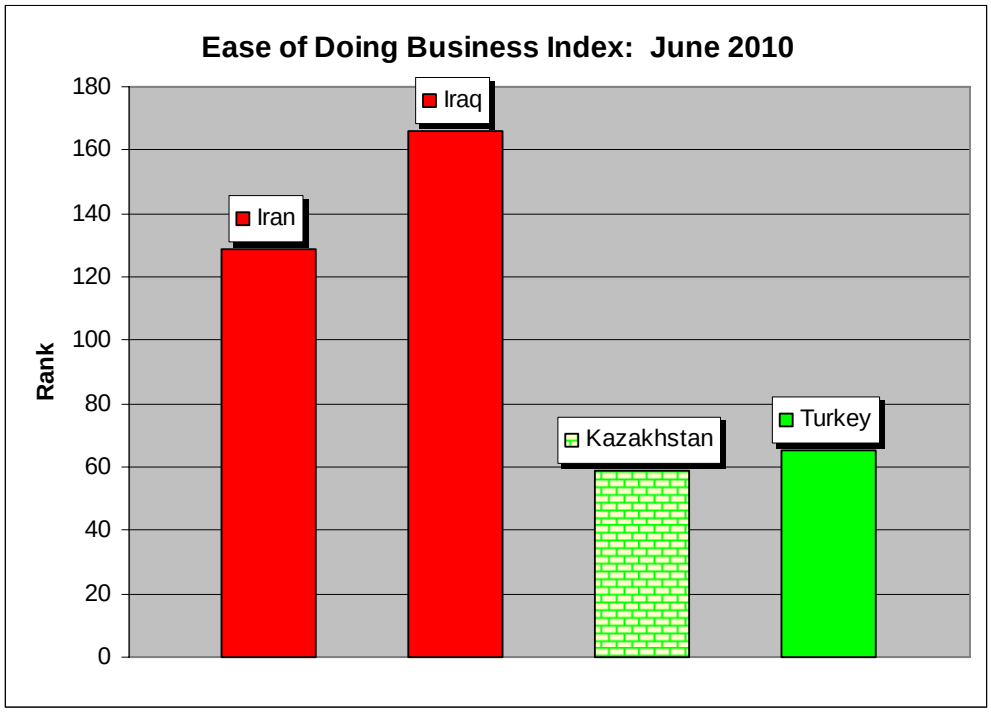


- Iraq and Saudi Arabia are most similar from a standpoint of population size and oil reserves. Saudi Arabia is primarily an oil exporter with oil exports being more than 12 times as large as the second place export, chemicals & related products.
- *Saudi Arabia is a WTO member and has shown trade surpluses at 30 percent of GDP in recent years, and is currently expanding investment and employment in non-petroleum sectors. Improvements in the ease of doing business index during the last five years (shown in earlier discussions) after Saudi Arabia's WTO accession resulted in peak years of FDI of more than $35 billion.*
- Iran has a larger population than Iraq -- 78 million vs. 30.4 million – and 84 percent of all exports are oil, followed by food & live animals. *Iran has shown trade surpluses at 10 percent of GDP in recent years as oil prices have increased, but is not a WTO member and has little investment or development outside the oil sector.*
- *With WTO accession, economic reform and expanded oil production, Iraq's economy and growth path will more likely resemble that currently in Kazakhstan during the next few years. Per capita output in Kazakhstan is nearly 3.5 times current output in Iraq.*
- *With a decade of expanded oil production and legislative reforms related to WTO accession the economy in Iraq could easily resemble the current economy in Saudi Arabia. Per capita output in Saudi Arabia is nearly seven times current output in Iraq.*
- *Without WTO accession and economic reform, even with increased oil production, Iraq's economy will more likely resemble that of Iran or Syria. Per capita output in Iran is only .4 times larger than current output in Iraq.* [**Source:** *All data for per capita GDP and Balance of Trade, http://data.worldbank.org/data-catalog*]

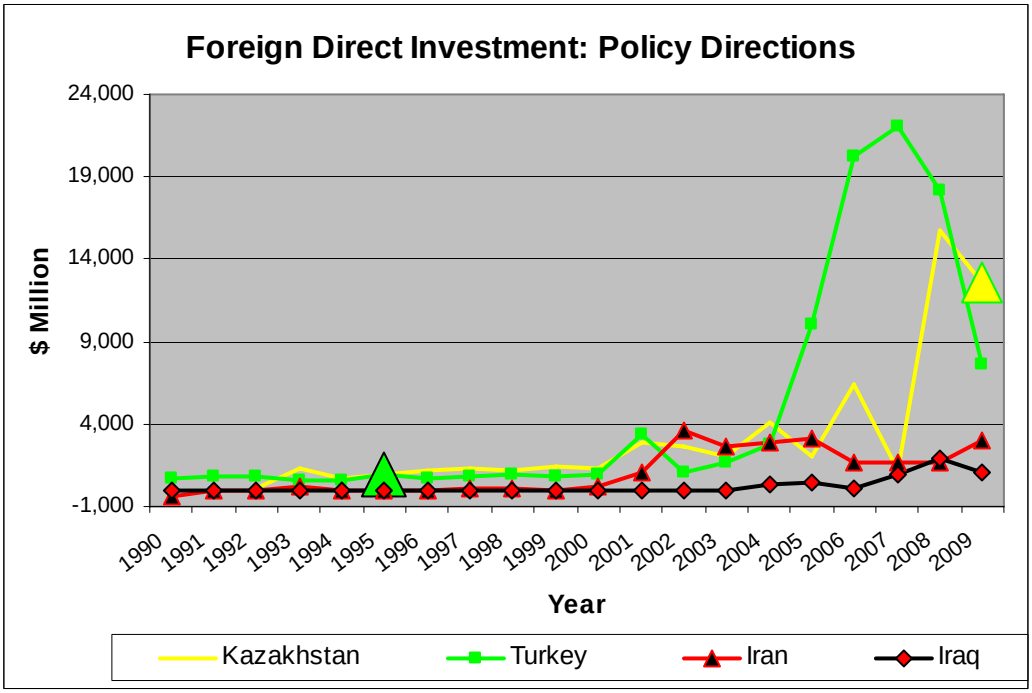
Policy Decisions and the Path Forward: Iran and Turkey are rapidly becoming the most influential external actors inside Iraq as the U.S. troop withdrawal proceeds, according to a recent US private sector report Many Iraqi officials share this view and have identified Iran and Turkey as "the biggest players and rivals in Iraq". [**Source***: "Turkey and Iran Vie for Control of Iraq, Wladimir van Wilgenburg, http://www.rudaw.net/english/news/iraq/3792.html July 2, 2011*]



- Iran and Turkey clearly offer different policy alternatives. Turkey is a WTO member with a population – size, median age and literacy rate -- comparable to non-member Iran. Iran is a major oil exporter and Turkey is a net oil importer. *Per capita GDP in WTO member Turkey is nearly twice per capita GDP in WTO non-member Iran and nearly four times per capita GDP in WTO non-member Iraq.*
- *Either Iraq will pursue legislative reform and WTO accession and follow a growth path like Kazakhstan that will equal, then bypass, per capita GDP in oil importing Turkey -- or Iraq will remain an inward looking, oil exporter that resembles WTO not-member Iran.* [**Source:** *http://data.worldbank.org/data-catalog]*



- Legislative and regulatory reforms in WTO member countries have resulted in a more friendly business enabling environment. Kazakhstan will finalize WTO accession before the end of 2012 and has also been recognized among the top 10 reformers for ease of doing business during recent years. [**Source:** *http://www.doingbusiness.org/rankings]*



- Legislative and regulatory reforms in WTO member countries have resulted in a more friendly business enabling environment and that has attracted foreign direct investment (FDI). WTO member Turkey and near-member Kazakhstan have been much more successful in attracting FDI than WTO non-members Iraq and Iran where doing business is much more difficult. [**Source:** *http://data.worldbank.org/data-catalog]*