2018 ANNUAL REPORT
Riding the Oil Markets:
Iraq's Economy in Transition
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Editorial Team
Yesar Al-Maleki, Research Fellow
Robert Tollast, Research Fellow
Harry Istepanian, Senior Fellow

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Introduction: The Struggle to Diversify

Iraq’s fortunes in 2018 transitioned from concern that reconstruction funding would not be available following the Kuwait Reconstruction Conference, to optimism as the oil price recovered from $63 in February to $85 in October.\(^1\) By April, BMI research were predicting economic growth of 4.5% in 2019.\(^2\)

Missing from this picture was the modest emergence of non-oil investment in Iraq through early 2018, in the form of small ventures in the hotel sector, the app economy and the cement industry. While relatively small compared to potential energy sector investment, these projects illustrate the potential there is for economic diversification. Unfortunately, much focus has been on oil prices and foreign donations, to the neglect of a better environment for greater investment and sustainable job creation.

In one of the more interesting trends of 2018, small scale Iraqi entrepreneurs have beaten a path to new business in the digital economy. 2018 saw more media coverage of pioneering companies such as Baghdad’s Miswag grocery service, circumventing or (in the case of Sulaymaniyah-based Bazary) actually changing legislation at the local level. Miswag even used a voucher system for online transactions, a workaround for Iraq’s largely un-banked population.\(^3\)

These trends in the e-commerce and the app economy have been building for some time in Iraq, with early champions of innovation such as Fikra Space pushing against bureaucracy, a testament to the entrepreneurial spirit that has been dormant in Iraq. But until Iraq’s banking system and access to banking catches up with the requirements of these job creating new industries, most critically in the realm of start-up capital, struggles will continue for these “leapfrogging” trends. There is a risk non-Iraqi firms in the app economy will take advantage of new opportunities, with companies such as the UAE-based Careem taxi-app launching in Baghdad this year.

Efforts to support the sector have been limited so far. A Central Bank of Iraq (CBI) start-up capital fund, Tamwil, has disbursed only a small amount of available funds because the requirements for securing loans are beyond

\(^{1}\) Dan Eberhart. Oil markets are in for a rough ride in 2019. Forbes. 07.01.19

\(^{2}\) Mahmoud Kassem. Iraq economy forecast to grow 1.5% in 2018 according to BMI. The National.

\(^{3}\) Aaron Bartnick. Obstacles and Opportunities for Entrepreneurship in Iraq and the Kurdistan Region. American University of Iraq Sulaimani.
the capacity of most small businesses. Iraq’s efforts to facilitate the private sector must go much further, although Tamwil is at least an improvement on the nearly impossible requirements for obtaining a loan from most Iraqi banks, which make it prohibitively difficult for non-government employees. There is now growing private sector pressure on banks, including discussions being held, to ease the flow of start-up capital for new business. Without these vital efforts, Iraq will remain dependent upon hydrocarbon revenues that increasingly cannot serve a rapidly growing population. See below for more analysis on regulation in Iraq’s SME sector.

## Riding the Energy Markets

The trajectory of oil prices through 2018, from a surge back to a crash and then a see-saw of movement on conflicting data, again illustrates how Iraq’s fate rests upon factors outside its control, presenting an almost perfect picture of resource dependency.

Without urgent implementation of reforms, Iraq will be at the mercy of global markets, with factors such as U.S.-China trade tensions or the budgeting decisions of shale producers comprising just a few of the factors influencing oil in 2019. The challenge is to adapt to this difficult situation and make policy accordingly.

By mid-2018, Iraq’s monthly oil revenues were rising well above the state salary and pensions expenditure of around $5 billion, approaching $7.5 billion by July (see below for more detailed analysis of the oil sector.) There followed demands from many lawmakers in Iraq to end “austerity” as total federal oil production rose to 4.68 mbpd in September, leading to pushback against the 2019 budget, which assumed $56/ bbl.

Extra finances had become available only through stabilisation of expenditure: Iraq had sustained enough fiscal discipline for foreign reserves to surpass $60 bn by October. This was a substantial improvement on the $47 bn foreign reserves at the end of 2017 and a massive change from the previous low oil price cycle years, that had drained Iraq’s financial resources.

At the same time, the optimistic picture at the end of 2018 was tested as oil prices reduced, despite Moody’s Investors Service predicting that growth in Iraq would rise to 4.1% in 2019, up from 2.8%. Whether this will translate into

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4Ibid.
5 Ibrahim Saleh. How To Get A Loan In Baghdad - At 30% Interest, Repaid In 3 Months. Niqash. 
http://www.niqash.org/en/articles/economy/5983/
6 Nick Cunningham. Shale under pressure as oil falls below $50. Oilprice.com. 18.12.18.
10 Dania Saadi. Iraq’s GDP to grow 4.1% in 2019 thanks to oil prices, Moody’s says. The National. 13.12.18. 
https://www.thenational.ae/business/economy/iraq-s-
real, sustainable growth, rather than traditional expenditure of petrodollars, is in question. For comparison, Iraq’s economic growth exploded over 10% in 2012, making it one of the fastest growing economies in the world, but this did not translate into service delivery or lasting poverty reduction.¹¹

There is now a serious debate over what investment funding will be available for 2019, following the 40% plunge of the Brent benchmark,¹² which pushed December’s oil revenues down to $6.1 billion despite rising production.¹³ The challenge for 2019 is that if oil prices do not recover significantly, Iraq’s oil revenues simply cover salaries and pensions, leaving Iraq with similar reconstruction challenges seen in 2017. There is a risk that any investment will remain dependent on inadequate foreign donations in liberated cities, or unsustainable borrowing, while service delivery across the south will continue to lag. France’s January 2019 pledge of EUR 1 billion, announced by Jean Yves Le Drian, will be highly welcome but pale in comparison to reconstruction needs.¹⁴ Failure to raise non-oil revenues and bring in foreign investment will pose a major risk to Iraq’s near term future.

As we reported in our 2019 draft budget analysis¹⁵, planned spending across all ministries for 2019 remains weighted towards operational expenditure. There were few signs that this situation would change at the end of 2018, as the draft budget was revised with cuts to both the Ministry of Education and Ministry of Electricity budgets, despite pressing needs in those sectors (although electricity had a significantly higher budget than in 2018.) Operational expenditure was expected to grow as the same pension rights and benefits are considered for employees on short term contracts, as their full time counterparts.¹⁶

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Oil and Gas Continue Ascendance

Preliminary data show that Iraq’s federal government oil production has reached 4.45 mbpd by December compared to approximately 4.2 mbpd recorded at the beginning of January 2018. Starting at 360 kbpd in January, the KRI’s production rose by approximately 105 kbpd to 465 kbpd by December. Combined, Iraq’s operational production capacity stands at 4.915 mbpd with 185 kbpd remaining underutilized. In terms of exports (Figure 1), State Oil Marketing Organisation (SOMO) has ended the year reaching a level of 3.726 mbpd with 3.63 mbpd being sold from Basra’s southern ports and the remainder through Turkey via Ceyhan and Trucking. With a revenue of $6.1 billion, SOMO’s selling price in December averaged at $52.803 per barrel. Compared to the federal government’s exports of 3.490 mbpd recorded in January, this shows a difference of 236 kbpd in 2018.

Figure 1: Iraq’s 2018 Oil Exports & Revenues

Source: State Oil Marketing Organisation (SOMO), Iraq Energy Institute Analysis


As shown in Figure 1 and 2, Iraq’s highest revenue month was September at $7.919 billion despite exports falling slightly below the previous month’s record exports. Exports were 3.560 mbpd in September compared to 3.583 mbpd in August. This revenue gain came on the back of the highest recorded average monthly price in 2018 at $74.16 per barrel. In August the selling price slightly reduced to $73.38 per barrel shipped. Iraq’s published sale prices in November and December were the least since March after seven months of price gains above $60 per barrel starting in April as shown in Figure 2.

Exports were seen to ramp up in anticipation for OPEC+’s ministerial meeting on June 23rd where a supply jump of 1 mbpd was agreed upon. Compared to April’s 3.340 mbpd where 3-4 days of maintenance in Basra’s export terminals caused the lowest dip in the year, Iraq’s May exports saw an increase of 149 kbpd to reach 3.489 mbpd. In June, another 32 kbpd were added and in July a further 23 kbpd. By August, an additional 39 kbpd in exports brought the total gain to 243 kbpd compared to April. The sudden jump in exports, even before the June meeting, was not exclusive to Iraq; Saudi Arabia hiked exports by 350 kbpd from May’s 7.15 mbpd to June’s 7.5 mbpd.

Other OPEC+ partners followed suit including Russia, while Libya and Nigeria production was at near full capacity. The driver was replacing Iran’s sanctioned market share. In the US, shale producers started pumping at record levels reaching 11 mbpd with Bank of America-Merrill Lynch expecting more than 12 mbpd by 2019 as the oil price approached $75 per barrel in September and October (see World Bank Average Crude Oil Spot Price in Figure 2).

By November 23rd, it was clear that the international market was oversupplied, with crude oil inventories rising in the US and other OECD nations. Brent fell by 30% from October’s peak of $86 per barrel to $61 per barrel. Additionally, fears of negative trade war impacts and a realization that exemptions for Iranian oil importers reduced the effectiveness of US sanctions, accelerated the oil price correction19. By December, OPEC+ met again to re-adjust supply down by 1.2 mbpd20. Earlier in October, oil minister Ghadbian asserted Iraq’s interest to work with OPEC+ to stabilize the global market.

Iraq’s exports fell significantly in October and in November. October’s level of 3.478 mbpd was 82 kbpd lower than September, then suffered a decline of 106 kbpd in November due to weather conditions in Basra’s ports. These infrastructural and seasonal problems reversed in December allowing SOMO to end the year with a new record of exports at 3.726 mbpd aided by new routes that permitted the flow of 99 kbpd from Kirkuk via KPTT to Turkey and approximately 20-30 kbpd from Qayara by trucking21.

In 2018, on a 12-month average, SOMO’s monthly selling prices were discounted by $3.88 below the OPEC reference basket and $3.51 below Dubai. This was also $5.43 below Brent’s monthly average price. From January to May, published average monthly prices were above WTI except in July (See Figures 3 and 4). Moreover, the selling price was above the

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2018 budget forecasted price of $46 per barrel for 11 months of the year.

That said, in December Iraq was selling oil at $52.8 per on average, $3.2 below the 2019 budget assumed oil price of $56. While Brent is trading at $62 per barrel on 6 February 2019 well above the 2019 budgeted oil price, December’s selling price shows how price volatility may impact Iraq’s forecasted revenues, particularly if the price reverses back to the $50 range due to questionable commitment to the OPEC+ deal in the rest of 2019. This may indicate a lost opportunity to reduce the planned deficit, particularly if the oil price does not recover in 2019 as a result of the OPEC+ deal. This realization drives Iraq’s support for the market balancing measure decided in December in Vienna.

In 2019, Iraq is expected to lower exports by 140 kbd as part of the OPEC+ supply cut. In mid-October, SOMO allocated 67% of next year’s exports to buyers in Asia, 20% in Europe and 13% in North and South America. Shipments will flow from both Basra and Kirkuk.

As expected, Iraq is attempting to lure importers of Iranian crude in Asia. SOMO has increased available volumes to Asian customers by 7% in 2019. Earlier in March, Alaa Al-Yasiry, SOMO’s director general had announced their intention to build storage capacity in Japan and South Korea. There had been proposals for partnership from Exxon Mobil, Total, Sumitomo and Unipec.

This strategy is also supported by catering to Asian buyers with appetite for low sulphur lighter crudes. Iraq’s Ministry of Oil is introducing Basrah Light as a third grade with an API of 34-43. Effectively, this displaces the current Basrah Light to become Basrah Medium. Separating Basrah Medium and Heavy in 2015 helped SOMO retain Asian consumers’ confidence in Iraqi crude quality by isolating high sulphur and heavy volumes from newly developed fields. This also saves loading time by eliminating tanker delay during blending.

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24 Ahmed Rasheed. Iraq may build oil storage in Japan, South Korea to drive Asian sales. Reuters. 27.03.18
Figure 2: Monthly SOMO Selling Price & Revenues
Source: State Oil Marketing Organisation (SOMO), Iraq Energy Institute Analysis

Figure 3: 2018 Average Monthly Oil Prices
Source: State Oil Marketing Organisation (SOMO), Iraq Energy Institute Analysis

Figure 4: SOMO Selling Price Differential Above 2018 Budget’s Oil Price of $46/bbl & Incremental Discounts to Selected Indicators. Source: State Oil Marketing Organisation (SOMO), Iraq Energy Institute Analysis
The 250 kbpd federal production gain throughout the year came from the southern oilfields with the Ministry of Oil (MOO) run projects; Nahr bin Omar, Luhais, Ratawi and Tuba leading capacity additions as we reported in October. In January, Iraq’s federal production was 4.2 mbpd then became 4.45 mbpd by December. These fields began the year with rising production that peaked at 260 kbpd then slowed down by the year’s end to 130 kbpd. After the OPEC June meeting where supply restrictions were eased on members, Basra Oil Company (BOC) removed production restrictions over these fields in August, adding 105 kbpd to their 140 kbpd output almost immediately.

Iraq was expected to replace some of Iran’s market share as the US sanctions kicked-in in November. These barrel additions helped Iraq balance slight production declines in July stemming from difficult operational circumstances triggered by the protests around the oilfields in Basra, especially in the West Qurna 1 development under Exxon Mobil. Complications included road blocks, disrupted crew schedules and restricted movement in designated security bubbles, however, these interruptions were short lived and production rebounded in few days. From an average of 450 kbpd before July, production fell to 400 kbpd then rose to 470 kbpd by the end of August in West Qurna. There were no production losses reported in

Eni’s Zubair oilfield, another hotspot for the protests.

### Slow Recovery for the Kurdish Region’s Energy Sector

Starting the year after the dramatic loss of Avana and Bai Hasan (combined exports of 280 kbpd) the Kurdistan Region of Iraq (KRI)’s oil exports had dwindled to 360 kbpd by January 2018 after reaching a low of 230 kbpd in 2017. Before re-taking Kirkuk, in October 2017, Kurdistan’s average exports to Turkey were as high as 580 kbpd. Mid-way through the year, KRI oilfields were expected to increase production by 60 kbpd by year end. Interestingly, the KRI only refines 20 kbpd of regionally produced oil, leaving the rest to be exported to make up for lost revenues and to decrease financial pressure.

By August, pipeline exports stood at 417 kbpd. With the year end production reaching 465 kbpd, the KRI operators have raised an additional 48 kbpd. The KRG’s Ministry of Natural Resources (MNR) has been able to successfully uphold monthly payments to International Oil Companies (IOCs) operating in the autonomous region. As a result, the IOCs have been investing steadily in their

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awarded fields. Norway’s DNO has raised production to 50 kbpsd in Peshkhabir to substitute for declines in Tawke where production stands at 80 kbpsd (as an October company press release shows29). By contrast, in July 2017 Tawke’s production was 109 kbpsd30. Local operator KAR Group has also allocated investments to ramp up the Khurmala Dome of Kirkuk. However, these new additions have brought heavier crude quality to the KRI export mix with the average API falling from 31 to 2931. This has caused a resurgence in interest for discounted KRI exported crude but as production steadies, API readings are expected to lighten a bit.

In 2019, an additional 110 kbpsd is expected to add to KRI’s exports with Gulf Keystone and Taqa expected to add 20 kbpsd each. DNO is also expected to add another 20 kbpsd from Peshkhabir by end of 2019. Notably, Russian companies are getting a larger piece of the Kurdish pie. Rosneft has contracted drilling rigs in the region and while controlling 60% of the Kurdistan Pipeline to Turkey (KPTT), remains a strong buyer of KRI crude in Ceyhan32.

2019 Oil Production Growth Potential

Overall, Iraq’s production capacity has exceeded the 5 mbpsd mark when taking into account Kirkuk’s underutilized capacity and upcoming additions from CNPC operated Halfaya oilfield in Maysan province in the first quarter of 201934. Halfaya is expected to boost capacity from 370 kbpsd to 470 kbpsd35. Qayara was 2018’s success story: the MOO and

28 DNO Operations Update: Peshkabir Production Pushes 50,000 bopd. DNO press release. 09.10.18

29 Tsvetana Paraskova. Kurdistan Upgrades Oil Pipeline Export Capacity To 1 Million Bpd. Oilprice.com. 05.11.18

30 Aref Mohammed. Iraq lifts oil production at Halfaya oilfield to 370,000 bpd. Reuters. 12.12.18
https://www.reuters.com/article/us-iraq-oil-halfaya/iraq-lifts-oil-production-at-halfaya-oilfield-to-370000-bpd-idUSKBN1OB0PX

31 Gillian Carr. Kurdistan crude oil quality variance limits appeal for med buyers: sources. S&P Global Platts.07.02.18

32 Patrick Osgood. Iraq Kurdistan begins its recovery after a difficult year.03.01.19. Petroleum Economist.

33 Tsvetana Paraskova. Kurdistan Upgrades Oil Pipeline Export Capacity To 1 Million Bpd. Oilprice.com. 11.05.18

34 Iraq Energy Institute
Sanangol are ambitiously targeting to double production to 60 kbdp by May 2019\textsuperscript{36}.

More capacity can be developed this year. In Maysan, CNOOC operated Buzurgan, Fakka, and Abu Gharb were expected to add 80 kbdp to their 200 kbdp output. In Dhi Qar, former minister Luiebi had announced in July that a drilling program was to be commissioned by the Dhi Qar Oil Company (DQOC) to add 20 new wells to the Nassiriya oilfield to increase production from 90 kbdp to 200 kbdp\textsuperscript{37}, yet this plan remains dependent on how fast the small company can receive additional financing to build surface facilities for the processing and transport of oil, which may delay schedule beyond 2020. DQOC is expected to add 35 kbdp from Subba oilfield by the end of 2019 when 6 new wells are drilled and desalter units installed for the treatment of the high salt content\textsuperscript{38}.

In Basra, where the bulk of Iraq’s oil production and exports originate, BP’s Rumaila is expected to grow production from an approximate average of 1.47 mbdp to 1.6 mbdp on the back of recent facility upgrades and construction\textsuperscript{39}. In September, Basra Oil Company (BOC) officials forecasted that the field would comfortably reach 1.5 mbdp in production by the end of the year after the anticipated commissioning of a new gas separation unit with a 100 kbdp capacity in North Rumaila\textsuperscript{40}. Also, the MOO is expected to renegotiate field production plateaus soon with licensing round IOCs as we reported in our \textit{analysis} on the 2019 draft budget\textsuperscript{41}.

Legal Disputes & Opportunities for Resolution

Iraq’s oil and gas sector was on the verge of going through dramatic structural changes with the creation of the Iraq National Oil Company (INOC) as legislated by the Council of Representatives in March, 2018. The six month window to form the company passed as the process was delayed by uncertainty over the new government formation.

While the legislation was passed, it has been contested by sector experts in addition to the government of Maysan. The latter is demanding a seat on the INOC board of governors. The sector experts, a couple of whom are veteran economists from the original INOC, filed a complaint that objects to...
articles that outline INOC’s power and authority in addition to revenue management and board appointments. After selecting experts to advise on the complaint, the Federal Supreme Court has found constitutional discrepancies in articles 3, 4, 7, 8, 11, 12, 13, 16 and 18 of the draft law. These articles diverge with the constitution on issues of jurisdiction, oversight and hydrocarbon resource governance. This decision was taken on January 23rd after defences filed by the government and parliament against the plaintiffs. The Prime Minister’s deputy for energy affairs and minister of oil Thamir al-Ghadhban, who historically supported the reformation of INOC, has indicated willingness to re-draft the law within the council of ministers. Thus far, the MOO run companies and IOCs have been operating without any interruptions from the INOC case.

The reestablishment of INOC is expected to be a long process. A new INOC draft law, or written assurances, will be required to counter the recent Federal Supreme Court decision. In the case of a new law, it will need to pass through parliament to become legally binding.

Meanwhile, the Federal Supreme Court has been postponing another case brought by Baghdad against Erbil’s independent oil production and exports since 2012. For the first time, the KRG has sent a defence team in April 2018 to engage the case, an indication of possible willingness to compromise in order to secure KRI allocations in the 2019 budget then, while the Abdul Mehdi government is anticipated to have a friendlier approach with the KRG than his predecessors. This was later confirmed after the new budget was passed with the KRI export obligation omitted. The KRG no longer has to abide by an export quota to receive federal funding for salaries or budgeted expenses. This is a stark policy shift in Baghdad as it historically attempted to sanction international oil companies operating in the KRI or sue buyers and traders of Kurdish oil. Positively, this move will allow further reconciliation between Baghdad and Erbil. It could possibly pave the way for future coordination on exports and refining. This unprecedented constructive political environment in Baghdad and Erbil may accelerate settling the legal framework for securing the KRI’s export obligation of 250 kbps to the federal budget on the long term (although no longer necessary in 2019) while ensuring KRI related budget articles are fulfilled without modification or delay by future cabinets in Baghdad.

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42 Federal court: Articles related to the formation of the Iraqi national oil company are unconstitutional. Buratha news agency. 23.01.19
http://burathanews.com/arabic/news/344289

43 The Baghdad Post: the government is ready to amend the laws of the national oil company, 17.01.19
https://www.thebaghdadpost.com/ar/Story/145699/%D8%A7%D9%84%D8%AD%D9%83%D9%88%D9%85%D8%A9-%D8%A6%D8%A8%D8%AF%D9%8A-%D8%A7%D8%B3%D8%AA%D8%B9%D8%AF%D8%A7-%D8%AF%D9%87%D8%A7-%D9%84%D8%AA%D8%B9%D8%AF%D9%8A%D9%84-%D9%82%D8%A7%D9%86%D9%88%D9%86-%D8%B4%D8%B1%D9%83%D8%A9-%D8%A7%D9%84%D9%86%D9%81%D8%B7-%D8%A7%D9%84%D9%88%D8%B7%D9%86%D9%8A%D8%A9

North Oil Company: A Year of Hope

While the Washington brokered agreement between Baghdad and Erbil allowed the flow of 100 kbps of Kirkuk’s federal oil through the
Kurdistan Pipeline to Turkey (KPTT), the two North Oil Company (NOC) operated oilfields of Avana Dome and Bai Hasan can offer more production and exports. State Oil Marketing Organization (SOMO)'s exports through KPTT have reached 99 kbpd in December rising from an initial 50-60 kbpd at their resumption in early November. This is still below the 300 kbpd that the KRG used to pump from these fields before October 2017. So far, there has not been any clarification on the compensation mechanisms agreed upon with the Kurdistan Regional Government (KRG). In October, we reported that Rosneft, that owns 60% of the KPTT, was holding private talks with the federal government and KRG and proposing a transfer fee of $3.5 per barrel.

In July, Kirkuk’s North Oil Company (NOC) production from Avana and Bai Hasan had doubled to 60 kbpd then grew to 90 kbpd in September. This was mostly being sent to Kirkuk refinery and Baghdad’s Daura refinery and power plants, in addition to Sulimaniya’s Baziyan and Erbil’s Kalak and Ninewa refineries as feedstock. In 2018, this measure helped Baghdad use northern stranded production for local refining and power generation while freeing volumes for exports from the south. The commercial refining agreement between the government of former Prime Minister Abadi and Erbil was a positive development as gasoline and diesel were desperately needed in the newly liberated northern provinces. It also set the stage for the KPTT exports agreement under Prime Minister Abdul Mehdi.

By December, production from the NOC Kirkuk cluster of oilfields reached 360-370 kbpd after a long period of stagnation at 160-170 kbpd. At this rate, 280 kbpd are utilized for refining and power generation while 90 kbpd are exported. This is a remarkable development given the delicate security situation in newly liberated provinces, especially on peripheries of Kirkuk, where assassinations and limited attacks on vital infrastructure were witnessed in 2018.

Another development is that BP has started working on a Kirkuk production capacity development plan with company teams already present on the ground. NOC expects them to deliver a technical proposal by year end before an agreement is inked between MOO and the British oil and gas major. BP is expected to raise Kirkuk’s production to 750 kbpd.

The other northern state-run oilfield to add to production and exports is NOC’s Qayara in Mosul. The MOO has started to price it as a benchmark in addition to crudes from Kirkuk and Basra’s heavy and light. Since November, Qayara’s production is being trucked south to Khor Al-Zubair port in Basra and north to Ceyhan in Turkey. This replaces a trucking deal to Iran of 60 kbpd, an exchange initially set for refined Iranian products, later utilized as a means for paying Iraq’s electricity bill owed to

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46 Much of Kirkuk’s oil to feed Iraqi refineries, limiting exports: Minister. Kurdistan 24. 26.12.18 http://www.kurdistan24.net/en/economy/f77fc237-a93b-482a-8b47-b9857c00eb3c


48 Ibid.

49 Alan Mohtadi. Compromise is key to Kurdistan oil recovery. The National. 06.02.18 https://www.thenational.ae/business/compromise-is-key-to-kurdistan-oil-recovery-1.702203
Iran. The arrangement was dropped after the re-imposition of sanctions in November. An average of 30-40 kbpd was trucked from June to November but interruptedly either on a weekly or daily basis.

SOMO’s tender for Qayara exports highlighted the Zakho Border Gate as the route for the 30 kbpd to be trucked. Baghdad’s future federally controlled land port with Ankara, the Ovakoy Crossing, has not been opened as of February 2019. It is not clear whether the KRG has collected a fee for truck movements or whether this new export route will bring much needed petrodollar allocations to Nineveh Province. Despite this progressive step towards diversification of export routes, Qayara’s production is underutilized due to the inadequate number of trucks available. Operated by Sonangol, only 15-20 kbpd of Qayara’s 30 kbpd capacity is being trucked. From 83 kb in November, the field has contributed a share of 157 kb to overall exports in January of 2019.

Overcoming the Infrastructure Challenge

Rough weather in the northern region of the Gulf remains a strong factor in intermittent export declines from Basra. In October, tankers were reported to have slowed down their loadings causing a decline in exports and subsequently revenues, a situation cushioned by higher oil prices. As Iraq’s nameplate export capacity stands at 4.9 mbpd while production is steadily overtaking the 5 mbpd mark, more infrastructure will be needed for future exports. We have outlined Iraq’s infrastructure problems in our October report.

Limited storage capacity creates a backlog at exporting terminals as seen in November. When tanks are at full capacity, oil field operators are instructed to lower their production. Forced production curtailment is feared to cause long term reservoir damage as oil wells are regulated up and down in short time cycles. As mentioned, weather conditions are another factor for tanker loading delays.

Exxon Mobil and CNPC are in the final stages of finalizing an infrastructure deal with Baghdad that may include the long delayed CSSP water treatment project. The latter is vital for sustaining current production and supporting future additions. The multibillion-dollar package has been negotiated for years, but thus far no details of included projects or final costs are available. If signed, work could start as early as the first quarter of 2019. We have analysed the CSSP in a special report.

An announced goal upon signing the agreement is the expansion of southern export capacity from 3.9 mbpd to 6.5 mbpd. In the north, building a new federal pipeline to Turkey will account for 1 mbpd in exports.

53 CSSP project report by Robin Mills and Mohammed Walji. Available at: https://iraqenergy.org/
54 Iraq’s Kirkuk oil exports to stay restricted. Ahmed Rasheed/RTR
while another 1 mbpd proposed Basra-Aqaba pipeline is on track towards construction as both Amman and Baghdad are keen on seeing the project coming to light. In addition to diversifying Iraq’s export outlets, the pipeline will help create refining synergies with Jordan.

Gas Utilization Strides Forward

Iraq’s natural gas sector is poised to finally see positive progress after years of delays. Additional production is coming online from flared gas capturing activities by the Basra Gas Company (BGC) in Rumaila, West Qurna 1 and Zubair. There has also been further progress in gas capture in the Nassiriya oilfield and the newly producing Siba gas development. Combined, they have added approximately 340 million standard cubic feet per day (scf/d) of production in 2018. According to the MOO, Iraq continues to flare 56% of the 2.953 billion scf/d produced throughout the country. Associated gas flaring happens mainly in the South. Iraq continues to import 980 million scf/d from Iran for use in power generation.

BGC has been producing around 900 million scf/d of dry gas as of the beginning of 2018 with NGL upgrade projects that increased that by an estimated 250 million scf/d by the end of 2018. BGC’s future production is to rise to 1,300 million scf/d, 700 million scf/d below the agreed upon capacity of 2,000 million scf/d with the MOO. Iraq has reached self-sufficiency with LPG production from BGC averaging at 4,814 tons a day while 360 tons per day of LPG are exported, as of December. In 2018, Iraq also exported 735,230 thousand cubic meters of condensate. By year end, 32 shipments of condensate were exported and 53 for LPG. DQOC expects to capture 30-50 million scf/d from Nassiriya, while non-BGC production ranges between 200 and 250 million scf/d with the majority of this...
production to be immediately utilized at gas powered electricity plants. Recently, an American firm Orion, was awarded a contract for gas processing at BOC’s Nahr bin Omar oilfield. The infrastructure package with Exxon Mobil and CNPC may include both Nahr bin Omar and Ratawi gas development. In Anbar, the Akkas development remains behind schedule while Siba in Basra changed hands from Kuwait Energy to Hong Kong based, UEG. The latter has acquisitioned the Kuwaiti oil and gas firm for $650 million. Kuwait Energy produced 25 million scf/d from Siba in April of 2018 from 5 drilled wells and the field’s gas reserves are estimated at 1.083 trillion scf.

Elsewhere, Mansouriya in Diyala Province will move back to MOO operatorship after an exit deal is finalized with TPAO. Iraq remains committed to cease flaring by 2021 by building adequate NGL capacity, however, financial problems after the 2014 oil price crash have delayed state investments. In December, Ghadhban told reporters that gas export negotiations with Kuwait have reached final stages.

Refining Capacity to Expand, Major Challenges Remain

The Ministry of Oil announced in September that 140 kbpd of refined liquids production will be restored in the damaged Baiji refinery by the year’s end. Out of the previous lost capacity of 310 kbpd, the MOO was able to restore 70 kbpd by bringing the Salahaddin 2 (SD-2) refining unit back to full capacity. As for the Salahaddin 1 (SD-1) unit, it has been going through refurbishment in anticipation for coming online in 2019. The ministry has diverted some of Kirkuk oilfield’s unused capacity to SD-1 and plans to increase flows as SD-2 comes into operation in 2019.
In April, MOO signed a contract for the construction of the 300 kbdp Fao refinery and petrochemicals plant in Basra with PowerChina and Norinco International. The long awaited 150 kbdp refining project in Nasiriya was finally awarded to Pacific Future Energy (PFE), a Canadian firm. PFE will work on the project with Montreal’s SNC-Lavalin. Nevertheless, the fate of the deal, in addition to financial details, remain unclear. This is concerning, considering contracts signed by the caretaker government during the transition period were considered annulled. Another 150 kbdp refinery project in Anbar has not attracted foreign investor appetite yet, a similar situation for the 100 kbdp proposed Qayara refinery.

In January of 2018, the MOO signed a contract to build a 70 kbdp refinery specializing in high octane gasoline production with KRI based Ranya International. The KRG is an investor in the project. In February, representatives from Kuwait’s Al-Arfaaj Holdings signed an MOU for future cooperation with MOO on Methane production and gas capturing projects in Iraq. Interestingly, both sides are willing to study future prospects for building a refinery in India. By April, a 70 kbdp refining unit was inaugurated in Basra by the Southern Refining Company (SRC). While these developments show sustained interest in Iraq’s refining sector, hurdles to foreign investors remain in place including highly subsidized domestic fuel market, and limitations on capacity to export refined volumes. The latter may reverse with the construction of the Fao refinery with the potential to export excess refined volumes via Basra’s ports.

Electricity: A Struggle on Many Fronts

Iraq’s electricity sector in many ways began 2018 with similar challenges as 2019; the now traditional delay to approve the budget at the start of the year, while an ambitious program of reforms was well underway, most notably tariff collection trials in Baghdad. Today, the reforms are no single project such as tariff rationalisation but rather, a multifaceted plan to reform the sector and build technical and human capacity on the long run.

With the Ministry collecting less than 10% the sums spent on generation and salaries (around $7 billion total budget for 2018), the Zayouna and Yarmouk trials for tariffs which began in 2016 in Baghdad aimed to almost double this in line with IMF conditions, to around $2 billion. Private contractors were brought in to speed up the process of tariff collection, but there was intense opposition to rolling out the plans nationwide. This was both at the

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72 Iraq signs contract with PowerChina, Norinco to build Fao oil refinery. Reuters. 29.04.18
https://www.reuters.com/article/iraq-oil-refining-china/iraq-signs-contract-with-powerchina-norinco-to-build-fao-oil-refinery-idUSL8N1S60M3

73 UPDATE 1-Iraq signs agreement to build oil refinery near Kirkuk. Reuters. 08.02.18
https://af.reuters.com/article/commoditiesNews/idAFL8N1PY3M8

74 Iraq Ministry of Oil.


local level, with provincial councils rejecting the plans while at the national level, politicians complained about the proposed increases.

By most accounts the trials were a huge success with some data pointing to a 30% drop in demand as houses were connected to smart meters. This led to 24 hr electricity as consumers cut their usage and theft from the grid was largely eliminated, a rarity in Iraq since ISIS destroyed up to 4.5 GW after 2014, while customers paid less than they would to private generator providers.

But widespread fear that these policies impact the poor forced PM Abadi to reduce the fees in January 2018. Concrete work on generation continued in 2018, buoyed by higher oil prices. In January, Mitsubishi signed a contract for the continued upgrade to Basra’s Hartha power station, the renovation of which is now many years old. Mitsubishi is expected to finish the refurbishment of unit 1 (there are four units at Hartha, each 200 MW) by 2021, while Siemens has worked on installing new control systems for units 2 and 3.

Reconstruction at Hartha had previously been delayed in 2009 following a failed effort by an Italian contractor to reverse engineer spare turbine parts for the original Mitsubishi turbines, which were no longer available. This led to a payment dispute with a Russian contractor, which had already begun work despite the parts being stuck at customs for several months due to a bureaucratic delay. Only when the parts arrived was it discovered that they did not fit the turbines. A fire at the power station the following year was yet another setback for a power station that has been intermittently under reconstruction since 1991.

In April, Siemens secured more work to add 700 MW to the 1500 MW Rumaila Gas Power Plant, with an expected completion date of 2020. That month, GE announced that it would be repairing the 750 MW power station at Qayarah, which had been largely destroyed by ISIS. More post conflict reconstruction was lined up in July when it was announced that Orascom would be joining Siemens in adding another 500 MW to the Baiji power plant, which was expected to reach 1500 MW by the year end.

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A third major project for Siemens was the announcement in August that the company would upgrade the Shatt Al Basra Gas Power Plant, installing another 650 MW capacity to the 1,250 MW facility. As with Siemens’ Rumaila project, this is not scheduled for completion until 2020. Major work on transmission and distribution infrastructure—in some ways Iraq’s electricity Achilles’ heel, continued at the start of summer with ABB securing a contract to install five fixed and 15 mobile 132kV substations to improve grid efficiency. Technical and non-technical losses to Iraq’s grid can be as high as 42% with speculation it reaches 50%.

By the summer, Iraq was experiencing its worst electricity crisis since 2005. This is despite electricity generation rising 300% since 2003, because demand, along with Iraq’s growing population, rises ahead of supply generation capacity, at around 7% per year (although summer demand varies on the severity of the summer and economic factors that are hard to predict.) Problems with grid efficiency and illegal connections, particularly in informal settlements, hinder the ability of new capacity to translate into new power.

By mid-2018, Iraq’s generating capacity stood at around 14-15 GW, far below installed capacity of 26.2 GW, with demand for the summer spiking at around 23.5 GW. Iraq’s demand is expected to reach 26 GW during 2019. Two major problems made this situation dramatically worse. Firstly, water levels for the Mosul dam hydropower plant were already critically low in May after low seasonal rainfall, a problem made worse at the start of June when Turkey began filling the Ilisu dam, although Turkey postponed the filling a week later after an outcry in Iraq. The Mosul dam is producing well below its nameplate capacity of 1050 MW.

Almost one month later, Iran cut approximately 1.5 GW from Iraq’s grid following delayed payments to Tavanir, the Iranian electricity company exporting the power, while Iran also shored up power supplies to deal with its own electricity crisis. Iraq was therefore struggling to keep supply close to 15 GW over the summer. It appears these net losses, combined with water shortages described above, worsened the ensuing protests, which would go on for the next three months culminating in a major crisis.

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85 Power Technology. ABB to supply substations to strengthen power grid in Iraq. 06.06.18. https://www.power-technology.com/news/abb-supply-substations-strengthen-power-grid-iraq/
86 EIA. Iraq country analysis. 07.01.19. https://www.eia.gov/beta/international/analysis.php?iso=IRQ
With the heat of summer residing and the severity of protests decreasing, Siemens and GE continued talks with the ministry as both companies positioned to compete over “road maps” to add 11 GW (Siemens) and 14 GW (GE) to Iraq’s grid. The Ministry of Electricity has decided on a synthesis of the proposed plans coordinating the efforts of both companies and looking to add as much capacity as possible in the short term, although this would be strategically focused on areas which had suffered a chronic lack of power, in part using GE’s and Siemens’ mobile power stations, which run on natural gas from oil fields. In the long run, it is hoped that World Bank supported efforts to modernise grid management, through the use of Supervisory Control and Data Acquisition (SCADA) systems and geo-referenced customer databases will lead to modern, real time assessments of grid efficiency.

Concurrent with this plan, long term projects have been put in place to improve grid efficiency and upgrade power stations to combined cycle, which includes GE’s plan to install 36 Advanced Gas Path (AGP) units under the Power Up Plan II. This will make use of Iraq’s growing gas processing capacity, which has hit a year end high of 1050 million standard cubic ft/day (mmcf/d) through the Shell-Mitsubishi-South Gas Company Basra Gas company, with an eventual target of 2 mmscf/d. Much of this gas will go to power generation, saving Iraq money by using gas that would be flared and further cutting the wasteful use of crude oil and diesel in power plants.

It is hoped that 2019 will see around 2-4 GW additional power coming to the Iraqi grid, with the projects mentioned above adding much more in the coming years, not including other non-Siemens/GE led projects such as South Korea’s STX Marine Service deal to restore diesel electric capacity, which began over the summer.

In the long term, Iraq will urgently need to revisit plans for privatisation of distribution, to help ensure funding viability of massive Independent Power Producer (IPP) projects like the 3 GW Bismiyah power station. Otherwise, the relentless rise of demand, at around 7% per year and growing costs will only mean more problems in future, with demand projected to soar to 30 GW, perhaps even 40 GW, by 2030 (although much of this will depend on industrial demand, which is extremely hard to predict.)

Iraq is working on concrete sustainable measures to be taken to reduce the number of hours of power cuts especially during the peak summer months in the next few years. In addition to signing two MOUs late last year, technology-helps-iraqs-najibiya-power-plant-reduce-downtime/
with the giant electricity companies GE and Siemens to come up with quick and long term solutions for the power shortage, more IPPs are willing to enter the Iraqi market to build large scale gas fired power generation and solar PV.

**The Struggle for Economic Reform**

Recognising that even the best energy sector scenarios cannot create jobs sustainably, Iraq in 2018 saw another push for regulatory reform to incentivise private investment. Much difficulty, as PM Adil Abdul Mehdi has stated, is political obstacles to reform. We note for example, that some Iraqi government entities are cognizant that oil prices are unpredictable and the private sector is weak, as emphasised in the Ministry of Planning National Development Plan 2018-2022.97

These warnings are not new, as multiple government plans to diversify the economy over the years have made clear, but there is an evident struggle to implement recommendations. During the Kuwait conference, the National Investment Commission (NIC) reminded prospective investors of ongoing efforts to consolidate investor access and registration in a One Stop Shop (OSS) which was established as the OSS Department under Investment Law No. 13 of 2006.98 One of the big challenges for business, both local and foreign, has not only been procedures to start a business, but also dealing with different government entities. An OSS plan has intended to stop this problem, but it has encountered difficulties.

In November, the NIC complained that the OSS Department was often cut out of decision making when in fact it should have been central, with the role of streamlining and eliminating bureaucracy. The NIC also complained there were still major problems in allocating land for investment. Laws on this matter were often interpreted according to local or national interests. According to the NIC, “relevant state departments are very conservative regarding allocated lands for investment which has created a huge obstacle for investment projects.” The NIC warned that political quotas, corruption and central government interference in the work of Provincial Investment Commissions were leading some companies to abandon projects.99 Iraq will need another major push in this area if job creation is to be feasible at the required scale for stabilisation.

**Reform Focus Areas**

In part due to these ongoing problems, Iraq’s attempts to increase non-oil investment have suffered in 2018, despite notable projects announced throughout the year and despite


minor reforms (discussed below) that if extended to other sectors, could be promising.

Important non-oil projects announced at the end of 2017 and early 2018 have not materialised or been delayed. This is a tragedy since one of the key ingredients to economic stability is job creation. More concerningly, 2018 again saw demands directed at a multiplicity of state and non-state actors, ranging from national oil companies, local and federal governments, the religious establishment and a range of different groups. While reform demands focused on three key issues—electricity, jobs and clean water, there has been attempts in 2018 to address the challenges.

Firstly, in July former Minister of Oil Jabbar al Luaibi summoned IOCs to discuss the Integrated South Project, the scaled down Common Seawater Supply Project (CSSP) that now aims to provide 5 mbpd of treated seawater (down from 12 mbpd) for enhanced oil recovery, vital for Iraq’s long term production targets. In the long run, new seawater injection facilities may still rise to 7 mbpd in order for Iraq to meet ambitious production targets. In the absence of this project, IOCs are drawing freshwater from the Garraf river. In Iraq’s hot summers, an overall lack of water is contributing to seawater encroachment of the Shatt al Arab, negatively impacting drinking water quality in Basra, a problem compounded by Turkish and Iranian dam construction, water-use inefficiency within Iraq and leaking infrastructure. At most, the water requirements for IOCs are projected to reach around 1.7 billion cubic metres (bcm) per year by 2035, with domestic demand projected to reach over 6 bcm/year. For comparison, Iraq’s marshes are thought to need around 5.3 bcm/year to maintain their ecosystem. However, with a rapidly growing population, vast water demand for agriculture and difficulty in making accurate projections, the sooner Iraq can complete seawater injection facilities the better.

Secondly, a significant challenge is job creation. As we have noted, Iraq needs to create approximately 500,000 jobs per year, due to rapid population growth, a target that cannot be reached even remotely by the public sector. Some estimates place the maximum number of jobs Iraq needs to create in 2018 as high as 900,000. In southern Iraq, high unemployment has led to tribal disputes over who is allowed to work at oilfields, where hiring of local security guards is often a tribal matter. This led to a promise of creating 10,000 jobs in the sector, although we note some of the major tribes have hundreds of thousands of unemployed young men. The dynamic of protesters demanding jobs is likely to continue, a pattern that is now years old and ultimately unsustainable.

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100 Iraq’s IOCs press on upstream, despite protests. Middle East Oil and Gas. 24.07.18. https://newsbase.com/topstories/iraq%E2%80%99s-iocs-press-upstream-despite-protests
Economic Governance Gains

Despite these unfavourable indicators, Iraq made some headway in 2018 to facilitate foreign investment and announce plans to renew efforts against corruption in 2019. Firstly, the Iraqi government has said it is introducing changes to simplify visa and residency procedures for visitors, international investors and entrepreneurs from a number of countries, beginning with Lebanon following an agreement between the two governments.\(^{104}\) Iraq’s visa application process has in the past been notoriously difficult and often cited as an obstruction to investment, so any progress in this area is notable.

This follows important progress in February 2018, when Iraq acceded to the New York Convention on commercial arbitration, often regarded as the international “gold standard” for aligning the rights of investors and governments. Iraq’s accession to the convention follows its signing of the ICSID convention in 2017, which focuses on investor-state disputes.\(^{105}\)

Within Iraq itself, progress on kickstarting the small and medium enterprise sector (SME) has been mixed. In the 2019 World Bank Ease of Doing Business survey, which attempts to standardise assessment of SMEs for comparison across borders, Iraq ranked 155 out of 190 on procedures for starting a business, ahead of Iran (173) but behind Saudi Arabia (141). The bank classes SMEs as having a startup capital 10 times the per capita income and employing between 10-50 domestic nationals.\(^{106}\) In Iraq, the average time for men to start a business was 20.5 days with 8 procedures, while women took on average nine procedures over 27 days. On these metrics, Iraq was behind in the region, particularly on the length of time required to start a business.

The report also details other areas where bureaucracy is stifling business. For example, it takes on average 312 hours per year for medium size businesses to deal with tax and related post filing procedures and complying with tax legislation, compared to 197 hrs for the rest of the MENA region. The report also details Iraq’s currently weak legal environment for businesses and weak contractual enforcement, where Iraq ranks at 48.02, behind the MENA regional average of 55.04.

Contract enforcement and an equitable access to markets is of course related to Iraq’s overall rule of law environment. Aware of these challenges, prime minister Adil Abdul Mehdi held his first meeting with the Supreme Council for Combating Corruption at the end of December, where he urged stronger cooperation in the body which works with the Commission of Integrity and Ministry Inspector Generals.\(^{107}\) Performance in this area is

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\(^{107}\) Sangar Ali. PM says corruption ‘distorts’ Iraq’s image and reputation, calls for its eradication. Kurdistan 24. 01.01.19.
important, as earlier in 2018 commissioner Hasan al Yaseri resigned his position at the Commission of Integrity in protest claiming that only 15% of 10,000 cases had resulted in a court case in the previous year.

On the investment front, President Barham Salih discussed the need to improve the environment for FDI by “draining Iraq’s swamp” of corruption at the Mediterranean Dialogue Forum in Rome at the end of November. He announced the creation of a national infrastructure and industrial development agency, which would attract investment for “deep port facilities in Basra, railway networks, highway networks, airports, industrial cities, dams, irrigation projects in the Nineveh plains, Garmiyan and Erbil, as well as land reclaims in the south.”

This would, he said, put Iraq at the “heart of a new Silk Road.” Any progress here in 2019 will depend very much on improving the investment environment for mega projects. In this area, some companies were still showing appetite for risk through 2018, with a significant breakthrough being the cooperation between Standard Chartered Bank and the Trade Bank of Iraq who together finalised a $600-million financing agreement for General Electric’s “Power Up Plan,” which aims to add 2 GW to the grid and maintain over 6 GW.  

First Mover Advantages

Despite these challenges, a number of non-oil sector companies pushed ahead with investments in 2018. In a sign that Iraq was joining the world’s increasingly digital economy, UAE-based Careem ridehailing app launched in Baghdad in January, a rival in many developing countries to Uber, with half a million drivers registered globally. In February 2019, we launched a series of articles covering this nascent but potentially transformative sector.

Another significant development was the entry of a Lebanese firm in the dairy sector in Basra, with a $10 million factory that will produce 10 tons of produce per hour. The factory is already operational, but it is noteworthy that the investor was initially looking at Basra in 2013, either a sign that companies are regaining confidence after the 2014-17 conflict, or the bureaucratic hurdles faced when launching a business.

Nearby, the Saudi Northern Cement Company acquired Iraq’s Umm Qasr Northern Cement Company in February 2018, another investment in a sector that should be growing with Iraq’s reconstruction needs. Here the

108 Salih envisions Iraq as hub of revitalised middle east. Rudaw. 22.11.18.
http://www.rudaw.net/english/middleeast/iraq/22112018 3
109 Trade Bank of Iraq, StanChart, GE close $600 million power finance deal. Reuters. 25.11.18
112 Northern Cement aquires Umm Qasr Cement Company. Cwgrp.com. 12.02.18. https://www.cwgrp.com/cemweeknews/m-a/496996-
challenge for Iraq is to balance protecting its own industries with the need to keep reconstruction costs down.

Cement market entrants such as Pakistan’s Lucky Cement and France’s Lafarge (who have been in Iraq for over a decade) will benefit from cement tariffs currently in place. This year, cement production projects in Iraq amounted to at least $300 million in investment, with Lucky Cement launching a 1.2 million ton/year project as a joint venture with a local firm in Samawah, in addition to its existing plant in Basra. Elsewhere, the Danish company FLSmidth has a $200 million contract with the Iraqi Cement Company for a 6,000 ton/day (2.2 million tons/yr) facility in Al Muthana, a project initiated in 2016. These plants will receive a huge boost if and when reconstruction of seriously damaged areas such as West Mosul gets underway, but tariffs may crowd out cheaper sources of cement, or raise the cost of the imports for the Iraqi market.

Iraq’s steel industry faces a similar conundrum. At the present time, cheap imports are making it hard for steel production in Iraq and the Kurdish region— a similar problem faced by the steel industry globally since the steel glut. In 2018, Iraq used 1.41 million tons of steel, only 430,000 tons of which was produced locally, with around 980,000 tons imported, with Iranian, Turkish and Ukrainian companies supplying the bulk of these imports. In a sign of the distorting effect of tariffs, Iraqi fees on steel imports at the Ibrahim Khalil border crossing are far higher than tariffs on imports coming into Basra. As a result, steel importers in the KRI are now using Basra, despite the long distance, to import steel.


114 Gavin Davids. $200 million deal signed between Iraq Cement and Denmark’s FLSmidth. meconstructionnews.com http://meconstructionnews.com/18640/denmarks-flsmidth-signs-200m-deal-with-iraq-cement-co

115 Demand for Kurdish steel tempered by cheap imports. Rudaw. 17.12.18 http://www.rudaw.net/english/business/17122018
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