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Iraq: economic consequences of the 1991 Gulf War and future outlook

ABBAS ALNASRAWI

On 2 August 1990 Iraq invaded Kuwait. This was followed by the freezing of Iraq's assets in the industrialised countries and a United Nations comprehensive embargo on all transactions with Iraq. On 16 January 1991, a US led bombing campaign against Iraq was launched. The bombing of Iraq, which was both concentrated and comprehensive, led to the destruction of Iraq's infrastructure and the crippling of its economy. The Gulf War, which officially ended on 28 February 1991, was followed by an outbreak of a country-wide general uprising against the institutions and the authority of the Iraqi government and the ruling Baath Party. The breadth of the uprising and the manner in which the government suppressed it added to the woes of the country.

To assess the economic cost of the war and the implications of such cost to the future outlook for the Iraqi economy one must start with some understanding of the economic consequences and dislocations caused by the Iran–Iraq war of 1980–88.

Economic costs of the Iran–Iraq war

In 1972 Iraq nationalised the foreign owned Iraq Petroleum Company (IPC) and in 1973 it nationalised the assets of the two affiliates of IPC. These acts of nationalisation together with the October–December 1973 oil price explosion increased government oil revenue from $1 billion in 1972 to $8.2 billion in 1975. This sharp increase in revenue enabled the government to finance infrastructural projects, increase investment in goods-producing sectors, expand social services, modernise and expand the military, and accumulate foreign reserves.

The availability of reserves and the financial assistance which Kuwait and Saudi Arabia extended to Iraq in the early phases of the war helped Iraq maintain high levels of both military and civilian spending.[1]

Such patterns of spending could not be maintained as oil revenues declined drastically, from $26.3 billion in 1980 to $7.8 billion in 1983, due to the destruction of Iraq's oil exporting capacity in the course of the war and the marked decline in the price of oil after 1982.[2]

The decline in oil revenue and the emergence of a chronic foreign trade deficit forced the government to adopt policies of economic austerity and retrenchment. The new policies entailed a drastic reduction in non-defence spending, a freeze on infrastructural projects, lowering of imports, devaluation of the dinar, and cutbacks in investment in the industrial and agricultural sectors. An indicator of

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Iraq's severe economic problems is the decline in its share in the combined value of projects contracted by members of the Organisation of Arab Oil Exporting Countries (OAPEC). This share, which reached 30% in 1980 and 31% in 1981, fell in 1982 to 9% and to 2% in 1983.[3]

Another indicator of Iraq's deteriorating economic conditions was the change in its status from a creditor country to a debtor country as it was forced to rely on short- and long-term borrowing to finance its imports. This borrowing was in addition to the financial assistance given to Iraq by Saudi Arabia and Kuwait which averaged $1 billion per month for the first two years of the war.[4]

In addition to changes in imports and debt status the war had other effects on the Iraqi economy. These include military expenditure, lost oil revenue, lost gross national product, disorganisation of planning, an increase in the size of the armed forces with a consequent impact on the civilian labour force, forced importation of foreign workers, loss of economic independence, the cost of rerouting of foreign trade, the appropriation of a larger portion of government spending for the disabled and the survivors of the war victims, acceleration of rural migration, and an increase in investment in military industrialisation. No less important for the future of the Iraqi economy and society was the high level of casualities which had been estimated to have reached the one million mark for both countries.[5]

The cost of the eight year war to the Iraqi economy was estimated by Kamran Mofid to have amounted to $452.6 billion. To place this loss in some perspective suffice it to say that Iraq lost the equivalent of 112% of its GNP every year for the period of the war, 1980–88.[6] Another way of looking at the cost of the war is to relate it to Iraq's oil revenue. Since in the period 1980–88 Iraq's total oil revenue from oil amounted to $103.9 billion, this means that Iraq's estimated war loss amounted to 435% of its oil revenue. But the $452.6 billion loss represents only the monetary cost of the war and does not include non-monetary cost elements such as inflationary costs, loss of services and earnings of those who were killed or disabled by the war, depletion of national resources, loss of potential earnings due to the postponement of development projects, cost of delayed education and training, and the burden on society of those who were disabled.[7]

The crisis of the Iraqi economy prior to the invasion of Kuwait

When the Iran–Iraq war ended in August 1988 Iraq's economy was in a serious crisis: its oil-exporting capacity from the southern fields was destroyed, its infrastructure was seriously damaged, a major segment of its labour force had been drafted into military service and a large number of foreign workers had to be imported, its development plans were disorganised and lacking in investment funds, its foreign debt was high and its service was a major drain on a declining level of oil income, progress along the path of industrialisation and diversification was blunted, its reliance on food imports increased, and inflation was rampant.

In addition to the war-caused destruction and dislocation which set the stage to the postwar economic crisis there were three other factors that exerted particular influence on deepening the crisis. These were the persistent decline in oil revenue, foreign debt, and the privatisation policies of the government. These new influences

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had the effect of aggravating the economic crisis—a crisis which the government sought its solution in the invasion of Kuwait.

The new phenomenon of Iraq's foreign indebtedness

Since the early 1950s Iraq had been a foreign debt free country. The eight year war with Iran, however, forced Iraq to borrow on the international financial market. There are no precise data on Iraq's foreign debt. Nor is there an agreement as to what constitutes debt. Thus Iraq's foreign debt was estimated to comprise $35 billion to Western governments and banks, $11 billion to the Soviet Union and Eastern Europe, and as much as $40 billion to other Arab countries.[8]

The Iraqi government for its part tends, however, to consider the funds it received from the Gulf states during the Iran–Iraq war as a grant or assistance. This was made clear in a report submitted by the Iraqi government to the United Nations regarding Iraq's foreign exchange requirements for the period 1991–95. This report states that 'Iraq's total external debt and obligations amount to 13 118 million Iraqi dinars (ID) or the equivalent of $US 42 097 million as of 31 December 1990, excluding interest'.[9] The report asserts that Iraq is obligated to pay over the five year period, 1991–95, $75.3 billion to cover debt amortisation and interest. In other words, Iraq's annual debt service is projected to average $15.1 billion per year for 1991–95.

Privatisation and government economic policy

As the war with Iran continued the government was forced to mobilise an increasingly large portion of the labour force, consequently causing labour shortages in every segment of the skill structure. While in 1977 Iraq had 0.262 million persons in the armed forces or 8.7% of its labour force, by 1988 the size of the armed forces had increased to 1 million or 21.2% of the labour force. To stem the effects of such a labour drain a large number of workers mainly Egyptians were admitted to the Iraqi labour market.[10] One of the serious implications for the balance of payments of having a large number of foreign workers is the size of remittances which was estimated to be $4 billion in 1983 alone.[11]

But the most significant economic policy response to the 1982 war conditions was the change in the economic policy of the ruling Baath Party toward the role of the private sector in a state-run economy. At the July 1982 conference of the Baath Party a political decision to promote the private sector was made. This decision was endorsed publicly by the president in 1984 and then again in 1986 when he stressed that '. . . all activities of the private sector form part of the national wealth, and are as important as the activities of the socialist sector'.[12] He reiterated this position again in 1985 when he said that 'our brand of socialism cannot live without the private sector whether now, or after the war'.[13]

The new policy of supporting the private sector was further enforced when the government introduced in February 1987 an ambitious economic liberalisation and privatisation programme. While certain industries such as oil, defence, steel,

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railways petrochemical, banking and insurance, and public utilities continued under state control, other industries were turned over to the private sector. The new measures were characterised as representing a turnround in the official ideology propounded since the Baath came to power in 1968. The main features of the new measures include the following:[14] (1) selling state land, farms, factories to the private sector; (2) encouraging private enterprise; and (3) deregulation of the labour market by abolishing labour law.

Following the announcement of this plan several changes affecting the economy were made. These include the reorganisation of state enterprises, restructuring of ministries and commissions, the creation of companies to run state enterprises, enactment of laws to induce investment of Arab capital with local private capital in the Iraqi economy, introduction of limited competition in the banking sector, encouragement of import substitution industries, decriminalisation of the use of foreign held balances to import goods, encouragement of private initiative in agriculture, and the possibility of creating stock and bond markets to help raise capital for the private sector and funds for the government.

It is important to note that the new policy of privatisation was reiterated in a 2 July 1987 article in the party's *Al-Thawra* newspaper by the head of the presidential office which stated. 'It has been decided . . . that the party and the security shall not interfere in the essential work and tasks of productive enterprises'.[15]

Although the decline in oil revenue, the unanticipated length of the war, and the mounting foreign debt prompted some of these changes in policy it would be more accurate to say that the war and its consequences accelerated tendencies that were already at work. A major reassessment of economic policy especially in the agricultural sector was actually initiated in 1979 when it was realised that the goal of food self-sufficiency proclaimed under the 1976–80 Five Year plan would not be achieved.[16] Indeed it was a political and financial embarrassment when the food import bill reached $1.4 billion in 1980 and $2.5 billion in 1984.[17] To cope with this problem the state invited the private sector to play an active role in agriculture by extending credit, leasing land, selling state farms,allowing agricultural prices to rise and increasing allocation to import inputs.

The privatisation of agriculture was followed by a major policy to liberalise Iraq's import trade. In order to ease pressure on its declining foreign exchange earnings the government enacted in 1984 a law which permitted the private sector to import without having to obtain the traditional import license and thus repatriating foreign held and privately owned balances.[18]

Iraq's leap into the fashionable world of privatisation was encouraged among other things by the failure of the state sector in its import substitution industrialisation, the emergence of consumer societies in the Gulf with their demonstration effect, the enhanced US presence in the region, and Saddam Hussein's need to consolidate his power and broaden its base beyond the party.[19]

Iraq's new economic policy of liberalisation was extended to foreign capital when the government decided to adopt measures to encourage its flow into the Iraqi economy.[20] But the single most significant indicator of the government's desperate need for funds was its decision to invite foreign capital, which has been barred from the oil fields. The new policy departure sought to entice foreign oil

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companies to develop new oil fields as well as providing the requisite financing for such development.[21]

It is important to note that an important factor which contributed to the general shift toward a more liberal economic policy was the desire to develop closer relations with the USA.[22]

Assessment of economic policy

Leaving political and ideological considerations aside it can be said that the policy of privatisation was driven by economic expediency. The decline in oil revenue and the rise in foreign debt and the need to service it persuaded the government that the private sector should be given the task of generating part of the economy's foreign exchange requirements.

The privatisation of agriculture failed to increase output since large numbers of rural workers and peasants were drafted into the armed forces. The liberalisation of foreign trade failed to persuade the private sector to repatriate its foreign-held capital. Instead it engaged in a large-scale export of the local currency to neighbouring countries to import consumer and capital goods for sale in Iraq at exorbitant prices. The tendency to set high profit margins on imports, estimated to range up to 500%, encouraged other segments of the private sector to raise prices thus setting the stage for unprecedented high inflation rates.[23]

Another contributing factor to higher prices and the ability of the private sector to push up profit margins was the monopolistic or quasi-monopolistic market structure in which it was operating, as the privatisation measures which replaced one monopolist by another allowed the new owners to charge any prices they wished. The removal of the government from the practice of price fixing removed with it also the subsidies to government-owned enterprises—a practice that had the effect of blunting the impact of inflation.

There were other problems with the new economic policy. While the state was interested in shifting some of its economic tasks and responsibilities through the transfer of enterprise ownership, it did so without first creating the legal, economic and institutional framework that was necessary for the functioning of the private sector. This is attested to, by the speed with which the transfer was made and which resulted in many enterprises being sold at prices that were well below their book value or replacement value. As one observer noted; 'In most cases, the prices paid barely covered the market cost of the land the factories were built on. The government required only a down payment of 40%, to be transferred in increments'.[24]

A more serious problem was the income redistribution effect of privatisation as a result of the elimination of subsidies to enterprises which produced or distributed essential consumer goods at low cost to consumers with a low or fixed income. Since personal income failed to rise to offset the erosion in purchasing power the new policy had the effect of lowering the living standards of millions of Iraqis.

In the face of unprecedented inflation rates, recurrent shortages, and high and rising unemployment, the government found itself retreating from its declared policy of hands off the private sector. Instead it attempted to mitigate the effects of its

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policies through a number of changes introduced in 1989. These included an increase in the monthly salary of civil servants, selective price cuts of state-produced goods, a one-year price freeze on all consumer goods and services produced by the public sector, a decision that profit margins of state-owned and mixed-sector enterprises would be lowered from 25% to 20%, an increase in the subsidy paid to producers of agricultural products, and a reduction in the amount of foreign exchange which can be remitted by ex-patriate workers.[25]

But such changes which may have provided temporary political relief to the government failed to address—they could not have—the multiple crises in the Iraqi economy. When the 1989 measures failed to address the deepening economic crisis the government began to look southward—to Kuwait.

The invasion of Kuwait as a solution to the crisis

Oil revenue has always been the single most important source of the country's economic viability, growth and reconstruction. The proceeds from the sale of oil provide the only source of funds to pay for imports, to service foreign debt and to serve as the basis of credit worthiness and fresh borrowing. Given the fact that Iraq has become 70–80% dependent on foreign suppliers for its food needs it becomes very clear that oil income has become indispensable for economic recovery, but also very essential for political stability. Yet the determination of oil revenue was simply beyond the control of the government since the prices of Iraq's oil exports as well as the volumes of these exports were determined by external factors.

Theoretically Iraq's oil exports and prices are set in accordance with the decisions of the Organisation of Petroleum Exporting Countries (OPEC). But in order for these decisions to be effective they need to be implemented by all countries, otherwise deviation by any one country from strict compliance would affect other countries' exports and incomes. Thus following the 1986 price collapse OPEC decided to re-establish a reference price of $18 per barrel and the system of quotas was re-introduced. As certain member countries chose to produce above their assigned shares, prices failed to reach the agreed upon reference level—averaging $16.92 per barrel in 1987; $13.22 in 1988; and $15.69 in 1989.

Given Iraq's need for a steady and rising level of oil income it had no choice but to focus its attention on prices as the only means to increase, or at least stabilise, oil revenue. In its quest for higher prices Iraq had the support of other oil producers such as Venezuela, Iran, Algeria, Libya and Nigeria. The primary explanation of the position of these countries was rooted in their short-term need for cash and their desire to stretch their oil reserves over a longer period of time by regulating output.

By contrast to the policy of price maximisers, countries like Kuwait, Saudi Arabia and the United Arab Emirates, sought to increase revenue by increasing output even if this increase meant lower prices. The magnitude of their crude oil reserves coupled with their small population made these output maximisers less dependent on price than the other group.

Furthermore, Kuwait was in a class by itself in that its own foreign investment portfolio was capable of generating as much income as its oil sector. In addition

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Kuwait was unique among other oil-producing countries in that it possessed refining capacity and marketing outlets abroad. From Kuwait's perspective it must have made little economic sense to have an integrated international operation and to fail to take advantage of its low cost crude.[26]

The manner in which crude oil prices behaved in 1989 and the first half of 1990 brought the conflict between the two groups of countries into sharp relief.

By the end of 1988 OPEC's oil price was around $14 per barrel, considerably below OPEC's reference price of $18 per barrel. The rise in price which began in December 1988 continued its upward trend in 1989 when the market price actually overtook the reference price to reach $18.84 per barrel in December 1989. The price rise continued into January 1990 when it peaked at $19.98 per barrel. Between January and June 1990 the price fell sharply to $13.67 per barrel—a decline of nearly 30%—causing a major decline in the oil income of Iraq and other oil producers. Given the level of Iraq's oil exports at the time it was estimated that for every $1 decline in the price of oil Iraq lost $1 billion per year. The 1990 price decline deepened Iraq's economic crisis and provoked the Iraqi government into using its political and military power to arrest and even reverse the slide in oil prices and income.

One of the most significant expressions of the fundamental difference in oil policy objectives between Iraq and Kuwait was enunciated by Kuwait's oil minister Ali Khalifa al-Sabah in February 1990 when he said:[27]

> First of all, I will tell you that we are producing above quota at the moment. Let us not beat about the bush on that. And I think that our obligation to stay within the quota applies when the price of the OPEC basket is below $18/B and if the price is above $18/B, I think everyone should be producing above quota.

The Kuwaiti oil minister went on to assert his government's policy for the future when he said he hoped that the current range of $18 per barrel for the OPEC basket would remain in nominal terms for a considerable period of time—at least three or four years. And when asked when he would like to see the OPEC quotas scrapped his answer was categorical:[28]

> As soon as possible. From a practical standpoint they are already irrelevant, so all that is needed is a recognition of that fact.

It can be seen from these statements that Kuwait's blueprint for OPEC had three elements: (1) that the price of oil should remain stable in nominal terms at $18 per barrel; (2) that whenever market forces push the price above this level countries with spare capacity, such as Kuwait, should expand their production to bring the price down; and (3) that the quota system should be scrapped.

Again from Kuwait's perspective this blueprint was rational since Kuwait's crude oil reserves were considerable relative to the size of its population; it had downstream outlets for its own oil; its production capacity was about 2.5 million barrels per day or 1 million barrels per day above its quota; and its income from its portfolio investment was considerable. On all these counts Iraq was in no position

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to compete with Kuwait since it had no spare capacity; it wanted to adhere to the quotas; and it had no portfolio income.[29]

At any rate the decline in the price of oil by 33% between January and June 1990, from nearly $20 per barrel to $13.67 per barrel triggered a series of reactions by Iraq. In early May of that year Iraq's foreign minister expressed his country's serious concern over the violation of OPEC's production quotas and characterised over-production as an irresponsible game. Meanwhile the Baath Party organ *Al-Thawra* asserted that the policy of overproduction was a concerted effort to undermine the Iraqi economy. More seriously the paper linked overproduction with a Zionist–imperialist campaign against Iraq.[30]

On 30 May at the Arab Emergency Summit Conference in Baghdad Saddam Hussein took up the same theme when he spoke of damage inflicted upon the Iraqi economy as a result of lower oil prices. In its effect on Iraq the lower prices were interpreted as an economic war of aggression that was similar to the damage inflicted by conventional wars. At the Summit Conference the Iraqi president issued this warning:[31]

> I wish to tell those of our brothers who do not seek war, and those who do not intend to wage war on Iraq, that we cannot tolerate this type of economic warfare which is being waged against Iraq. I believe that all our brothers know our situation and are informed about it and that, God willing, the situation will turn out well. But I say that we have reached a state of affairs where we cannot take the pressure. I believe we will all benefit and the Arab nation will benefit from the principle of adherence to OPEC resolutions on production and prices.

Underlying his threats and warnings the Iraqi president was acknowledging the economic crisis that was engulfing Iraq. The desperate state of the Iraqi economy was made clear by Saddam Hussein when he said 'a few billion dollars could solve much that has been at a standstill or postponed in the life of the Iraqis.'[32]

Following the Summit Conference Iraq's deputy prime minister Saadoon Hamadi announced in Kuwait that: Western oil consumers would be prepared to pay $25 a barrel and that he did not consider $25 a high price by any standard. Furthermore he asserted pointedly that the price would go up if Kuwait and the United Arab Emirates will refrain from overproducing. It should be noted that at this particular juncture Iraq was not the only OPEC member country advocating adherence to OPEC quotas as there was an effort by other oil producers to persuade these two states to lower their production.[33]

In the middle of July Iraq intensified and broadened its efforts against the policies of Kuwait and the UAE by lodging an official complaint with the League of Arab States. Iraq accused the two governments of what it described as 'a planned operation to flood the oil market with excess production'. The Iraqi memorandum accused Kuwait of far more serious acts than mere overproduction.[34] In short:

> As far as the Kuwaiti Government is concerned, its attack on Iraq is a double one. On the one hand Kuwait is attacking Iraq and encroaching on our territory, oil fields and stealing our national wealth. Such action is tantamount to military aggression. On the other hand the Government of Kuwait is determined to cause a collapse of

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the Iraqi economy during this period when it is confronting the vicious imperialist Zionist threat, which is an aggression no less than military aggression.

Besides oil price and production Iraq demanded that the fiscal support which it had received from Kuwait during its war with Iran should be written off on the grounds that its war with Iran was waged not only to defend its own territorial integrity but also the eastern flank of the Arab homeland especially the Gulf region and that the war enabled Kuwait to reap considerable fiscal benefits as it was able to sell oil at higher prices. In addition Iraq felt that the unforeseen length of the war with its attendant higher cost was another reason why the loans should be considered as assistance. To bolster this claim Iraq cited the fact that the cost of the military hardware alone, which it purchased and used in the war, amounted to $102 billion.[35]

On 17 July Saddam Hussein reiterated in public the accusations that his government had already levelled against the Gulf states particularly Kuwait.[36]

On 27 July, as Iraqi troops moved along the Iraqi–Kuwaiti border, OPEC decided to raise the reference price of oil by $3 per barrel to $21 per barrel. It also voted to adopt new quotas with the injunction that no member country was allowed to exceed its allocated share for any reason whatsoever.[37]

The new OPEC agreement was not given time to be tested as a result of the invasion of Kuwait by Iraq only a few days after the adoption of the agreement. And on 29 August 1991 OPEC decided to suspend quota allocations so that member countries could expand their output without restrictions.[38] The removal of output quotas which was intended to bring down oil prices proved successful. Thus the price of OPEC oil which increased from $15.68 per barrel in July 1990 to peak at $37.22 per barrel in October, declined to $17.19 per barrel by March 1991.[39] The 29 August decision by OPEC was, furthermore, characterised as having been adopted under considerable pressure by the USA which amounted to a direct order.[40]

Human and economic consequences of the invasion

While political historians and other analysts will debate the motives, the causes, and the objectives of the invasion there is little doubt that the crisis which engulfed the Iraqi economy played a decisive if not the decisive determining factor in the decision to invade, occupy and annex Kuwait. A review of some of the economic evidence reveals the depth of the crisis and its endemic nature.

The changing market conditions for oil caused a drastic decline in Iraq's oil revenue per capita from a peak of $2000 in 1980 to $792 in 1989, equal to that of 1976 and 1977. If we take into consideration the erosion in purchasing power of the dollar (the currency in which oil is sold) due to inflation and devaluation, we can see the extent to which this particular source of income has declined.

Per capita GDP at current prices in 1977, the first full year before the rise in the price of oil occasioned by the 1978 events of the Iranian revolution, was $1600. In 1989 per capita GDP increased to $2818 an increase of 76%. But such an increase is meaningless as it does not take into account the erosion in purchasing power

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which resulted from rampant inflation rates, which are estimated to have ranged between 20% and 40% per year during the 1980s.[41]

In order to have a more meaningful measurement of GDP per capita we have to consider, therefore, real GDP per capita to measure what has happened to the living standard of the people. According to UN data, real GDP per capita in 1980 stood at $1674 and averaged $1145 for the six year period, 1983–88, reflecting a decline of 32% in purchasing power. More significantly, in 1988 GDP per capita was lower than in 1975—a strong testimony to the vast economic losses suffered by the people in the 1980s.[42] But the extent of loss is much larger if we remember that a major portion of the country's income was absorbed by military expenditure as military spending per capita doubled from 30% of GDP in the period 1975–79 to 60% of GDP in the period 1980–86.

Another indicator of the worsening situation of the Iraqi economy may be found in the performance of the agricultural sector. Thus between 1980 and 1989 while the population increased by 38% the agricultural production index increased by 34%. Similarly the cereal production index actually declined to 72% in 1989 relative to its 1980 level. On a per capita basis the cereal production index was only 52% of its level earlier in the decade.[43]

In short by 1990 the Iraqi economy reached a dead end from which there was no prospect for recovery. It was in this context that the Iraqi government decided to invade Kuwait and annex it. Had the annexation of Kuwait succeeded, the prospects for the recovery of the economy and its growth would have been vastly improved.

The economic importance of Kuwait for Iraq was underscored by Iraq's deputy prime minister for the economy when he said one month after the invasion that Iraq now would be able to pay its debt in less than five years; that Iraq's oil reserves had doubled; that the 'new Iraq' would have an oil production quota of 4.6 million barrels per day instead of 3.1 million barrels per day; that its oil income will reach $38 billion per year to rise to $60 billion in the near future; that there would be considerable expansion in the private sector once the two economies are integrated; and that Iraq will be able to vastly increase spending on development projects and imports.[44]

But no sooner had Iraq invaded Kuwait than its foreign held assets were frozen and a tight system of embargo on its exports and imports was imposed by the UN. The effectiveness of the embargo is reflected in the decline in Iraq's oil output from 3.3 million barrels per day in July 1990 to less than 14% of that level in subsequent months—enough to meet the needs of the local economy. The financial loss from this decline is estimated to be $8.5 billion in 1990 and is projected to be between $15 and $20 billion in 1991 and 1992.

Given Iraq's high degree of dependency on imports of inputs for its industrial sector, capital goods and equipment for all sectors of the economy, military goods for its armed forces, and food and other goods for private and public consumption it is not surprising that the effects of the blockade were felt throughout the economy within a short period of time. In a 5 December 1990 testimony before the US Senate Foreign Relations Committee on the impact of the blockade it was reported that the blockade and embargo had worked, effectively shutting off 90% of Iraq's imports and 97% of its exports, resulting in mounting disruptions to the economy

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and hardships to the people. Industry was hardest hit due to the departure of foreign workers and the cutoff of imported industrial inputs which comprised 60% of Iraq's total imports.[45]

The Iraqi government's own estimate of the cost of the embargo for the period 2 August 1990–17 January 1991 was set at $17 billion–$10 billion in lost oil exports; $5.1 billion in production cuts cost; $1 billion in increased production costs; $0.7 billion in losses resulting from delays in development projects; and $1.3 billion for other losses.[46] Another source, however, estimated that between 1989 and 1990 Iraq's GDP declined from $66 billion to $35 billion or by 47%.[47]

But such mounting disruptions and hardships proved to be no more than a small-scale preview for the destructive calamity visited upon Iraq during the 43 day 1991 Gulf War. The intensity and scale of the bombing spared none of Iraq's military targets, civilian infrastructure and industrial structure. Buildings, transport and telecommunications networks, power stations, fertiliser plants, iron and steel plants, bridges, oil facilities, factories, hospitals and storage facilities were all on the target lists for the bombing campaign. And what was not bombed, such as water purification and sanitation facilities, was rendered inoperable because of the bombing of power generating plants. The extent of the destruction which resulted from the savage intensity of the US-led bombing was captured in a report prepared by a special United Nations mission to Iraq which stated:[48]

> It should, however, be said at once that nothing we had seen or read had quite prepared us for the particular form of devastation which has now befallen the country. The recent conflict has wrought near-apocalyptic results upon what had been, until January 1991, a rather highly urbanised and mechanised society. Now, most of modern life support have been destroyed or rendered tenuous. Iraq has, for sometime to come, been relegated to a pre-industrial age, but with all the disabilities of post-industrial dependency on an intensive use of energy and technology.[48]

An estimate of the economic cost

In the absence of accurate official data, it is very difficult to assess the extent of the destruction and the requirements for reconstruction. The following analysis, therefore, will have to be considered provisional until more information becomes available.

In assessing the damage to the Iraqi economy the following elements must be taken into consideration: (1) the implications of human losses both civilian and military; and (2) the replacement cost of destroyed assets.

Human losses

Although no data on human losses has been released either by the Iraqi or US governments available estimates indicate that on the military side anywhere between 50 000 and 120 000 Iraqi soldiers were killed during the Gulf War. On the civilian side the range of estimates is wide. During the war itself it was estimated that between 5000–15 000 Iraqi civilians have lost their lives. But in the month-long uprising against the government that followed the war it was estimated that between 20 000 and 100 000 civilians died. In addition it was estimated that 15 000 to 30 000

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Kurds and other displaced people died in refugee camps and on the road and that another 4000–16 000 Iraqis died of starvation and disease.[49]

The breakdown in health care delivery systems, lack of food and medicine, lack of purified water, and the destruction of power generating plants were cited as factors contributing to further deaths among Iraqi civilians, especially children. Thus according to the May 1991 Harvard Study Team Report it was projected that some 170 000 children, a doubling of prewar figures, under the age of five will die during the year following the end of the war from the effects of the war.[50]

In addition to war-caused death there are other forms of human losses whose magnitude is difficult to quantify. First, there are the injured, maimed and traumatised who were victimised by the war and its aftermath and whose numbers and the extent of their plight are not known. Second, there was a sudden emergence of large numbers of refugees and displaced persons whose plight was caused by the manner in which the government repressed the March 1991 uprising. While some 28 000 Iraqis fled to Iran between January and mid-March, in late March more than two million 'got up and left their homes in less than six days', fleeing to Iran and Turkey, or seeking refuge in the marshes near the Iraq–Iran border.[51] The third group is comprised of those civilians who were drafted into the war only to return to a declining and inflation-ravaged economy capable of offering only unemployment and impoverishment. The fourth group of victims is composed of families and dependents of those soldiers who lost their lives in the conflict. Unlike the dependents of the victims of the Iran–Iraq war the victims of the 1991 Gulf War were not provided for with financial compensation.[52]

But above and beyond the present economic cost of human losses there is the long-term loss to the economy which Iraq will have to endure. It has been estimated for instance that about half Iraqi males aged 18–45 have been inducted into the army. Moreover, this war like the Iran–Iraq war, which lowered life expectancy for Iraqi males by a full ten years, will undoubtedly have a similar impact on life expectancy.[53]

In short, a loss of 100 000–200 000 active persons on top of the loss in the Iran–Iraq war, plus the large numbers of injured, will undoubtedly affect the future growth and size of the Iraqi economy.

Replacement of assets

As was indicated earlier the invasion of Kuwait took place at a time when the Iraqi economy was in the midst of an economic crisis which had no prospects of a solution. The crisis which pushed the economy into a dead end was a direct result of the economic effects of the Iran–Iraq war. The war not only exhausted Iraq's foreign reserves and forced it to borrow extensively, both internally and externally, but its length and scale forced Iraq to devote much of its GDP to it. Another complicating factor was the changing conditions of the oil market and the sharp decline in Iraq's oil revenue relative to its prewar levels.

In terms of economic damage the Gulf War of 1991 was a replay of the Iran–Iraq war, but on a much harsher and more devastating scale. In short the US-led bombing nearly erased Iraq's infrastructure. Soon after the invasion of Kuwait, US military planners had identified 57 strategic targets in Iraq. By the time the bombing was initiated the list was expanded to include 400 targets, expanded again during the

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war to 700 targets as the military hoped the bombing would amplify the economic and psychological impact of international sanctions.[54] Moreover 'Some targets, especially late in the war, were bombed primarily to create postwar leverage over Iraq, not to influence the course of the conflict itself. Planners now say their intent was to destroy or damage valuable facilities that Baghdad could not repair without foreign assistance.'[55]

An illustration of the kind of bombing that was certain to increase Iraqi dependency in the postwar period was the obliteration of Iraq's electrical system. By the time the bombing stopped over 90% of Iraq's power generating capacity had been destroyed.[56]

Two studies indicate the magnitude of the replacement cost of Iraqi assets damaged during the war. In a UN report on humanitarian needs in Iraq it was stated that the complete replacement of Iraq's power generating system will cost $20 billion.[57] The other study estimated the replacement cost of assets destroyed during Operation Desert Storm to be $200 billion[58]

To put these replacement costs in some context it can be said that to replace its power generating system Iraq must spend the equivalent of one year's oil revenue, assuming that it would be producing and exporting at full capacity and selling its oil at $20–21 per barrel. By the same token, to replace all assets destroyed in the war Iraq will be called upon to spend the equivalent of one decade of its oil revenue or nearly 400% of its 1988 GDP.

It should be noted that the $200 billion replacement cost cited above includes the cost of military equipment lost during the war. This means that to the extent that Iraq will not be allowed to replenish its military equipment the bill for replacement will be that much smaller. But regardless of whether Iraq will be free to acquire new arms, the bill for reconstruction remains staggering given the small size of its economy. Moreover, to the cost of reconstruction one must add the cost of replacing those assets that were damaged in the course of the Iran–Iraq war. In short Iraq in the years and the decades to come will have to find the resources to rebuild what two successive wars in the span of less than a decade have destroyed.

The future of the Iraqi economy

It is safe to say that no country in the Third World, other than resource-rich Iraq, has received so much income in such a short period of time and ended up with heavy foreign debt, heavy internal debt, a destroyed infrastructure, a shrinking and isolated economy, an impoverished and starved population, and staggering inequality in the distribution of income. This is so because no other country has suffered the consequence of such wars inside one decade—it is difficult to see how the economic consequences will be overcome.

A measure of Iraq's deteriorating economic condition is the value of its GDP in real terms. According to UN calculations Iraq's real GDP, computed at 1975 prices, was $8.5 billion or $904 per capita in 1970. By 1980 the figures were $22.1 billion and $1674 respectively. The impact of the war with Iran forced continued decline in the economy up to 1985 when GDP was $17.1 billion and per capita GDP $1081. The years 1986–89 witnessed a gradual improvement in the economy to the point where GDP rose by 1989 to $23.3 billion and GDP per

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capita to $1273—still considerably below their 1980 levels but higher than their 1983 levels.[59] If we assume that Iraq's GDP declined by a quarter in 1990 due to the embargo and by another 40% in 1991 we arrive at GDP levels of $17.5 billion in 1990 and $10.7 billion in 1991. This means that per capita GDP had plummeted to $926 in 1990 and $546 in 1991. These figures indicate that the Iraqi economy was set back to the early 1970s, while the average income of the population is comparable to that in the late 1960s.

Given this gloomy state of affairs and given the combined magnitudes of the losses of the Iran–Iraq war and the Gulf War, the question is what are the likely prospects for Iraq's economy recovery, reconstruction, and growth and development.

To begin with, Iraq's dependence on its oil sector has never been stronger, but the government is denied access to the world market because of the UN economic sanctions and the embargo which does not permit Iraq to import consumer goods, inputs and capital goods freely. Iraq must apply to the UN Security Council for permission to do so. Moreover, under the cease-fire resolution (Resolution 687, April 1991) a special UN administered Compensation Fund (the Fund) was created to which a certain percentage of Iraq's oil revenue is to be diverted (it was assessed in a subsequent resolution to be 30%) to pay compensation for claims against Iraq for any direct loss, damage, including environmental damage and depletion of natural resources, or injury to foreign governments, nationals and corporation, as a result of Iraq's invasion of Kuwait. And by accepting the resolution Iraq in effect mortgaged its oil revenues indefinitely.

If the 15 August 1991 Security Council resolution authorising the sale of Iraqi oil is a harbinger of how future sales will be handled then it is very difficult to see when the Iraqi government will regain its freedom of action. Under the terms of the resolution Iraq was authorised to sell $1.6 billion worth of oil over a six month period. Iraq was to select the buyers but the Security Council must approve purchase. The proceeds from the sale would be divided into two parts—30% would be placed in the Fund to be used to settle war claims; and the remaining 70% would be used by the UN to buy food and medicines for distribution in Iraq and underwrite the cost of the various UN missions to Iraq. In other words none of the oil money would go into the hands of the Iraqi government. With such restrictions on Iraq's freedom of action it was not inaccurate on the part of the Iraqi ambassador to the UN to say that the plan would make 'a trusteeship of Iraq'.[60]

But even in the absence of restrictions on its freedom of action it is difficult to see how Iraq can hope to rebuild its shattered economy and break away from the present vicious cycle of foreign debt, lack of resources and underdevelopment. This is so because in order for the economy to grow it must invest in its goods-producing sectors, which requires the economy to generate the necessary saving. In order to generate the necessary savings the economy must have a level of income that would exceed the sum total of private and public consumption.

In the past 30 years Iraq has relied heavily on its oil income as the primary source of national saving and investment. Successive governments found it both necessary and easy to invest in infrastructure and industry and agriculture. Income from oil

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enabled governments to avoid imposing taxes to finance investment. Indeed to the extent that governments provided food subsidies and social services at low cost, or free, they enabled the society to have a level of consumption that was higher than the non-oil national income. In other words the availability of oil income made it possible for society to engage in dissaving without having to borrow to support a certain standard of living. It is, therefore, impossible to call upon society now to reverse a long established tradition and a way of life and demand that it must save. Furthermore, at this juncture it is futile to call upon the people to save when they are on the brink of starvation and lacking both employment and income. A society that has suffered so much death and destruction, as a result of policies that it had no role in formulating, cannot be asked to sacrifice what it does not have. It is this bind, or dead end, that the government must break away from. Can the government succeed? Very unlikely, given the imbalance between the resources at its disposal and the vast claims against these resources.

For the infrastructure to be rehabilitated, plants and factories to begin to function, foreign debts to be paid, and the people to receive food and medicines, the economy must be capable of generating enough income to pay for the imports that are necessary to help the economy move again. But Iraq has only one source of foreign exchange, i.e. the sale of oil. In other words the fortunes of the economy and society are intimately related to, and to a considerable extent determined by, what happens to oil. What happens to oil is beyond the control of the Iraqi government since it is in the final analysis a price taker, the price being set by conditions in the world oil market.

Looking at the oil picture in the first half of the 1990s we find a market that is flooded with oil, and if Iraq were to re-introduce its oil to the market again other countries must accept lower shares.

Assuming that other producers will comply and assuming that Iraq will export at its pre-war capacity and sell its oil at the pre-war agreed upon price of $21 per barrel, then it should be able to generate $21.5 billion a year. Of this amount Iraq will have access to only $15 billion or 70% since the first 30% is earmarked by the UN Security Council to go into the Fund to pay war claims.[61]

Assuming that Iraq exports at full capacity during 1991–95, an unlikely occurrence, and sell its oil at $21 per barrel, then it should be able to generate $75 billion during the five year period. But of this $75 billion, $22.5 billion will go into the Fund leaving Iraq with $71.5 billion to cover the following expenditure items over the same period: $40.8 billion for the payment of foreign debt; $12.4 billion for net services; $48.5 billion for imports; $2.4 billion for the reconstitution of stocks; $20.6 billion for the repair of war-damaged infrastructure; $55.4 billion for development plan projects; or a total of $214.4 billion for projected foreign exchange requirements over the five year period 1991–95.[62]

It can be seen from the data that Iraq's projected resource gap is estimated to be $161.9 billion, or the equivalent of another 11 years of oil income. The gap, of course, will be narrower if the price of oil rises above the projected $21 level and by the same token the gap will be wider if the price falls below $21.

The other key determinant is whether the Security Council will allow the Iraqi government to export at the projected full capacity, and/or whether it will allow

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it to import according to the plan outlined. Regardless of the position of the Security Council and regardless of what the level of price will be the gap is too wide for Iraq's capacity to export to bridge it.

This means that Iraq will have to reschedule its debt which will undoubtedly bring it under the rules of the Club of Paris, a situation which Iraq has consistently attempted to avoid. Iraq will also be forced to seek fresh loans and credits to meet at least part of its foreign exchange requirements. This, in turn, will bring Iraq under the surveillance mechanism of the International Monetary Fund for the first time. Another avenue for Iraq will be to seek new commodity credits from Western governments, and if such credits are to be granted they will carry with them another set of conditions regarding Iraq's economic and foreign policy. In short, Iraq's dependence on the international capitalist system will increase and its freedom of action will be compromised.

Iraq may choose to postpone the implementation of its development plans and thus reduce its foreign exchange requirements. But such a policy will have direct consequences for its growth potential since the plan was drawn to achieve an annual rate of growth of 3.6%. This is a low growth rate to begin with, especially if we realise that at present the size of the Iraqi economy has shrunk to the level it was in 1970 and current real per capita GDP is only one-third of its level in 1970.

Concluding observations

Regardless of how the Iraqi government conducts its economic policy in the postwar period its options are very few and very narrow. The economic assets that were established in Iraq were built over five decades with the help of oil revenue and foreign expertise. The two wars not only resulted in the destruction of these assets but also led to the fiscal bankruptcy of the country, impoverishment of the people, underdevelopment of the economy, and deepening of dependency on the West. The wars also led to an unmitigated disastrous reliance on the oil sector. It is worth noting that when Iraq turned to oil to finance its development projects in the early 1950s it had a population of five million but before the end of the 1990s its population will reach 26 million.

The economic outlook for Iraq is indeed bleak and it will be decades before the country can regain the economic initiative it once had.

Notes

1 For a detailed analysis of these issues see Abbas Alnasrawi, 'Economic consequences of the Iraq–Iran war, *Third World Quarterly*, 8, (3), July 1986, pp 869–895.

2 See *Middle East Economic Digest* (MEED) various issues.

3 See OPEC, *Secretary General's Annual Report*, Kuwait.

4 See The Economist Intelligence Unit, *Quarterly Economic Review of Iraq*, No 2, 1983, p 7; *Middle East Economic Survey* (MEES), 14 March, 4 April, 23 May, and 11 July 1983; K Mofid, *The Economic Consequences of the Gulf War*, London: Routledge, 1990, p 41.

5 See, for example, *The New York Times*, 23 September 1985.

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[6] See Mofid, *The Economic Consequences*, pp 127–135.
[7] *Ibid*, p 127.
[8] See K Bradsher, 'War damages and old debts could exhaust Iraq's assets', *The New York Times*, 1 March 1991.
[9] See 'Iraq outlines dire economic prospects in plea to the UN for five year moratorium on war reparations', *Middle East Economic Survey* (MEES), 13 May 1991, pp D6–D9.
[10] Economist Intelligence Unit, *Country Report: Iraq*, No 4, 1987, p 7.
[11] *Middle East Economic Digest* (MEED), 9 August 1985, p 5.
[12] *Middle East Economic Digest* (MEED), 15 February 1986, p 17.
[13] *Ibid*, 28 March 1987, p 18.
[14] *Ibid*, 15 August 1987, pp 6–7.
[15] EIU, *Country Report: Iraq*, No 4, 1987, p 7.
[16] For a good analysis of economic policy in the agricultural sector see Springborg, 'Iraqi infitah: agrarian transformation and growth of the private sector', *The Middle East Journal* 40 (1), winter 1986, pp 33–52.
[17] For Iraq's food imports see League of Arab States *et al*, *Joint Arab Economic Report, 1987*, p 267.
[18] See I El Khajaji, 'The war and the Iraqi economy', *Al Thaqafa Al Jadidah* (in Arabic), June 1989, p 11.
[19] Springborg, 'Iraqi infitah'.
[20] *MEED*, 18 November 1988, p 18.
[21] See *MEES*, 12 February 1990, p A10.
[22] See *MEED*, 4 July 1987, p 21. It is relevant to note in this connection that Iraq's interest to join the US to play a role in the security of the Gulf had already been voiced by Iraq's foreign minister Tariq Aziz in a 1984 interview when he said:

> Iraq is the major power in the Gulf . . . A power for what? Not to change the governments in the area. Not to impose policies. But, rather, a power which is an important partner in shaping the security, prosperity, and future of the 1980s . . . What I am saying is this: the US which is very concerned about how to secure this area, should consider the role that Iraq could play in helping to provide that security.

See A H Cordesman, *The Iraq–Iran War and US–Iraq Relations: An Iraqi Perspective, An Interview with Iraqi Foreign Minister Tariq Azis.* Washington: National Council on US–Arab Relations, 1984, p 38.
[23] Estimates of inflation rates vary. According to data cited by Al Khafaji consumer price index (CPI) increased between 17% and 45% in the period 1980–86. The Economist Intelligence Unit places the CPI increase at between 25% and 45% for the period 1985–89 while the Iraqi government uses an average annual increase CPI of 17.7% for the period 1985–89. See Al Kafaji, 'The war and the Iraqi economy', p 6; Economist Intelligence Unit, *Country Report, Iraq*, No 4, 1990. p 3; and 'Economic prospects', p D8.
[24] See K A Chaudhry, 'On the way to market: economic liberalization and Iraq's invasion of Kuwait', *Middle East Report*, May–June 1991, p 18. See also Economist Intelligence Unit, *Country Report: Iraq*, No 1, 1990, pp 10–11.
[25] See *MEES*, 23 January 1989, pp B3–4 and *MEES*, 18 September 1989, pp B1–2.
[26] See *MEES*, 15 January 1991, pp B2–B3.
[27] *MEES*, 12 February 1990, pp 1–5.
[28] *Ibid*.
[29] For an articulation of Iraq's policy see R Salman, 'Iraq's oil policy', *MEES*, 12 March 1990, pp D1–6.
[30] See *MEES*, 7 May 1990, p A8.
[31] See 'Documentation in Iraq–Kuwait crisis', *MEES*, pp D1–9.
[32] See 'Documentation' *MEES*, 22 July 1991, pp D1–D9.
[33] See 'OPEC lobbies overproducers', *MEED*, 6 July 1990, p 9.
[34] See 'Documentation', p D5. In a letter from the Kuwait's Director General of the State Security Department to the minister of interior reporting on the former's visit to the CIA the following item is reported:

> We agreed with the American side that it was important to take advantage of the deteriorating economic situation in Iraq to put pressure on that country's government to delineate our common border. The Central Intelligence Agency gave us its view of appropriate means of pressure, saying that broad cooperation should be initiated between us, on condition that such activities are coordinated at high level.

See P Salinger & E Laurent, *Secret Dossier: The Hidden Agenda Behind the Gulf War*, London: Penguin Books, 1991, pp 239–41.
[35] See 'Documentation', pp D6–D9. Another dimension of the oil dispute between the two countries was Iraq's contention that Kuwait took advantage of its preoccupation in the war with Iran to use diagonal drilling to produce oil from the Iraq side of the Rumailah oil field which straddle the border between the two countries. See 'Documentation', p D4.
[36] See 'Documentation on Iraq–Kuwait crisis', *MEES*, 23 July 1990, pp D1–9.
[37] See *OPEC Bulletin*, September 1990, p 7.
[38] *Ibid*, p 8.
[39] See *OPEC Bulletin*, January and June 1991.
[40] See Youssef M Ibrahim, 'OPEC members close to raising output ceiling', *The New York Times*, 28 August 1990.
[41] The lower inflation rate was reported by the government while the higher rate was estimated by outside agencies.

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For inflation rates for the period 1980–83 which were estimated by the government to have increased by 77%, see Ministry of Planning, *Annual Abstract of Statistics*, p 143. For the period 1985–90 the government reported a rise in the consumer price index of 126%. See 'Economic prospects', p D8. The much higher inflation rates may be found in Economist Intelligence Unit, *Country Report, Iraq*, various issues.

[42] For GDP data see United Nations, *Monthly Bulletin of Statistics*, July 1991, p 278.

[43] See Food and Agriculture Organization, *FAO Yearbook: Production, 1989*, pp 85–102.

[44] See 'Iraq: dreams and figures', *Tareeq al Shaab*, October 1990, p 5.

[45] See *The New York Times*, 6 December 1990, p A16.

[46] See *MEED*, 30 August 1991, p 22.

[47] *Country Report, Iraq*, No 1, 1990, p 3.

[48] See *Report to the Secretary-General on humanitarian needs in Kuwait and Iraq in the immediate post-crisis environment by a mission to the area led by Mr Matti Ahtisaari, Under Secretary-General for Administration and Management, dated 20 March 1991*, p 5.

[49] See C Murphy, 'Iraqi death toll remains clouded', *The Washington Post*, 23 June 1991 and R Sinai, 'Greenpeace says 200 000 died in war', *Burlington Free Press*, 30 May 1991.

[50] Harvard Study Team Report, *Public Health in Iraq After the Gulf War*, May 1991, p 1.

[51] J Miller, 'Displaced in the Gulf War: 5 million refugees', *The New York Times*, 16 June 1991.

[52] For a brief review of some of these problems see K Evans, 'Years of war wrack Iraqi families', *The Christian Science Monitor*, 6 June 1991.

[53] C Haub, 'A demographic disaster', *Manchester Guardian Weekly*, 10 March 1991.

[54] B Gellman, 'Allied air war struck broadly in Iraq: officials acknowledge strategy went beyond purely military targets', *The Washington Post*, 23 June 1991.

[55] *Ibid*.

[56] See Harvard Study Team Report, Table 6.

[57] *MEES*, 29 July 1991, p D6.

[58] See A Kasslow, 'Shifting fortunes in the Arab world', *The Christian Science Monitor*, 26 June 1991, p 7.

[59] United Nations, *National Accounts Statistics: Main Aggregates and Detailed Tables, 1988*, New York, 1990, pp 821–27.

[60] See J Gray, 'UN decides to permit Iraq oil sale of $1.6 billion', *The New York Times*, 16 August 1991, p A8 and M Houk, 'Plan to allow Iraqi oil sale puts UN Chief in charge and Iraqi officials bristle', *The Christian Science Monitor*, 19 August 1991, p 6.

[61] It should be noted in passing that the $15 billion annual income translates in 1991 into $769 per capita or lower than the 1976 oil revenue per capita of $792 when total oil revenue amounted to $9 billion in that year.

[62] See 'Economic Prospects', *MEES*, 19 May 1991, p D9.

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