

# BUSINESS IN THE TIME OF WAR

Why Iraq is still a hot market and how to engage it

August 2014

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**Summary.** Following two months of fierce conflict, Iraq is experiencing a great paradox. On the one hand, the country is entangled in a deep political crisis that could lead to its breakup into two or even three states. On the other, its economy is holding up well, fueled by the country's oil bonanza. In particular, the consumer market continues to grow virtually untroubled and at a fast pace.

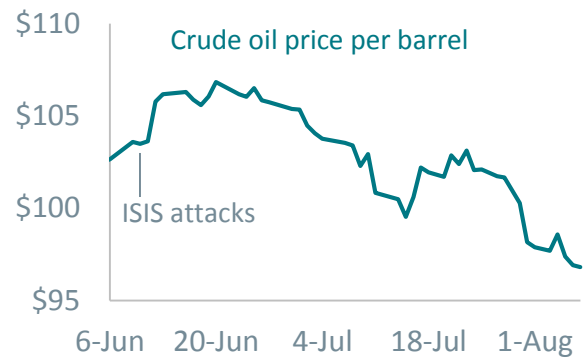
However, the rules and challenges of business have changed. The widening rift between Kurdistan and central Iraq now calls for the design of separate market strategies for each. Trading companies must also account for a transformation of the shipping and distribution industry. Most notably, the conflict has spurred the development of maritime routes for the import of merchandise to central and South Iraq.

After several years of relative stability, last June Iraq plunged back into sectarian violence, casting doubts about the country's political and economic prospects. In an impressively rapid assault, the Islamic State of Iraq and Syria (ISIS), a nebulous Wahhabi group, took over a large portion of the country, all the while vowing to pursue its spread throughout the Levant. Renaming itself the Islamic State (IS) since, it declared a caliphate with Mosul as its capital, and now rules over a number of cities of Iraq's North-West.

*The Islamic State is strong only in the Sunni areas, far from Iraq's main oil production sites*

News of the Iraqi army's debacle sent shockwaves around the globe with crude oil prices soaring up to \$107 per barrel by June 20. However, the markets progressively quieted down as it showed that the bulk of Iraq's oil production was actually under little threat, with all major facilities located South, far from IS's reach. As spectacular as its initial gains were, it is now clear that IS does not have the military strength to push

the war beyond the predominantly Sunni areas, where it enjoys strong, albeit faltering, support.



That said, uprooting IS will not be an easy task. Time and again since its creation in the mid-2000's, the jihadist group has proven to be exceptionally resilient and opportunistic. It is now in control of significant resources, further bolstering its capacity for nuisance. Adding to that are the deep political divides that have resurfaced among Iraqis, not least the separatist ambitions of the Kurds. In this regard, the capture of oil-rich Kirkuk by the Peshmerga (under the pretense of securing the city from IS) added further strain to the already tumultuous relationship between the Kurdish Regional government and Baghdad.

*Kurdistan and Central-South Iraq are increasingly divided, but both remain fast growing consumer markets*

Thus, what has emerged from the dramatic events of the past two months is a complex and probably long-lasting political crisis. On the ground however, the conflict has progressively evolved to a less volatile configuration, with now relatively stable front lines. In fact, business in Iraq seems to be adapting with measured confidence.

This is not to suggest that we are witnessing a return to the pre-crisis situation. The one crucial element that businesses and investors must now factor into their

strategies is the fragmentation of the market, which mirrors Iraq's political divisions. Put simply, Iraq should henceforth be thought of as three separate markets with individual needs and rules: Kurdistan in the North, the predominantly Shia center and South, and the predominantly Sunni North-West.

Paradoxically, the Sunni areas are not where the big changes are expected. Demographically small and resource-poor, they have represented for over a decade only a small portion of Iraq's market and attracted little investment. If anything, IS's brutal rule will cast them further away from the country's economy.

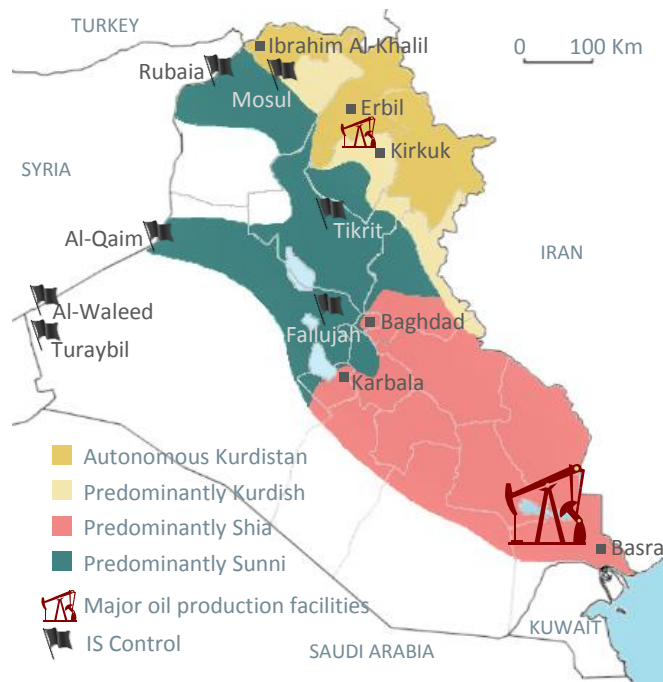
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*Five new border crossings are opening between Turkey and Kurdistan to accommodate for growing trade*

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By contrast, all signs indicate that Kurdistan's economy will continue to grow steadily. The autonomous region has experienced a few setbacks since the beginning of the crisis. In particular, it has run into legal hurdles over its attempts to exploit and export Kirkuk crude oil without Baghdad's consent. In reprisal, the central government has been holding up all payments to the Kurdish government, which as a result is facing a budgetary crisis. However, none of this seems to have had yet a strong impact on investors' confidence. Just in the past few weeks, the Kurdish government signed energy contracts with both Turkey and Iran. Rumors are that other big deals, notably with the UAE, are underway. As for trade, no less than five new border gates with Turkey are to be opened in the coming weeks to accommodate for growing traffic.

One recent development of particular importance for businesses is the deteriorating security situation along



the roads from Baghdad to the North of Iraq, which has hindered the transport of merchandise. Before the crisis, many trading companies had been using Baghdad as a hub to distribute their goods nationwide. While trucks today can still travel from the capital to Kurdistan through alternate routes along the border with Iran, transport fees have doubled, from an estimated \$2,500 to \$5,000 per vehicle.

It is not excluded that the Iraqi military will ultimately regain control over and secure the roads from central to North Iraq. Even so, it would be a strategic mistake for businesses to disregard the implications of the widening political rift between the autonomous Kurdish Region and the central government. A formal declaration of Kurdistan's independence may not be up for a while because the international community is generally opposed to it, and because Peshmergas and Iraqi forces are coming to realize the need to join forces against IS. Still, with the capture of Kirkuk, the Kurdish government has further improved its bargaining position and we should expect that it will continue to emancipate politically from central rule. Among other things, this should translate into more region-specific business regulation and control over the transit of people and merchandise. In short, it is high time for companies that have not already done so, to explore and engage Kurdistan as a market of its own, in particular with regards to transport and distribution operations.

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*Meeting the consumer is the easy part. The challenge is to set up safe and efficient distribution systems*

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Even though the impact of the crisis is more important in the predominantly Shia regions of central and South Iraq, there too, the market has much to hold on to. Most importantly, the oil production facilities, which

are the country's main source of revenue, continue to operate untroubled with a daily output of 3.15 million barrels, of which 2.25 million are exported. This is more than ten times Kirkuk's production. Through the crisis, foreign investment has continued to flow into oil and gas infrastructure, further testifying to the prevailing confidence in the security situation of southern provinces.

Unfortunately, the same cannot be said of areas closer to the front lines like Baghdad, which IS may not have the capacity to reach through ground assault but can seriously harm through terrorist attacks. In fact, the past two months, have been the deadliest to Iraqi civilians since 2007. Now in control of the Mosul dam, IS could also cause considerable damage to urban infrastructure along the Tigris river.

All that has not been without discouraging private sector investment in Central Iraq. Consumer demand however has not slowed down as may have been expected. Central and South Iraq remain an immense underdeveloped market of 20 million consumers, continuing to grow at a fast pace, fueled by the colossal revenues of the oil sector.

Hence, the problem currently facing the trading business is not one of demand but of supply. With IS ruling over the province of Anbar where the border crossings of Turaybil (Jordan), and al-Waleed and Al-Qaim (Syria) are; and with the Peshmerga now in control of both the Rubaia (Syria) and the Ibrahim Al-Khalil (Turkey) border crossings, all the major merchandise routes to Baghdad have been disrupted.

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*Iranians goods are filling the shelves, with over \$15 billion of imports expected in 2014*

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This is proving to be an exceptional opportunity for Iranian trading companies, which have moved fast to fill the gap, so much so that two new border crossings with Iran have been opened since the beginning of the crisis. The trade volume between the two countries estimated at \$12 billion in 2013 is set to well exceed the 25% growth originally forecasted for 2014.

For companies that import goods from the West, there is the possibility of using Basra's seaports, the largest

of which are Umm Qasr and Khor al-Zubair. Poorly maintained and managed by highly bureaucratic administrations for years, they have generally been avoided by trading companies in favor of land routes. However, in 2011, the government of Iraq kicked off colossal projects to modernize and increase the capacity of its ports. This, combined with the escalating costs and safety risks of using land routes into central and South Iraq, is making the maritime alternative increasingly interesting for trade.

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*Maritime shipping is becoming the cheaper and more reliable alternative*

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It would be a mistake to view this situation as temporary. The shift from land to maritime shipping obeys long-term market forces, with the crisis acting merely as a catalyst. The fact that the Iraqi market was being supplied mostly by trucks coming from Aqaba (Jordan) and other westward ports is only the result of decades of conflict and economic sanctions, during which Basra's infrastructure was neglected. However, with the liberalization and revival of Iraq's economy, it is expected that Iraq's ports will progressively regain prominence and change the local distribution landscape.

In a way, this adds one more layer to the stack of factors that make business in Iraq a complex venture. A highly lucrative one as well.

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**About IMRI.** The Iraq Market Research Initiative is a consortium of consultancies, which leverages local and international expertise to provide key intelligence for building successful business operations in Iraq.

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