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Iraq: Private ownership of oil and the quest for democracy Revisited

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Abstract

In Razzak (2006), I argued that the state-ownership and the state-management of oil (on behalf of the Iraqi people) is not conducive to democracy and economic development. Iraqis have had dictators for decades. They were only able to maintain power by controlling the oil. The events of 2019 uprising confirmed that. I also argued that it could impoverish the average Iraqi citizen. This has become clear to everyone now. The statistics demonstrate that the average Iraqi is poor. The new political establishment has failed to develop the economy and squandered Iraq's oil wealth. In 2006, I proposed a change to the Iraqi constitution regarding oil and provided a strategy of a gradual transfer oil wealth to the Iraqi people. In this paper, I revise my idea based on the new information that became available from the recent uprising of the Iraqi people in 2019, and argue for an immediate transfer of oil wealth to the Iraqi people.

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Keywords Oil, private ownership, development

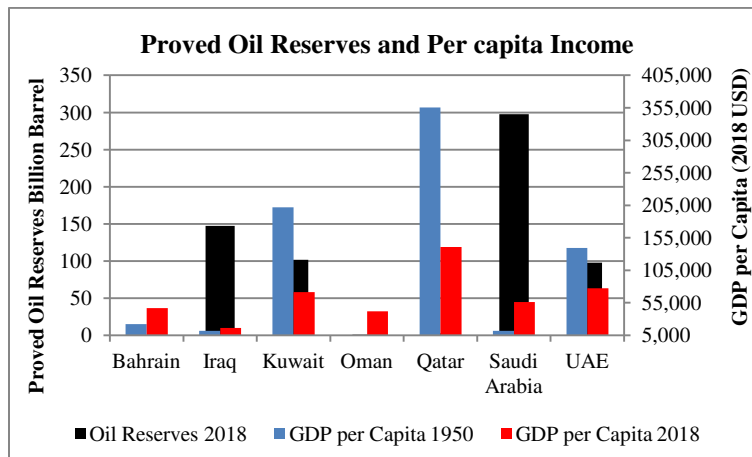
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1. Introduction

Iraq has proved oil reserves of 147.2 billion barrels (BP Statistical Review), and its unproven reserves are just as much. Vast oil wealth notwithstanding, the Iraqis are poor.

Figure (1) plots income per capita (in 2018 U.S. dollar) for Iraq and the GCC countries in 1950 and in 2018, along with the proved oil reserves in 2018. The proved oil reserves measured in billions of barrels are on the left vertical axis. On the right vertical axis, we plot GDP per capita in 2018 U.S. dollar. Despite the vast oil reserves (second largest after SA), Iraq has the smallest income per capita, not even close to Bahrain and Oman, which have no or insignificant oil reserves.²

Figure (1)



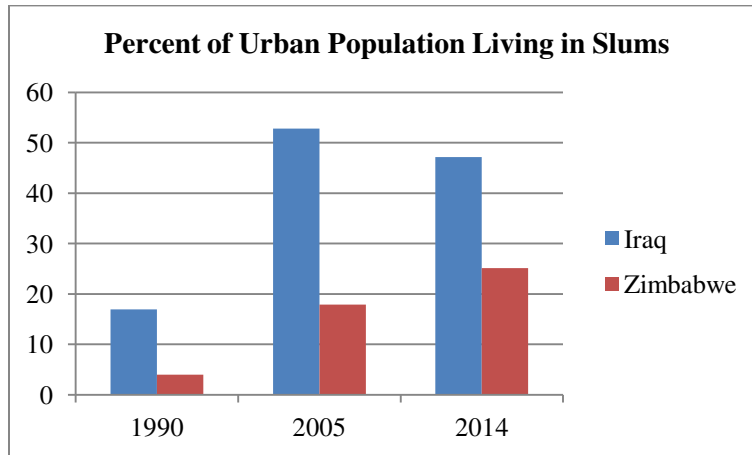
Further, figure (2) plots the percent of urban population living in slums as a proxy for poverty.³ I compare Iraq to Zimbabwe.⁴ I chose Zimbabwe arbitrarily from a number of poor nations. The increase of poverty in Iraq is striking. Iraq is relatively poor. It is rather unimaginable that Iraqis have so much wealth yet they are so poor. In 1990, just a year after the end of the Iraq-Iran war, there were about 3 million Iraqis living in slums (16.9 percent of the population). The number increased to about 15 million in 2005 (a staggering 52.8 percent), and to more than 17 million in 2014 (47.2 percent).

² The Conference Board reports income per capita from 1950.

³ These statistics are the only ones that I could find for Iraq.

⁴ The World Bank poverty statistics.

Figure (2)



The current uprising, which began in October 2019, is a popular response to the dire economic conditions. For Iraq to make the transition to a true democracy and to develop its economy and its people, the ownership of oil must be addressed.

The future of Iraq remains uncertain more than fifteen years after the US forced up democracy on this country. There is no doubt that oil is the main reason behind the political alliances among the elites, the corruption, and the violence that contributes to the economic weaknesses and uncertainty. Political groups have been positioning themselves strategically to control oil wealth.

Private ownership is associated with political and economic freedom, See for example, Hayek (1944), Friedman (1962), Pipes (2000), and O'Driscoll and Hoskibs (2003). History tells us that development requires market institutions and most importantly private property rights. There is reliable empirical evidence on the significance of private ownership on GDP growth. For example, historians North and Thomas (1973), and Rosenberg and Birdzell (1986) presented evidence that private property played a major role in enriching the West. Barro (1991) used proxies for the quality of private property to test the effect on GDP growth. Kormendi and McGuire (1985) used measures of political freedom and civil liberties to proxy the quality of property rights and reported

positive association with GDP growth. A recent paper by Heitger (2003) illustrates the same point.

Ross (2001) examines the effect of oil on democracy empirically. He examined a panel of 113 countries over the period from 1970 to 1997. Testing several hypotheses (the rent state, the repression effect, and the modernization effect) revealed that oil adversely affects democracy and more so in poorer countries. Elbadawi and Makdisi (2011) provide evidence that oil is one of the main reasons for the lack of democracy in the Arab countries.

Privatization of Iraq's oil has been proposed by some economists; see Wolf (2005) for example. My original idea in Razzak (2006) was that there were a few problems that prevent immediate privatizations of oil and other assets: Firstly, political groups in the government – and the Parliament – strongly resist relinquishing control over oil wealth. For example, there was an attempt by some politicians to establish the Basra province *a la* Kurdistan Province because Basra produces two-third of Iraq's oil. The Kurds attempt to control the oil city of Kirkuk, which produces a vast amount of oil is another.

Secondly, there is an old and a widespread belief among Iraqis, and among the educated people too, that the government should be managing oil and providing services to people, including jobs. I believe that the reason for that is the socialist education the Iraqis received for more than forty years from socialist governments.

In Razzak (2006), I argued that although privatization – redistributing oil wealth to the Iraqi people – is necessary, it might not be possible immediately because of the above issues.⁵ The objective of Razzak (2006) was to provide an alternative strategy such that it is not only consistent with and conducive to democracy, but also attainable. The essence of the strategy is gradualism, which were in two phases.

⁵ In a well-developed economic model, one can probably show that it is an optimal first-best solution.

Milton Friedman strongly agreed with the idea of transferring the oil wealth to the people, however, he disagreed with gradualism.⁶ Given how poor the Iraqis have been and the recent uprising of the Iraqi people in October 2019, I now argue for immediate measures to enable the people to earn income. There is need for an immediate change in the constitution regarding oil and the redistribution of oil wealth.

In sections 2 and 3 we discuss the steps and in section 4 we conclude.

2. The current situation

The first step is to change the constitution. In Iraq's new constitution Article 109 states,

“Oil and gas is the property of all Iraqi people in all the regions and provinces.”

The constitution acknowledges that oil and gas belong to the Iraqis, but there is a wrinkle because Article 110, says,

“The federal government and the governments of the producing regions and provinces together will draw up the necessary strategic policies to develop oil and gas wealth to bring the greatest benefit for the Iraqi people, relying on the most modern techniques of market principles and encouraging investment.”

The constitution implies that the government controls oil revenues and redistributes the wealth in a fashion similar to what has been happening in the past 85 years or so. It seems clear that the new constitution maintains the old rules under the old assumptions of government agent benevolence and omniscience. Boettke *et al.* (2006) cite Buchanan (1969, pp. 77-92) who taught us to question such assumptions. The rules of the past Iraqi regimes inhibited individual freedom and creativity and eventually were responsible for the backwardness of the Iraqi society and its dismal economic performance.

If oil is the property of the Iraqis then the Iraqis must own it directly.

In most market-oriented democracies, the people own resources and factors of production.⁷ All the Eastern European countries (e.g., Russia, Poland, Hungary, the

⁶ Friedman sent me a letter, which is available upon request.

⁷ Norway is an old democracy, but the states own and manage the oil.

Czech Republic, etc), which became democracies after the fall of the USST, privatized their economies rather quickly. Iraq could do the same. The method of privatization could be different, however, depending on the objectives and the economic and political conditions. The Russian and the Czech Republic, for example, privatization processes was different from Poland or Hungary or even the U.K. The distribution of the oil wealth is different in Alaska from Norway. That is beside the point now. Most Iraqis agree that (1) economic development has never occurred; (2) oil wealth has been squandered; and as a result, the Iraqi people have been impoverished. This situation has to change.

Ending the economic hegemony and control of the state is the only solution to free the economy and the people now.

3. How to proceed

I still favour the idea in Razzak (2006) that includes: (1) the separation of the state from the oil industry by establishing a number of *independent private oil companies*; (2) establishing the market value of oil assets and shares; (3) distributing the oil shares to all Iraqi people *equally*.

3.1 Independence

Just like the judiciary and the central bank, the oil industry must be *independent of the state* in this case. This means that all decisions regarding oil are apolitical and are purely Iraqis. This independence must also be constitutional.⁸

I propose *immediate* establishment of three private regional oil companies, the Southern Petroleum Company (SPC); the Northern Petroleum Company (NPC) and a Central Petroleum Company (CPC), hence the Iraqi Petroleum Company, (IPC). Evidence from experimental economics suggests that 4 to 5 firms would be sufficient to generate a competitive market.

⁸ In the future when more oilfields are developed in the West of Iraq, they can establish a fourth company, West Petroleum Company (WPC).

The law states the objectives of the IPC. The law must establish the governance system of the IPC. The parliament can establish the conditions to hiring technocrat, chief executives. The CEOs and the parliament sign contracts, which determine the duties and the powers of the CEO, and describe the governance system. For example, having a board or not, its duties, its members etc and the form of decision making, - e.g., individual decision making, a committee, the makeup of the committee, etc., the length of the contracts and anything deemed necessary for the CEOs to do the job. We have a good insight about the optimality of these types of contracts in monetary economics and this is not different in my opinion, Walsh (1995). The companies must be transparent and fully accountable.

3.2 Determining the share value

It is important that the privatization process managed very independently too and without government interference. The parliament could establish an independent committee of experts to manage this process. The committee must have clear objectives, which determine the method of privatization.

In Russia, the government handed shares in state-owned companies to the people directly, which I prefer in the case of Iraq too. In the Czech Republic, people were sold vouchers (each included 1000 investment points) then they bid on shares in a large number of the state-owned companies. The bid-offer process converted these points into share prices. The Czech Republic objective of the privatization was to establish a free market economy. In the UK, state-owned companies were sold directly to the public.

In Russia, the Oligarch went door-to-door offering to buy the shares from the people. It is essential that shares are tradable in a free market immediately so ordinary Iraqis can benefit from buying and selling these oil shares, thus oil wealth could generate oil income. However, the mistakes that occurred in the Eastern European countries must be avoided by all means.

To protect people, the process needs to be regulated. The Parliament can regulate the process of ownerships, sales, transfer, inheritance etc, e.g., it could regulate the number of shares allowed per individual. Furthermore, it should determine the age at which Iraqis are eligible to receive free shares. Purchase and sell transactions of shares must be approved in a court of law such as the financial court, which Iraq established recently. This will protect women, the elderly and sick people from exploitations.

In the future, the IPC pays back dividends to the Iraqis. Profits from *all three companies combined* are used in the calculation of the dividends. By this time, also, one would expect the banking system to be functional and most Iraqis will have checking accounts.

The size of the government is expected to shrink significantly because oil revenues are no longer government revenues. That is probably a very good thing. The government has been inefficient, unable, and unproductive. The Iraqi people having their wealth back, could run a free market economy. There is no *apriori* reason why the people cannot build their schools, hospitals, and factories. There is no reason why the Iraqis cannot re-establish farming and agriculture. The government could tax the IPC directly and use the tax revenues to do the fewer important jobs such as defence, police, law and order, etc.

As the dividends increase and the tax base increase, the state can begin taxing the dividends gradually. At some point, the government budget will be financed by taxing the IPC profits, and by non-oil revenues. Note also that the government can at this point or even earlier, borrow from the public; i.e., sell bonds to finance the deficits. In fact, it might a very sound policy, which has implications for the social security system, but it is beyond the scope of this paper.

I predict that this strategy will have stabilizing effects. The people will recognize the good intention of the government. This empowers the government. The strategy will enhance democratic practices and contributes to the building of free market institutions such as the banking system, the tax system, the share market, the post office, etc that are required to achieve efficiency in the distribution of wealth. The incentive system will be

set properly such that resource allocation becomes optimal and economic efficiency increases over time. It took New Zealand about 15 years to realize the fruits of its market-oriented policy reforms of the 1980s.

When Iraqis begin to receive dividends from oil shares they will become more interested in the performance of the oil industry as a whole regardless of the regions because when any one regional company makes profits all Iraqis will benefit. This kind of privatization and the independence of the oil business will unify the country, as the people of Iraq will recognize that they own and share their country. It might also eliminate the need for federalism. Regional oil companies will also invest in their regions.

Private property laws reduce corruption and thus, increase potential growth. The strategy will make the Iraqis rich. There is evidence about the negative correlation between corruption and economic growth, for example see, Chafuen and Guzman (1996). High-expected rate of regulations makes corruption more possible. The number of Private individuals who bribe government officials increases in order to have their contracts honoured. Iraq is one of the worst countries in the world in terms of freedom from repudiation of contracts. Iraq also scored high on almost all corruption indices, Easterly (2002).

Private ownership and allowing Iraqis to hold shares in their own oil industry is also consistent with Islam. Interest rate is forbidden in Islam. However, Muslims are encouraged to invest in stocks and equity so they share the gains and losses.

The Iraqi shareholders will benefit when the IPC, or any regional company, does well and the share price increases. However, if the new government of Iraq elects to pursue the old policies and keeps control over oil it will eventually become another authoritarian government and economic development will stall.

4. Conclusions

Previous Iraqi governments were powerful dictatorships because they controlled oil wealth. They did not need to consult with the Iraqis on how the revenues are spent. Under

those governments, Iraq was a centralized economy with a dominant public sector. Those public institutions were inefficient and inhibited individuals' freedom and creativity. Iraq's economy was weak and the average Iraqi was poor relative to many others. It is puzzling that the new Iraqi constitution (articles 109 and 110) is still inconsistent with the principles of democracy and maintains the same rules of the past. It is not conducive to economic development because it does not guarantee the transfer of oil wealth from the state to the Iraqis, which will inhibit economic freedom and creativity.

This paper argues that articles 109 and 110 of Iraq's new constitution must be changed such that oil wealth is redistributed to the Iraqi people on equitable basis. The new Iraq must have new institutions that guarantee economic freedom. Further, I propose, first, establishing three *independent* (from the government) *private* oil companies. Second, shares are distributed to the Iraqi people equally under a newly established law and regulations by the Parliament. These share must be tradable in an organized security market. Oil companies should begin paying dividends to the Iraqi people in the near future. Eventually, the Iraqi government must have a functional tax system that finances the federal budget.

The transfer of oil wealth to the people of Iraq is a transfer of power from the ruling elites to the people, which is what true democracy means. I predict that within a decade this setup will create a new Iraqi economy comparative with the rest of the democratic world. Also, it will unite the Iraqi people. Once the Iraqis realize that the benefits of oil are theirs, they will support their government. The world will be better off with a democratic Iraq, especially when decisions about its oil are apolitical and consistent with free market principles.

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